SECTION A

# THE PROFESSIONAL AND ETHICAL DUTIES OF THE ACCOUNTANT

# A1

# STUDY GUIDE A1: PROFESSIONAL BEHAVIOUR AND COMPLIANCE WITH ACCOUNTING STANDARDS

## Get Through Intro

The educational standards and guidelines set out by the International Federation of Accountants (IFAC) state that:

- professional accountants should first acquire the knowledge of ethics;
- then develop ethical sensitivity;
- then use ethical judgement to evaluate situations; and
- finally, should demonstrate ethical behaviour through implementing decisions appropriately.

After the accounting scandals of recent years such as Enron and WorldCom, it's vital for accountants and finance professionals to be equipped to operate in an industry subject to tight scrutiny. The finance profession has moved towards strengthened codes of conduct, regulation, and legislation and so it is important that the accountant is aware of the ethical and professional issues in advising on corporate reporting and complying with accounting standards.

For example, the code of ethics for professional accountants, issued by the IFAC, states that a person cannot accept an external audit if he has an interest in the financial statements i.e. the external auditor should be independent. Robert, who holds 20% of the shares in Ropeway Co, has just accepted an external audit of Ropeway Co. This clearly violates the code of ethics. Robert cannot argue that he was not aware of the code of ethics and, therefore, is not guilty of professional misconduct.

Understanding this Study Guide will help you to understand your ethical and professional duties as an accountant / finance professional so that you are not caught in the same situation Robert finds himself in! Acquiring ethical knowledge is the first step towards ethical behaviour so necessary in today's business environment.



## Learning Outcomes

a) Appraise and discuss the ethical and professional issues in advising on corporate reporting.
b) Assess the relevance and importance of ethical and professional issues in complying with accounting standards.

## Introduction

### Case Study

In the light of repeated press reports, Emily Hamilton, the CEO of Major Keys, raised two thought provoking questions:

1. Are workers paid enough to allow them to live honourably?
2. Is there a system that allows workers to collectively bargain for their interests?

Going by the repeated claims and subsequent investigations into Double Trips Inc's operations, the answer to both of these questions would be an emphatic NO. It was these investigations that forced Double Trips to 'voluntarily' disclose the names and locations of its manufacturing units as part of its corporate social responsibility report.

This report was the result of an audit of 60 clothing manufacturing units scattered over 20 countries, over eleven months. When gathering data for this report, Double Trips' management came across abuses of basic amenities such as unclean toilets and the absence of drinking water. In addition to this, it also found working hours in most third world countries extending to more than 55 hours a week.

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The above extract illustrates how large corporations have not only to pay attention to the ethical principles they practise in their own organisation but also to those being followed by the factories from whom they source their products.

As an accountant, you have to consider the ethical and professional aspects while advising your directors on corporate reporting matters.

## 1. Appraise and discuss the ethical and professional issues in advising on corporate reporting.[3]

**[Learning Outcome a]**

### 1.1 Accountant's code of ethics

### Case Study

Francesca Darcy had been the internal auditor of a small department store, Wise Pocket, for the last six years. The owner of the store, Rob Collins had not found any fault with her work and both shared a very good professional rapport. On 15 June, 20X3, Rob received a notice from the tax authorities regarding a scrutiny assessment. In short, they, the tax authorities, wanted to take a closer look at Rob's financial records and, in particular, the personal cash inflow and outflow register he secretly kept under the cash register. Rob was eventually indicted on tax evasion charges. During the trial, it came to light that Francesca had been passing on information regarding Rob's finances to the taxation authorities which helped to support their case.

When Rob sued Francesca, one of the points Rob's attorney argued in court was that any client should feel that he was getting complete loyalty and confidentiality support from his accountant. The jury felt that the professional code of ethics for accountants fully supported this contention. However, the defence attorney contradicted this point stating that, as an accounting professional, the accountant has a moral, legal and ethical obligation to turn over information to the authorities when he (i.e. the accountant) feels that the concerned information violated any law or is in any way contradictory to public policy.

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As an accounting professional, there may be several instances when one is caught between professional and moral issues. Accountants, among other duties, are conditioned to report a true and fair position of the client's business and perform their duties with honesty and integrity. However, until recently, accountants did not have any formal training in the ethical aspects of their profession nor was there any uniform, clear cut code of ethics governing the accounting profession. Since most accountants are conditioned to adopt a practical approach, they could find themselves lost should a question of ethics arise.

However, with the collapse of major companies like WorldCom, HealthSouth and the most infamous of them, Enron, which also led to the disintegration of its auditor, Arthur Andersen, the need for a uniform code of ethics in financial reporting by an auditor who in no way could be influenced by the company's management was voiced.

