Professional Ethics, Independence and Audit Quality

Concept of a profession

• Five attributes of a profession
  – A systematic body of theory
  – Authority
  – Community sanction
  – Ethical codes
  – A culture

Concept of a profession

• Professional characteristics
  – Mastery of a particular skill
  – Adherence to a common code of values and conduct
  – Acceptance of a duty to society
Concept of a profession

• Duties of a profession:
  – Competence in the field of expertise and knowledge
  – Integrity in client dealings
  – Objectivity in offering services
  – Confidentiality
  – Discipline

Duties of a professional accountant

• Duties to sustain a fiduciary relationship
  – Behaviour that espouses responsible values
  – Attention to requirements of clients and stakeholders
  – Acquire & maintain required skills and knowledge
  – Maintain credible reputation
  – Maintain acceptable personal reputation

Duties of a professional accountant

• Values required to carry out duties and maintain rights includes:
  – Honesty
  – Integrity
  – Exercise of due care
  – Objectivity
  – Confidentiality
  – Competence
• Assumes a commitment to put the public, client, the profession and employer ahead of any self-interest
Professional ethics and the accountant

- Ethics is concerned with the evaluation of choices where options are not clear or where there is no absolute right or wrong
- Study and practice of ethics are important to enable an accountant to examine critically a situation in which there is a conflict of loyalties and interest

An understanding of ethics and ethical issues

- The word ‘ethics’ is derived from the Greek word ethos, meaning ‘character’
- Whereas morality focuses on the ‘good’ and ‘bad’ of human behaviour, ethics focuses on what is ‘right’ and ‘wrong’, and how and why people act in a certain manner
- Focuses on a study of choices, standards and behaviour

An understanding of ethics and ethical issues

- The nature of ethics
  - Teleology
  - Deontology
  - Virtue ethics
  - Ethical relativism
Professional ethics for accountants

- Include standards of behaviour for a professional person
- Designed for practical and idealistic purposes
- Co-regulation of audit independence and standard setting
- Professional ethics is foundation left to the profession

Code of Ethics for professional accountants

- Issued July 2006 by the Accounting Professional and Ethical Standards Board (APESB)
- Part A – Fundamental principles
- Parts B and C – Illustrate how conceptual framework is to be applied

Code of Ethics for professional accountants

- Changes from 1 January 2011
  - Independence requirements extended
  - Requirements for members joining public interest audit clients
  - Extending partner rotation
  - Provisions regarding non-assurance services
  - Pre or post issuance review
  - Non-assurance services provided to clients
Fundamental principles

- Public interest is the overriding responsibility
- Integrity
- Objectivity
- Professional competence and due care
- Confidentiality
- Professional behaviour
- For each principal, a conceptual framework is used to identify possible threats and safeguards

Types of threats

- Self-interest threats are as a result of financial or other interests of a member or of an immediate or close family member
- Self-review threats may occur when a previous judgement needs to be re-evaluated by the member responsible for that judgement

Types of threats

- Advocacy threats may occur when a member promotes a position of opinion to the point that subsequent objectivity may be compromised
- Familiarity threats may occur when, because of a close relationship, a member becomes too sympathetic to the interests of others
Types of threats

- Intimidation threats may occur when a member may be deterred from acting objectively by actual or perceived threats
- Public practice behaviour threats may occur as a result of inappropriate marketing of professional services and products

Safeguards

- Safeguards may eliminate or reduce threats to an acceptable level
- Safeguards are created by the profession, legislation or regulation
- Examples: continuing professional development requirements, corporate governance regulations, professional standards

Professional independence

- Independence is the cornerstone of the auditing profession
- The fact of independence depends on the auditor’s integrity, objectivity and strength of character
- Corporations Act and s.290 of the Code stipulate principles, rules and guidelines
Statutory provisions enhancing auditor’s independence

- The auditor who conducts an audit of the financial report for a financial year or half-year must form an opinion about whether the financial report is in accordance with the Corporations Act.
- Includes compliance with accounting standards and showing a true and fair view of the financial state of affairs of the audited body.

Statutory provisions enhancing auditor’s independence

- Shareholders are permitted to provide written questions to the auditor within 5 days before the AGM and the auditor must attend to AGM.
- Auditors independence declaration required.

Statutory provisions enhancing auditor’s independence

- Special rules for retiring partners of audit firms and retiring directors of audit companies.
- 2 year cooling period for such personnel to become engaged as an officer of the audited body.
- Rotation obligation required for individual auditors, audit firms and audit companies.
- Limited term of 5-7 years for auditors who play a significant role in audit.
Independence of mind and appearance

Independence of mind
- State of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgement
- Requires accountant to exercise scepticism and act with integrity and objectivity

Independence in appearance
- The avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, would reasonably conclude a firm’s or professional accountant’s integrity, objectivity or professional scepticism had been impaired

Threats to independence
- Financial interests
- Loans and guarantees
- Close business, family and personal relationships
- Employment relationships
- Recent service and serving as an officer on the board of assurance clients
Threats to independence

- Long association
- Provision of non-assurance services to assurance clients
- Appointment and removal of auditors
- Fees and pricing
- Gifts and hospitality

Monitoring auditor independence

- Under the Corporations Act, ASIC has responsibility for surveillance, investigation and enforcement of regulatory requirements for auditor independence

Corporate collapses and reform

- Enron
- HIH Insurance Ltd
- Parmalat
- Akai Holdings
- Lehman Brothers
Corporate law economic reform program

- Key areas relating to auditors
  - Auditor appointment, independence and rotation
  - Annual general meetings
  - Expansion of duties

Audit Quality

- Technical competence
  - Compliance with:
    - Accounting standards and auditing guidance statements
    - Standards for taxation, insolvency and management consulting services
  - Ethical competence

Quality control in auditing firms

- A multi-level regulatory framework developed by profession and regulators to assure quality audits:
  - Standard setting
  - Firm regulation
  - Self-or peer regulation
  - Government regulation
Quality control elements

- Leadership responsibilities
- Ethical requirements
- Acceptance and continuance of client relationships
- Human resources
- Engagement performance
- Monitoring and quality control review

Professional discipline

- Value of the auditor’s opinion is enhanced by the public’s recognition of high standards of professional practice and conduct by:
  - High entry standards for membership
  - High standards of performance and conduct required by members
  - Power to discipline