# Chapter 4

# PROFESSIONAL ETHICS

## 1. Introduction

The ACCAs guide to professional ethics sets out certain fundamental principles about how its members should behave. It also recognizes how its members could be subject to certain threats which would compromise their behaviour and suggests ways in which members can safeguard themselves against the operation of those threats.

The guide applies to all members of ACCA and also to all ACCA students. Note that its operation is not restricted to auditors and covers ACCA members working in industry and commerce.

The ethical framework recognises that there are:

- Ethical principles to be followed.
- These are subject to risks
- Accountants should use safeguards to avoid or to respond to risks.

## 2. Fundamental principles

**The ACCA's fundamental principles are as follows:**

- First, **integrity**, basically this means that members should be honest, straightforward. If they see something is amiss, they should say so and shouldn't try to conceal it; they shouldn't 'turn a blind eye'; they shouldn't try to be ambiguous; they should state things plainly.
- Secondly, **objectivity**, members should be influenced by the facts and the facts only. They must avoid bias, conflict of interest and undue influence.
- Third, members should exercise **professional competence and due care**. They must keep themselves up-to-date with legislation and recent developments. They shouldn't take on work which they are not qualified for or for which they have no skills. They must be diligent, they must be careful.
- Fourth, **confidentiality**. Members, particularly perhaps those who are auditors, have access to information that is highly confidential and which is price sensitive. That information must be held confidentially. Members should not disclose confidential information unless they have a legal or professional duty to do so. An example of a legal duty to disclose information can arise if a member thinks that a client or the person they are working for is involved in money laundering. Many countries have very strong regulations nowadays so that money laundering suspects should be reported to the authorities.
- Finally, members should show **professional behaviour.** They should comply with the law and they should avoid any actions which discredit the profession. So, for example, when they are trying to advertise their services they shouldn't say that other members

are bad or poor. They should confine themselves to promoting what they are good at; they shouldn't criticise other professionals.

# 3. Threats to professional ethics

**Threats to professional ethics arise from**

- Self-interest
- Self review
- Advocacy
- Familiarity
- Intimidation.

Note also there are management threats, where the auditor performs managerial functions for the client. These are not listed by the IESBA, but covered under several of the above, such as self-interest and familiarity.

Where such threats exist, the auditor must put in place safeguards that eliminate them or reduce them to clearly insignificant levels. Safeguards apply at three levels: safeguards in the work environment, safeguards that increase the risk of detection, and specific safeguards to deal with particular cases. If the auditor is unable to implement fully adequate safeguards, the auditor must not carry out the work.

## 3.1 Self-interest threats

Self-interest threats are the following:

- Financial: For example if an auditor own shares in the client, the auditor could be accused of wanting the client's profits to look good, so that the share price rises thereby enriching the auditor.
- Close business relationships are also threats. For example, if a partner retired from an audit partnership and then immediately went to work for a client, they could be accused for having lined themselves up for a job and to do that they perhaps did not do their audit rigorously. A period of at least two years should pass before an ex-partner takes up an appointment with a client. Having a partner on the client board is also unacceptable.
- Close family and personal relationships between the auditor and owners or directors of the company they are auditing lay the auditor open to suggestions that the audit has been neither objective nor independent, and that the auditor did not show the proper degree of integrity.
- Loans and guarantees from the client to the auditor should be looked at carefully. If the audit client is a bank and it makes a loan on a normal business terms to a member of the audit staff, for example a mortgage, this would normally be regarded as acceptable. If however the bank (the audit client) makes a large loan into the partnership then this again could leave the audit firm open to accusations of having being treated faithfully by the bank. Certainly no loans or financial relationships should exist between a client and an auditor if it is not normal business for the client to make loans.
- Overdue fees put the auditor at some risk as there is a possibility that client will never pay those fees. This could lead to accusations that the auditor has not qualified the audit report to reduce the likelihood that a worried creditor triggers the company's liquidation. If there are overdue fees the auditor should not make the situation worse

and should not incur any more chargeable time until those fees have been settled. If fees remain outstanding, the auditor should resign.

