

FUNDAMENTAL PRINCIPLES OF PROFESSIONAL ETHICS

All professional accountancy bodies (e.g. ACCA, ICAEW ,CIMA) have their own codes of ethics and conduct. These are aligned with the IFAC's Code of Ethics for Professional Accountants

There are 5 fundamental principles which are :

Integrity

Members should be straightforward and honest in all business and professional relationships

Objectivity

Members should not allow bias, conflicts of interest or undue influence of others to override professional judgment

Professional Competence and Due Care

Members have a continuing duty to maintain professional knowledge and skill at a level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques. Members should act diligently and in accordance with applicable technical and professional standards when providing professional services

Confidentiality

Members should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties without proper or specific authority or unless there

is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of members or third parties

Professional Behaviour

Members should comply with relevant laws and regulations and should avoid any action that discredits the profession

THREATS TO INDEPENDENCE AND OBJECTIVITY

The threats to independence and objectivity are detailed below. Appropriate safeguards must be put in place to eliminate or reduce such threats to acceptable levels

Self – Interest

This may arise as a result of the financial or other interests of members or of immediate or close family

e.g. close business relationships, gifts and hospitality, loans and guarantees , overdue fees, high% of fees, lowballing

Self – Review

Self review threats may occur when a previous judgement needs to be re-evaluated by members responsible for that judgement

e.g. preparing accounting records and financial statements, tax services, internal audit services

Advocacy

Advocacy threats arise in those situations where the audit firm promotes a position or opinion to the point that subsequent objectivity is comprised. Examples include commenting publicly on future events in particular circumstances, having made assertions without detailing the assumption, or acting as an advocate on behalf of a client in litigation or disputes with 3rd parties. Advocacy threats might also arise if the firm promoted shares in a listed audit client

Familiarity

A familiarity threat occurs when, because of a close business relationship, members become too sympathetic to the interests of others. There is a substantial risk of loss of professional scepticism in such circumstances

This often arises in conjunction with a self-interest threat for example when there are close family or personal relationships between the client and firm, long association with a client, employment with a client etc

Intimidation

This threat occurs when members of the audit team may be deterred from acting objectively by threats, actual or perceived. This could arise from family or close business relationships or litigation,

These are also examples of self-interest threats, largely because intimidation may only arise significantly when the audit firm or individual has something to lose

ADEQUACY OF THE ETHICAL STANDARDS

- These are guidelines only
- The guidelines contain many vague statements, without adequate definitions of terms (and the difficulties involved in defining such aspects)
- The relative laxness of the regulation system
- The fact that this is the output of a self-regulatory system
- The notion of a professional who can decide for him/herself on such matters
- The impossibility of anticipating every possible threat to independence, therefore general principles become relatively more important

PROFESSIONAL ETHICS AND CODES OF CONDUCT

(A) INDEPENDENCE AND THE AUDIT

An auditor's objectivity must be beyond question . Objectivity can only be assured if the auditor is , and is seen to be , independent

Areas of Risk

- **Undue dependence on an audit client**

An audit firm needs to monitor the situation if an undue high proportion of its overall audit fee income stems from one client .

	Initiate Review	Extreme Situation
Listed and other public interest companies	5%	10%
Other clients	10%	15%

- **Family and Other Personal Relationships**

An auditor should not take part in the conduct of an audit of a company if he has been an officer or employee of that company in recent years

- **Loans**

A practice should not make a loan to or accept a loan from an audit client

- **Overdue Fees**

The practice should ensure that an audit client should not build up a significant volume of overdue fees as this could be considered as akin to a loan

- **Goods and Services --- Hospitality**

Should not be accepted unless the value is modest

(B) COLD CALLING

- Until relatively recently 'cold calling' has been largely prohibited throughout the profession. Therefore the 'direct' approach may not be suitable.
- Where 'cold-calling' restrictions have been relaxed it may still only be permitted for existing business clients (ie to offer them additional services), the direct approach to non-business clients being prohibited. This inhibits competition.
- Although the practice may be reviewed as 'a bit grubby and commercial' it is now generally regarded as an accepted modern business practice
- Whilst an audit firm may be permitted to 'cold call', the fundamental ethical principles must be adhered to. Whilst solicitation which is decent, honest and truthful may be acceptable, cold calling which amounts to harassment is not.

(C) ADVERTISING

- Advertising is generally allowed subject to the observance of the fundamental principles of ethical codes.
- Although direct advertising (ie on television, radio, cinema) is sometimes prohibited , an advertisement in a national accountancy magazine is generally permitted.
- Where advertising is permitted, the minimum requirements are that it be decent, honest, truthful , in good taste and should not compromise the integrity of the profession

It should not create expectations of favourable results (e.g. lower tax liabilities)

It should not make unjustifiable comparisons with other professional accountancy practices (e.g. "we are the best")

(D) LOWBALLING

- 'Lowballing' is a practice in which auditors compete for clients by reducing their fees for statutory audits. Lower audit fees are hopefully compensated for by the auditor carrying out more lucrative non-audit work (e.g. consultancy and tax advice) or by an increased audit fee if the client is retained in future years
- The quotation of a lower fee than other tendering firms is not improper providing that the prospective client is not misled about:
 - the precise range of services that the quoted fee is intended to cover; and
 - the likely level of fees for any other work undertaken.

- The risk is, that if the non-audit work does not materialise, the audit firm may be under pressure to cut corners or resort to irregular practices in order to 'keep within budget'. If a situation of negligence were then to arise the firm could be found guilty of incompetence.

REASONS FOR ALLOWING

- Free market --- loss leadership strategy
- Audits put out to tender --- objective = cheapest
- A lower audit fee will still provide a contribution towards the audit firm's fixed costs
- May lead to improvements in audit methodology
- Cost consciousness promoted

REASONS FOR DISALLOWING

- Audit is not a commodity but a statutory service
- Undermines credibility
- Quality of work/service threatened
- Implications for independence
- Costs may be passed on elsewhere
- Price is not necessarily the only factor in assessing a quote

(E) PROVISION OF MULTIPLE SERVICES

It is common for an audit firm to provide a range of accountancy services including preparation of accounting records

This leads to possible problems as to the maintenance of independence

Also is audit firm maybe accused of making management decisions for the client

If the firm is both preparing the accounting records and performing the audit , it is in effect reviewing its own work

However , the advantages of the provision of multiple services to the audit firm are additional fees , work for non-audit staff , enhancement of staff expertise

RECOMMENDED ETHICAL SAFEGUARDS

- The client must accept responsibility for the accounting records as its own
- The audit firm should not assume a management role
- The practice must plan and perform the audit in compliance with auditing standards
- Different staff should perform the audit compared to those who were involved in the preparation of the accounting records

(F) OPINION SHOPPING

This involves a client seeking a second opinion on a particular accounting treatment or the audit report from another accounting practice

There are strict ethical rules regarding 'second opinions'. Practitioners are advised NOT to provide second opinions, when requested, without following a procedure of contracting the incumbent auditor/accountant. Therefore to be offering second opinions clearly goes against ethical guidelines – as the practice is to be discouraged