

Resolving an ethical dilemma – suggested answers

<p>There are a number of threats present. First, there is a self-interest threat to Joe's objectivity. This is because Joe is reliant on the income from XY Ltd as his major client and thus, would not want to do anything that could damage his relationship with them and compromise his revenue from them.</p>	
<p>Second, there is a self-review threat which could impact on his integrity and his objectivity. That is, Joe performs certain non-audit work and is asked to sell and promote the sale of shares of XY Ltd. He is required to audit the sale of shares and some of the non-audit work that he did as part of the external audit. Thus, in a sense, Joe would be auditing himself and his own work.</p>	 
<p>Third, there is an advocacy threat. Selling and promoting the shares of his audit client would impair his independence as he would have a vested interest in the company. A reasonable third party would conclude that Joe is not independent of XY Ltd and thus his independence in appearance is also impaired.</p>	  
<p>Fourth, there is an intimidation threat present. The board of XY Ltd are threatening Joe by potentially not renewing his contract.</p>	   
<p>And last, there is also a familiarity threat since Joe has been the auditor for the past three years, he may have developed personal relations with the client.</p>	    

Applying step 2 of the conceptual framework, it is likely that	Not significant	Less than significant	Significant
Self-interest self-review and advocacy threats are evaluated as significant. This is because they affect more than one fundamental principle and the likelihood of the threats occurring are high.	 Not significant	 Less than significant	 Significant
Intimidation threat is evaluated as less than significant. This is because it can be argued that the board did not intentionally attempt to intimidate Joe. Further, they indicated that, based on the sale of shares, they would 'consider' the renewal of his contract and did not explicitly indicate that failure to meet their share sale target would result in a 'definite termination' of future contracts.	 Self-interest	 Self-review	 Advocacy
Familiarity threat in this example is evaluated as not significant. This is because it is common for auditors to audit their clients for a number of years. It is important to identify this as a potential threat and then to evaluate it every year that the audit is being done.	 Intimidation	 Familiarity	 Self-interest
	 Self-review	 Advocacy	 Intimidation
	 Familiarity	 Self-interest	 Self-review
	 Advocacy	 Intimidation	 Familiarity
	 Intimidation	 Familiarity	 Self-interest
	 Familiarity	 Self-review	 Advocacy

<p>Now let's apply step 3 of the conceptual framework to Joe's ethical dilemma. In order to address the significant self-interest threat, Joe needs to do reduce the reliance on XY Ltd as major source of income. Thus, he should decline the engagements to perform non-audit services and his income should be limited to only audit services. The same safeguard would address the self-review threat. Joe should also refuse to sell or promote XY Ltd shares.</p>	<table border="1"> <tr> <td>Self-interest</td><td></td><td>Decline engagement to perform non-audit work</td></tr> <tr> <td>Self-review</td><td></td><td>Decline engagement to perform non-audit work</td></tr> <tr> <td>Advocacy</td><td></td><td></td></tr> <tr> <td>Intimidation</td><td></td><td></td></tr> <tr> <td>Familiarity</td><td></td><td></td></tr> </table>	Self-interest		Decline engagement to perform non-audit work	Self-review		Decline engagement to perform non-audit work	Advocacy			Intimidation			Familiarity		
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<p>In terms of the familiarity threat, there is no further action required as we evaluated this threat as not significant.</p>	<table border="1"> <tr> <td>Self-interest</td><td></td><td>Decline engagement to perform non-audit work</td></tr> <tr> <td>Self-review</td><td></td><td>Decline engagement to perform non-audit work</td></tr> <tr> <td>Advocacy</td><td></td><td>Refuse to sell or promote shares of XY Ltd</td></tr> <tr> <td>Intimidation</td><td></td><td>Refuse to sell or promote shares of XY Ltd</td></tr> <tr> <td>Familiarity</td><td></td><td>No action required</td></tr> </table>	Self-interest		Decline engagement to perform non-audit work	Self-review		Decline engagement to perform non-audit work	Advocacy		Refuse to sell or promote shares of XY Ltd	Intimidation		Refuse to sell or promote shares of XY Ltd	Familiarity		No action required
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