- Contingent fees are obviously dangerous. A contingent fee, for example, would be where the auditor is paid a small fee if the auditor report is qualified, but a larger fee if the audit report is clean.
- High percentage fees. If the auditor earns a high percentage of total income from one audit client, then the auditor will rely too much on that client and can't afford to lose them. This can give the client too much leverage over the auditor. For a public interest company, such as a company listed on a stock exchange, the maximum proportion of fees arising form that client should not be more than 15% of total fees in two consecutive years. No figure is mentioned for non-public interest companies, but auditors need to be mindful of this threat..
- Low-balling refers to the practice of quoting a very low audit fee to a client and then hope that profits would be made another work awarded by the client. This means really that the audit does not pay for itself so how, therefore, could a proper audit be done? Winning an audit is a competitive business and the audit fee is an important factor to clients. However, an auditor could find it difficult to claim that a proper audit has been carried out if a loss were made on the audit. Fees should be profitable for the auditor.
- Recruiting staff on behalf of a client should not be undertaken. The danger here is that if members of staff are recruited by the auditor, particularly financial staff, then subsequently the auditor might be reluctant to criticise the performance of those staff members as the advice they gave on recruitment looks bad. Similar considerations should be taken into account when the auditor performs any management function for the client.

### 3.2 Self review threats

Self review threats arise when an auditor does work for a client and that work may then be subject to self-checking during the subsequent audit. For example, if the auditor prepares the financial statements, and then has to audit them, or the auditor performs internal audit services and then has to check that the system of internal control is operating properly. Auditors could obviously be reluctant to criticise the work which their own firms have earlier undertaken, and this could interfere with independence and objectivity.

Generally auditors must be very careful when undertaking such work. Certainly it is common for auditors to do additional work for their clients, but what is important that the work is done by an entirely different team from the audit firm.

Really, checking your own work is a waste of time.

### 3.3 The supply of other services

The issue of auditor supplying multiple services to their clients, such as taxation and management consultancy, is a controversial one and there are both pros and cons. For example, auditors will know a great deal about the operations of their clients and this can make the performance of other work much more efficient. If entirely new companies have to be brought in to supply these services, much of the information they find out about the client will already be known by the auditor and there is a real duplication of effort.

The danger, of course, is that the auditors come to rely too heavily on the fees earned from the other work and are therefore reluctant to risk losing a client because of an adverse audit opinion. Large audit firms can at least use separate departments, though this may be difficult with small firms.

In United States, listed companies are not allowed to obtain other services from their auditor. This is to ensure that the auditor is independent and performs only the audit. In most jurisdictions, there are no hard and fast rules but the overall guidance on ethics relating to objectivity and independence should be adhered to.

### 3.4 Advocacy threats

Advocacy is where the assurance or audit firm promotes a point of view or opinion to the extent the subsequent objectivity is compromised. An example would be where the audit firm promotes the shares in a listed company or supports the company in some sort of dispute. Advocacy can interfere with professional scepticism.

As always, the audit firm should weigh up the risks to its objectivity, integrity and independence and should withdraw from performing further work if those risks are too high.

### 3.5 Familiarity threats

Familiarity threats arise because of the close relationship between members of the assurance or audit firm and the client. The close relationship can arise by friendship, family or through business connections. There is no general definition of what's meant by close relationships, but if you were an auditor and your brother was the Finance Director of a client firm then there probably is a close relationship! If however the finance director was a remote cousin of yours, there might not be a close relationship. Note that there does not have to be any family or legal relationship: friendship can threaten independence and integrity.

When dealing with close business relationships between the auditor and the client firm, the ACCA suggests, the lead partner should be changed at least every five years and other partners involve change at least every seven years. This is to prevent too close a relationship and friendship growing between the two parties. The problem is that when a close relationship does grow, objectivity and skepticism are liable to be lost.

### 3.6 Intimidation

The final groups of threats are intimidation threats. These can deter the assurance team from acting properly.

Examples could be threatened litigation, blackmail, or there might even be physical intimidation, though it is to be hoped that that is rare. Blackmail could be more subtly applied and might relate back, for example, to a period where the auditor was not acting in accordance with the required ethical standards.

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