THE POWER OF BEING UNDERSTOOD

AUDIT | TAX | CONSULTING

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IESBA CODE OF ETHICS

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Objectives

At the end of this module, participants should be able to:

- Define the concepts of Ethics and Independence
- Decide whether specific situations create an Ethical conflict or not
- Be aware of some of the safeguards that can be applied to mitigate threats to the principles of the Code

Agenda

Fundamental principles

Professional Accountants in Practice

- Independence

Professional Accountants in Business

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Handbook of the Code of Ethics

Part A – General application – 14 pages

Part B – Professional Accountants in Public Practice – 115 pages

(including 87 pages on independence)

Part C - Professional Accountants in Business – 15 pages

The Fundamental Principles

- Integrity
- Objectivity
- Professional competence and due care
- Confidentiality
- Professional behaviour

Apply the fundamental principles and conceptual framework to

Identify threats → Implement safeguards where appropriate

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Scope

In this module we will look at many, but not all, of the threats to ethical behaviour identified by the IESBA Code and whether there might be safeguards that could reduce the threat to an acceptable level.

But remember, various regulators (CMA, CBK, etc) set their own ethical requirements, including the US Securities and Exchange Commission (SEC) in respect of subsidiaries of companies listed in the US.

Most ‘networks’ also have their own policies which may be more restrictive than the IESBA Code.

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Scope (continued)

ICPAK's Code of Ethics includes all of the wording of the IESBA Code, plus some additional guidance and some references to the Accountants Act

The Fundamental Principles

- *Integrity* - We are required to be straightforward and honest in professional and business relationships.
- *Objectivity* - We must not compromise our professional or business judgement because of bias, conflict of interest or the undue influence of others.
- *Professional competence and due care* - We are required to maintain professional knowledge and skill at the level required to ensure our clients or employers receive competent professional service. We are required to act diligently, in accordance with applicable technical and professional standards.

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The Fundamental Principles

- *Confidentiality* - We are required to refrain from disclosing to third parties, or using to our personal advantage or to the advantage of a third party, any confidential information acquired as a result of professional and business relationships, unless:
  - We have proper and specific authority to do so, or
  - There is a legal or professional right or duty to do so.

- *Professional behaviour* - We are required to comply with relevant laws and regulations and avoid any action that may discredit the profession.

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Conceptual Framework

All Partners and Professional Employees are required to:

1. Evaluate any threats to compliance with the fundamental principles
2. Consider qualitative and quantitative factors when evaluating the significance of a potential threat
3. Identify and implement appropriate safeguards to any identified threats, or where not possible, decline or discontinue the professional service or activity
4. Take whatever actions that may be possible to address the consequences of a breach, if one should be identified, and report the breach to those affected by it.

Threats

Advocacy threats

- May occur when a professional accountant promotes a position or opinion to the point that objectivity may be compromised.

Familiarity threats

- May occur when, because of a close relationship with a client or employer, a professional accountant becomes too sympathetic to their interests.

Intimidation threats

- May occur when a professional accountant is deterred from acting objectively by pressure, actual or perceived

Self-interest threats

- May occur as a result of the financial or other interests

Self-review threats

- May occur when a previous judgement needs to be re-evaluated by a professional accountant or firm of accountants responsible for that judgement

Possible safeguards

Safeguards include:

- Safeguards created by the profession, legislation or regulation
  - Continuing professional development requirements
  - Corporate governance regulations
  - Professional standards
  - External reviews
- Safeguards in the work environment
  - Strong internal controls
  - Consultation
  - Enabling employees to communicate concerns without fear of retribution (whistleblowing)

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Conflict of interest

Conflicts of interest create threats to objectivity. Such threats may arise when:

- A professional accountant undertakes a professional activity for two or more parties whose interests are in conflict
- A professional accountant undertakes a professional activity for a party whose interests are in conflict with his/her own interests

Safeguards include:

