Appendix 5 - Specific threats to objectivity with relevant safeguards

Self-interest – a result of financial or other interests of auditors, or their close family, in clients. Firms should publish "prohibited shareholding list".

Threat	Why	Safeguard
Dependence on client	The auditor will have a fear of losing a lot of income therefore will appease the client	To reduce fee dependency, auditors should not accept appointment of clients if their total gross recurring fees exceed certain limits. Total gross recurring fees should be no more than: – Listed Co's – 10% of the Firms total fees – Other Co's – 15% of the Firms total fees
Lowballing	The auditor will keep the client happy to ensure further work. Therefore will not disagree with client	Setting an audit fee low to try and get more lucrative work is frowned upon the fee must be based on pre-determined level of work required
Loans, guarantees and overdue fees	The auditor will have fear of not getting paid so will keep the client happy to ensure payment	▪ No loans or guarantees allowed to or from client, unless in normal course of business ▪ Significant overdue fees are deemed a loan, hence not allowed
Hospitality, gifts or other benefits	This could be deemed a bribe and potentially the auditor may lose professional scepticism	▪ Benefits should not be accepted unless modest ▪ Modest – means available to all the company's staff at same terms ▪ The assurance firm should establish policies on gifts and hospitality and should be communicated (e.g. decision must be made by partners and documented in the audit file)
Contingent fees	The auditor has an incentive, therefore may not be independent	▪ Assurance work should not be conducted on a contingent basis (i.e. where you receive a commission, or a % of fees is payable upon a specific event occurring) ▪ No safeguard – fee must be based on pre-determined amount
Financial/business interest **can also lead to intimidation threat**	The auditor will want the greatest return from investment, therefore may cover anything that could devalue the interest	Close business, family or personal relationship should be avoided between the client and the assurance firm ▪ i.e. seeking to gain employment with an assurance client ▪ i.e. entering a joint venture / arrangement with client

Financial interest in shares etc		Anyone involved with assurance must NOT have direct or indirect interest in a client i.e. holding shares Rules apply to ▪ Assurance firm ▪ Any partner in the firm ▪ Person in a position to influence engagement ▪ Immediate family member of above Safeguards: ▪ Dispose of interest ▪ Remove individual from the team ▪ Independent partner review ▪ Internal QC procedures in place (i.e. prohibited shareholding list)

Self-review threats - it might occurs when and auditor has to re-evaluate work they have already completed (e.g. the external auditors prepare the financial statements and then they will audit them).

Threat	Why	Safeguard
Accounting services	If the auditor reviews their own work they may miss errors, or be more relaxed about doing the work. Also if they do find any errors it's easier to cover them up and not disclose in the fear of looking incompetent	▪ Should not do for LISTED companies, unless it is an emergency ▪ For non-listed clients – permitted as long as safeguards in place (applicable to all self-review threats) ▪ No management decisions are made; client to prepare judgemental area ▪ Separate engagement letter/personnel / terms / partners ▪ Independent partner review
Internal Audit Services		Should not be provided to listed external audit clients, or where significant reliance will be placed upon the work of internal auditors
Former employee of client joining assurance firm		The employee cannot be involved with the audit until 2 years have elapsed ("cooling-off" period).

Familiarity – when the auditor is too sympathetic or trusting of the client because of a close relationship with them (because a close friend or relative of the auditor works in a key role for the client). The auditor may trust their friend/relative to not make mistakes and therefore not review their work as it should be (a consequence might be undetected material errors in the financial statements). It might also arise after a long association with the client.

Threat	Why	Safeguard
Participation in client affairs/family and personal relationships	The auditor may lose professional scepticism, or have the fear of upsetting the client	▪ Cannot be director, employee or a business partner if you are going to audit a client ▪ Must not take part in audit if have been officer / employee in that period, or in the last 2 yrs ▪ If the director / employee or business partner is an immediate family member of someone on the audit team, that audit team member must be removed ▪ May be extended to other close relationships within the firm (not just those on the team)
Audit partners leaving to join the client		▪ Can join the client, but must sever all links with the assurance firm (e.g. pension) ▪ Audit partner has to inform the audit firm immediately and is then removed from audit team as soon as decision to join client is made ▪ If partner becomes director or key management and has worked as partner on the audit in prior 2 years the audit firm must resign as auditors ▪ 2 year period must then elapse before the firm can be re-appointed as auditors
Acting for prolonged period		▪ Listed clients – Engagement partners can act for a maximum of 5 years, should then have a break of a minimum of 5 years before resuming role ▪ Anyone who has acted as a key audit partner for a period of 7 years should have a break of 2 years ▪ Senior staff on listed clients should also not act for longer than 7 years ▪ Non-listed clients – no compulsory rotation, but firm carry out annual reviews to ensure objectivity not threatened, but is advised that partners act for no longer than 10 years

Advocacy- when the auditor promotes or represents the client in some way (e.g. the client is asked to promote client's shares for a stock exchange listing or to represent the client in the court). In this situation the auditor would have to biased in favour of the client and therefore cannot be objective.

Threat	Why	Safeguard
Legal services	When representing the client you automatically view the same views as the client therefore may lose independence	▪ Should not offer legal services to a client and defend them in dispute or litigation which is material to the FS

Corporate finance services		▪ Should not advise on debt restructuring as part of Corporate finance – don't enter negotiations with bank or other lenders on clients' behalf ▪ Should not advise clients on debt restructuring as part of a corporate finance engagement

Intimidation – clients may try to harass or bully auditors into giving an 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 client.

- ❑ Auditors should maintain the fee thresholds noted as a safeguard to self-interest threat
- ❑ Auditors should always maintain an up-to-date engagement letter agreeing the basis of the fee, which has been signed by the client
- ❑ If the **relationship with the client breaks down irrevocably, the auditor should resign**

Management - taking on a management role.

Threat	Why	Safeguard
Undertaking any work which involves making judgements and taking decisions that are responsibility of management		▪ An engagement partner or employee of the assurance firm should not serve on the board of directors as they would be involved with decision making ▪ Engagement letters should always specify that clients are responsible for their own decision making ▪ Auditors should never make decision for their clients