The ACCA has, in its Code of Ethics, put forth five fundamental principles that it expects its members to follow. They are as follows:

**1. Integrity**

Those who work as accountants must have a high level of professional integrity. All members are expected to be straight forward and honest in their workings.

Accountants must, in order to project integrity, be independent. This means they must not allow their decisions, when declaring financial statements as true and fair, to be clouded by their other interests in the client. For this to be effective, they should not have any financial or management interest in the client they are currently auditing.

**Example**

An accountant is not expected to accept the external audit of a company if he is the director of the same company or his judgement is expected to be influenced by his interest in the company.

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However, some accounting scholars debate this point as they believe that as the client pays the auditor for a service, their fee depends upon their relationship with the client. Also, apart from audit, auditors take up other assignments such as tax consultancy and due diligence for acquisitions. This is seen as inhibiting the auditor's independence as he could be persuaded to overlook an unfavourable accounting treatment in order to keep the revenue coming in.

**2. Objectivity**

Members of the profession should not allow conflicts of interest, personal bias or undue influences to impair their professional or business judgements.

**Example**

The internal auditor cannot rate the internal controls of a particular department as "weak" only because he does not get along with the head of that department.

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**3. Professional competence and care**

This principle is extremely important because if accounting information is not presented properly, then it reflects badly on the accountant as well as the entire accounting profession. The accountant must ensure that:

- they have the necessary professional knowledge and skills to meet the requirements of their client and profession
- they work hard and with diligence while doing their job
- all their staff have the required training and supervision to fulfil their tasks efficiently

**Example**

An accountant who specialises in preparing and filing tax returns for individuals must ensure the following:

- He, as well as his staff, is kept informed of all the latest updates to tax law.
- He devotes sufficient time and attention to each tax return.

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**4. Confidentiality**

An accountant is bound not to disclose information related to his client acquired in the course of business to any one apart from in the following two situations:

(a) There is a legal duty to disclose information.
(b) There is a professional obligation to do so.

This principle is enforced in order to restrain the accountant from using personal confidential information relating to his client for personal gain. These rules of confidentiality also apply when the accountant is no longer engaged by that particular client.

**Example**

During the course of her audit, Peggy Woo, Xansee's auditor, chances upon information regarding the launch of a new product that will cause Xansee's stock prices to soar. However, Peggy cannot pass on this information to a third party unless the announcement is made publicly. Passing on material, non-public information like this is referred to as trading on the basis of insider information. This kind of trading is illegal in many countries.

**5. Professional behaviour**

Members of the accounting profession should comply with all the laws applicable to their client's audit and should avoid any situation which would discredit the profession. Furthermore, members are required to behave with courtesy and consideration towards all those with whom they come in contact in a professional capacity.

**Example**

Nick Delfino is a partner in a mid-sized accounting firm. He has been approached by Tough Corp, a large manufacturer of tyres, to discuss whether he would consider taking on some audit assignments for the business. Nick has heard through unsubstantiated rumours that Tough Corp is unhappy with its current auditor. Nick is eager to take on Tough as a client but has had no experience of auditing manufacturing firms. During his discussions with Tough, Nick cannot:

- claim to have any specialised expertise in auditing manufacturing organisations
- slander or unduly criticise Tough's current auditors

Auditors assure the users of financial statements of the reliability of the accounting information presented. In other words, they state that the financial statements presented to the shareholders and other interested parties represent the true financial position of the organisation. Billions of dollars are put at stake based on the auditor's opinion.

As a result, in addition to maintaining the highest ethical standards mentioned above, an auditor is also, above all, expected to be independent, in fact and in appearance, i.e. be free from any interest in the client, both financial and otherwise when providing auditing services to a client. There is a very fine line between consenting to the client's accounting policies so that the client is not subjected to loss, and allowing the client to influence his opinion so that the client can get away with unscrupulous accounting policies which eventually defraud its investors.



**SUMMARY**


### 1.2 Conflicts of interests

One way in which the auditor's opinion may be influenced is from the conflicts of interest arising from their duty to provide a true and complete opinion on an entity's financial statements versus their other duties owed to that particular client. This kind of situation is illustrated in the following examples.

**1. Payment of high fees**

There has been a long standing argument questioning the independence of the auditor especially when clients pay huge amounts of fees to the auditor. It becomes very difficult to say no to the client, especially when the fee runs into millions of dollars. For example Enron, the energy trading giant, paid Arthur Andersen $25 million in fees for its audit.