- Declining to accept the engagement
- Using separate teams (Chinese walls)
- Ensuring confidentiality of information (need to know basis)
- Disclosing the conflict and getting consent from the parties involved

PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE

Application of the Code

- Professional appointment
- Conflicts of interest
- Second opinions
- Fees and other types of remuneration
- Marketing professional services
- Gifts and hospitality
- Custody of client assets
- Objectivity
- Independence

Professional appointment

- Consider threats to fundamental principles and possible safeguards before accepting an engagement
- Periodically review acceptance decisions for recurring engagements
- When tendering for an engagement currently held by another professional accountant, an evaluation of the threats may require direct communication with the existing accountant. This will require the client's permission, both for the initiator and the existing accountant

Conflicts of interest

- Consider conflicts of interest and possible safeguards before accepting an engagement

- Generally necessary to disclose the nature of the conflict and related safeguards to the affected parties, and obtain their consent

Second opinions

- Threat is that the accountant providing a second opinion may not be aware of all the facts known to the accountant giving the first opinion.

- Safeguards include seeking permission to discuss the issue with the other accountant, and/or describing the limitations surrounding the opinion.

Fees and other types of remuneration

- Unreasonably low fees may present a threat to professional competence and due care
- Contingent fees may present threats to objectivity and due care
- Commissions and referral fees are acceptable provided there are appropriate safeguards

- Safeguards include disclosure of the arrangements to the client, and/or arranging for work to be reviewed by an independent third party

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Marketing professional services

- Main threat is to the principle of professional behaviour
- A professional accountant should be honest and truthful, and not:
  - Make exaggerated claims
  - Make disparaging references or unsubstantiated comparisons to the work of another.
  - If in doubt, consult the relevant professional body (ICPAK)
- Under the Accountants Act a member of ICPAK is guilty of professional misconduct if s/he solicits clients or professional work or advertises professional attainments or services by use of means which contravene the guidelines published by the Council

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Gifts and hospitality

- A professional accountant should only accept gifts and hospitality that a reasonable and informed third party, weighing all the specific facts and circumstances, would consider trivial and inconsequential.

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Custody of client assets

- Do not do so unless permitted by law
- Keep such assets separately from personal or firm assets
- Use such assets only for the purpose intended
- Be ready to account for those assets and any income generated
- Comply with all relevant laws and regulations
- Satisfy yourself that the assets were not derived from illegal activities, such as money laundering

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Objectivity

- A professional accountant in public practice who provides an assurance service shall be independent of the assurance client.
- Independence of mind and in appearance is necessary.

Safeguards include:

- Withdrawal from the team
- Supervisory procedures
- Resignation
- Discussing with those charged with governance of the client

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Definitions

What is independence?

Independence of mind

- The state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgement, allowing an individual to act with integrity, and exercise objectivity and professional scepticism

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, would reasonably conclude a firm’s, or a member of the assurance team’s integrity, objectivity or professional scepticism had been unacceptably impaired

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Period of Independence

- Starts when the Assurance Team begins to perform assurance services and ends when the assurance report is issued.

- For recurring engagements, the period ends upon the notification by either party that the professional relationship has been terminated, or upon the issuance of the final assurance report if later

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INDEPENDENCE – AUDIT AND REVIEW ENGAGEMENTS

Financial interests

None of the following shall have a direct financial interest or a material indirect financial interest in the client:

- A member of the audit team
- A member of that individual’s immediate family
- The firm

Safeguards:

- Immediate disposal of the interest
- Removal of the individual from the team
- Do not accept the engagement

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Definitions

Assurance Engagement

- An engagement in which a professional accountant in public practice expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. (Includes audit engagements, non-audit assurance engagements, and review engagements.)

