

CONSIDERATION FOR ACCEPTING AUDIT ENGAGEMENTS

In this KLIP, we will discuss a situation in which a professional accountant is in a dilemma as to whether to accept the appointment of a new customer.

To understand this, let's move to the case study.

Facts of the case:

LMN LLP recently won an audit tender for a medium-sized, investment holding company which actively participates in buying and selling of shares. Mr. Ann is the appointed audit partner taking over this new client for the sign-off of the company accounts.

As per normal audit procedure, Mr. Ann wrote-in to the predecessor auditors requesting for professional clearance and enquired if there were any matters to highlight. From the response received, it was noted that the auditor had specified that there was nothing to report other than the matters addressed in the audit report. Mr. Ann quickly reviewed the company's set of financial statements for the previous year and noted that an "except for opinion - disagreement with the accounting treatment - non-compliance with the accounting standard" was expressed in the predecessor auditor's report.

Upon further discussion with the auditors and client, it came to Mr. Ann's attention that the client is not willing to revalue the investments as they are of the opinion that the investments can be carried at cost.

Mr. Ann discussed the issue with his Senior Partner. The Senior Partner verbally informed him that the client does not believe in the revaluation of investments and feels that it is not worth paying for such information. The Senior Partner suggested Mr. Ann to adopt the same approach as the previous auditor and qualify the audit report on the same grounds.

In addition, the Senior Partner also informed Mr. Ann to "bear in mind that although the Managing Director (MD) of the client, is an acquaintance to me, it has taken the client a number of years to use our firm as auditors – I do not want to do anything that would upset him unnecessarily and jeopardise our business relationship."

Analysis:

From the facts above, Mr. Ann found out that:

- i. The predecessor auditors could have faced limitation of scope as the auditors have qualified the financial statements with an except for opinion on non-compliance with accounting standards, as failing to revalue the investments means that the gain or loss arising from the investments could be under or over-stated in the financial statements.
- ii. From the discussion with client, Mr. Ann realised that the client still disagrees to perform revaluation for the investments going forward, and they were not willing to perform valuation even after explaining the consequences.
- iii. The MD would be expecting similar qualification in the financial statements as received in the previous years.
- iv. The Senior Partner would not want to reject the engagement as the MD of the company is an acquaintance to him.

Comments/Recommendations:

Mr. Ann is in a dilemma whether to accept or reject the engagement.

He could accept it if:

- i. Mr. Ann can convince the client about the importance of complying with the accounting standards and the client also accepts to perform the revaluation or accept the audit opinion issued by Mr. Ann. As he is of the opinion that a "Disclaimer of opinion" would be most appropriate in this situation because, if the auditor had faced limitation of scope on the work, they would have to issue "disclaimer of opinion" report, bearing in mind the differences could be pervasive to the financial statements.
- ii. Mr. Ann's decision in issuing appropriate opinions is clearly identified and is not being influenced by either the Senior Partner or the Managing Director and he is able to explain the ethical duties

Alternatively, he could reject it, if:

- a) The client still disagrees to perform revaluation for the investments, hence failing to comply with the accounting standards.
- b) The situation is pressurising, and he suspects that he is being influenced in taking a decision, like - to issue an "except for" opinion even after being aware that the auditors faced limitations while performing audit, when the amount affecting the financial statement could be pervasive.
- c) He suspects that the intimidation threat is an issue because of the Senior Partner applying pressure to offer service to his acquaintance and issue report in his favour.

Hence, prior to taking any decision Mr. Ann shall ensure he applies all the appropriate safeguards to reduce or eliminate the threats to an acceptable level. Where there are no safeguards available to eliminate the threats, Mr. Ann should explain to the Senior Partner the reason for rejecting the engagement.

With this we come to the end of the KLIP.