

Topic 2

2.12, 2.13, 2.16, 2.17, 2.23, 2.34, 2.36, 2.37

2.12 Both aspects of independence are important. If an auditor has independence of mind the auditor will act independently. However, despite how independently the auditors may act, the audit reports will not be credible if the outside parties do not believe that the auditors acted independently.

2.13 An auditor has a self-interest problem if the outcome of the audit (and/or the success of the company) affects the auditor's (i.e. the audit firm or the auditor as an individual) financial interests. The self-review problem arises when the auditor, as part of the audit, has to test transactions or systems that were recorded or provided by another part of the audit firm or by a previous employee of the audit firm, or the testing is performed by a previous employee of the client. Familiarity refers to a general closeness between the auditor (including the whole audit team) and the client.

2.16 Outsourcing the internal audit function (IAF): how would this affect the external auditors evaluation of the reliability of IAF.

Potentially more independence than in-house internal auditors

Outsourcing an internal audit function could provide the advantages of potentially better qualified auditors and a better resourced auditing function. It also allows small companies that would not be able to justify the establishment of a fully functioning internal audit department to have an internal audit function.

Outsourcing has the disadvantage that the internal auditors would have less knowledge about the company and its systems.

Removed from social networks of employees

2.17 (Tort) a duty of care was owed by the auditor, there was a breach of the duty of care, loss was suffered as a consequence of that breach.

Duty of Care – did not do enough testing, did not gather sufficient information to verify the quality of the reports

Consequence – clients making loss financially, report was misstated

- (Contract law) Breach of contract (EL)

HH Royal Commission Report (2003) – Reasonable foreseeability must be proven if the auditor was aware that any negligence could cause a loss to the client

Esanda (1997)

2.23 Charles overstates his importance at the audit firm – breach of integrity

Charles tells William that the patriarch is having an affair with his personal assistant – this is gossip - professional behaviour

Charles tells William that the family has increased its shareholding in another company, with potential benefits to the company - confidentiality.

2.34 (a) Personal relationships between a partner of the audit firm and the two directors (Justin & Sarah) – familiarity threat. From APES 110 200.7 Examples of circumstances that may create familiarity threats.

(b) APES 110 suggests that the audit firm should document the policies that relate to this type of threat to independence, the evaluation of the threat and the safeguards to reduce the threats. They should also have policies and procedures to prevent that partner from inappropriately influencing the outcome of the assurance engagement. The firm should not use that partner on the Featherbed engagement, and should not accept the audit if that partner is required on the audit.

2.36 The CEO of TCCL has requested the auditor provide an opinion that the linear accelerators are fit for use without charging a fee as a gesture of goodwill, in the context of the future negotiations about the audit tender. There is an implicit invitation to provide a favourable opinion to ensure that the audit tender is awarded to Fellowes and Associates again.

If Tania provides the opinion without obtaining appropriate and sufficient evidence she would be compromising her integrity because the favourable opinion would not be honest, and her objectivity because her professional judgement would be influenced by the desire to win the tender again.

Accepting an engagement without appropriate remuneration is also likely to create a conflict of interest.

2.37 *One of the accountants intended to be part of the 2014 audit team owns shares in HCHG. The accountant's interest is not material to him.*

Section AUST290.41.3 of APES 110 states that a financial interest in a client may create a self-interest threat. Owning shares in an engagement client creates a direct financial interest. S. 290.104 requires the auditor to consider the nature of the financial interest in order to determine the significance of the threat and the appropriate safeguards. Matters to consider are whether the shareholding is direct or indirect, how material is the holding, and the role of the member of the assurance team.

Section 290.106 AUST290.41.3

At a minimum, Fellowes and Associates should apply the safeguards in s. 290.177 with respect to the intangible assets valuation. The valuation should be reviewed by an additional professional accountant, who is outside the audit team, they should obtain the client's acknowledgement of responsibility for the valuation, and should not use the personnel involved in the valuation on the financial report audit. However, it is likely that these safeguards would not be enough, given the high level of subjectivity in the intangible assets valuation. Therefore, the client will either have to obtain another independent valuation or Fellowes and Associates should withdraw from the audit.

In the future, the audit firm should not perform valuations for audit clients that are likely to be the subject of the financial report audit, unless they are immaterial and/or have a very low degree of subjectivity.