The Assurance Team

- All professionals participating in the assurance engagement
- All others within a member firm (and within any member firm in the case of an audit engagement) who can directly influence the outcome of the assurance engagement

Definitions

Financial Interest

- An interest in equity or other security, debenture, loan or other debt instrument of an entity, including rights and obligations to acquire such an interest and derivatives directly related to that interest

Direct Financial Interest

- A financial interest owned directly by and under the control of an individual, including those managed on a discretionary basis by others, or beneficially owned through a collective investment vehicle, estate, trust or other intermediary; over which the individual or entity has control

Indirect Financial Interest

- Any financial interest beneficially owned through collective investment vehicle, estate, trust or other intermediary over which the beneficial owner has no control

Definitions

Client	• Any individual or entity for which a member firm performs services
Immediate Family	• Spouse, spousal equivalent and dependants
Close Family	• Parents, siblings and non-dependent children

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Definitions

Immaterial

- With respect to a partner or professional employee, an amount that is less than 5% of the net worth of the affected individual, together with that of his or her spouse or spousal equivalent

Significant Influence

- The ability to exercise significant influence over an investee's operating and financial policies, which can be indicated in various ways, including representation on the investee's board of directors, participation in its policymaking processes, or the investee's dependency on the investor's technological or managerial resources (guideline 20%)

Financial interests

This extends to financial interests in the parent of an audit client, and subsidiaries and associates of an audit client.

It also extends to other partners in the office (Accountants Act extends this to partners in the firm) in which the engagement partner practices, and their immediate family members, and to partners and managerial employees, and their immediate family, who provide non-audit services to an audit client (unless their involvement is minimal)

Holdings by a firm’s retirement benefit scheme should also be considered.

Financial interests of team

		Assurance clients	Controlling entities	Subsidiaries and associates
Direct	Material	No	No	No
	Immaterial	No	No	✓
Indirect	Material	No	No	No
	Immaterial	✓	✓	✓

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Loans and guarantees

Not acceptable:

- Loans or guarantees from an audit client that is not a bank or similar institution to a firm or a member of the audit team or a member of that individual's immediate family
- Loans or guarantees by a firm or a member of the audit team or a member of that individual's immediate family to an audit client
- Loans or guarantees from an audit client that is a bank or similar institution to a firm or a member of the audit team or a member of that individual's immediate family that is not made under normal lending procedures, terms and conditions

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Loans and guarantees

May be acceptable:

- Loans or guarantees from an audit client that is a bank or similar institution to a firm or a member of the audit team or a member of that individual's immediate family that is made under normal lending procedures, terms and conditions. However, a loan to a firm that is material to the audit client or the firm presents a self-interest threat (NB CBK regulations also apply)

- Deposits or brokerage accounts with a bank, broker or similar institution by a firm or a member of the audit team or a member of that individual's immediate family that is held under normal commercial terms

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Business relationships

Not acceptable:

Business relationships between a firm or a member of the audit team or a member of that individual's immediate family, unless the financial interest is immaterial and the business relationship is insignificant to the client and the firm or a member of the audit team

Business relationships include:

- an interest in a joint venture with a client, or a controlling owner, director, or senior management of that client
- Combining services provided by the firm with services provided by the audit client in a package
- Distribution or marketing arrangements

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Business relationships

Acceptable:

Purchase of goods or services from an audit client if the transaction is in the normal course of business and at arm’s length

Family and personal relationships

Not acceptable:

An immediate family member of a member of the audit team being a director or officer of the audit client or an employee of the client in a position to influence the preparation of the client's accounting records or financial statements

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Family and personal relationships

May be acceptable, with safeguards:

- A close family member of a member of the audit team being a director or officer of the audit client or an employee of the client in a position to influence the preparation of the client's accounting records or financial statements

- A person who has a close relationship with a member of the audit team being a director or officer of the audit client or an employee of the client in a position to influence the preparation of the client's accounting records or financial statements

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Family and personal relationships

May be acceptable, with safeguards (continued):

- A relationship between a partner or employee of the audit firm who is not a member of the audit team with a director or officer of the audit client or an employee of the client in a position to influence the preparation of the client's accounting records or financial statements

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Other threats to independence

That may be acceptable, with safeguards:

- Employment with an audit client
- