

### 3. Conceptual Framework

Professional accountants often face complex situations and the circumstances in which they operate might create threats to compliance with the fundamental principles.

Conceptual framework sets out:

- A. Requirements  
and
- B. Application materials

#### A. Requirements:

The conceptual framework specifies an approach to:

1. Identify threats;
2. Evaluate the threats identified; and
3. Address the threats by eliminating or reducing them to an acceptable level.

In this KLiP, we will cover:

#### 1. **Identify threats:**

Accountants shall obtain understanding of the facts and circumstances, including any professional activities, interests and relationships that might be compromised in compliance with the fundamental principles.

Threats may arise due to one or more situations, as follows:

- (a) Self-interest threat – threat that a **financial or other interest** (personal/organisational) that will **inappropriately influence** an accountant's judgement or behavior;

**Example:** FrienZee & Co a significant audit client had advertised for an opening for the assistant finance manager position and offers a lucrative package. Mr. Max, an audit senior recently attended the interview in FrienZee and is expecting for the offer letter from them. In the meantime, the firm (being unaware) assigned Max to audit FrienZee.

Max is now confused as to what should he do in this situation. Should he report to firm about the job offer and withdraw from the audit or should he continue with the audit.

If Max continues with the audit without informing, there might be a self-interest threat arising, as Max plan to join the client in future.

- (b) Self-review threat – threat of **not** appropriately **evaluating the results** on own assessment, opinion, judgements or work performed earlier, in course of providing a current service.

**Example:** Mr. Jack, handled full set of accounts for an audit client, Sun Limited. Jack finalised the accounts for the financial year 2019 and passed it for audit. On 1<sup>st</sup> January 2020, he was internally

transferred to the audit department and was assigned a portfolio of clients. To his surprise, he noticed that Sun Limited was also assigned to him.

Jack realised a self-review threat might be created, as he was the one who finalised accounts for the financial year ended 2019 and as such he could be biased in his judgements. Jack intends to highlight the matter to the managers and withdraw from this engagement.

- (c) **Advocacy threat** – the threat that a professional accountant will **support client's position or opinion** to the point that the accountant's objectivity is compromised;

**Example:** Aqua & Co, an audit client approached the firm requesting Ms. Sarah, the audit manager to attend the meeting and represent the Company with the banker and also to support Aqua & Co management in the acquisition of Fish & Co.

Accompanying and representing with the client to such meeting will create advocacy threat to objectivity. As Ms. Sarah would be seen as representing the company, it would give an impression that the audit firm is supporting the acquisition and adds credit to the decision. So, Ms. Sarah must consider whether she intends to attend the meeting, else communicate the reason for not attending the meeting to the client.

- (d) **Familiarity threat** – the threat arising due to a **long or close relationship** with a client, or employing organisation and the accountant will be **too sympathetic to their interests** or too accepting of their work.

**Example:** OrchidBiz is an audit client of the firm for the past 7 years. Mr. Sam is assigned to review the audit for the year. During the audit review visit, Sam learnt that the company has invited the entire audit team for their annual office party and is expected, would give gift hampers as a token of participation. The audit senior, Mr. Paul, who was auditing past 3 years informed that the entire team is always encouraged to attend the party in order to develop good relationship.

The client's hospitality and auditor's close relationship by attending office party, creates familiarity threat. Sam is concerned as the audit staffs may get too close to the client due to these parties and this might result in team becoming less objective. Mr. Sam is considering how to address this threat.

and

- (e) **Intimidation threat** – the threat that an accountant will be **deterred from acting objectively** because of **actual or perceived pressure**, including attempts to exercise undue influence over the accountant.

**Example:** Chimp Chips, one of the major audit client has requested for Mr. Wong, an audit senior to be assigned in the current year audit team. The client also threatened the firm that it would terminate the service, if they refused to assign Mr. Wong. On further investigation, it was revealed that Mr. Wong is the brother of Chimp Chip's, finance controller.

Threatening the firm creates an intimidation threat and due to this, the team may not be able to act objectively. In addition, since Mr. Wong has no prior experience in handling this client, the cost of audit would also increase.

What should Mr. Wong do in such situations? Can he still continue to be a part of the team? He needs to assess whether he has sufficient expertise and competence in handling this client.

The firm also needs to make an informed decision and communicate the same to the client and staff accordingly.

We will cover on how to evaluate and address threats, in our next KLiP.

---

-END-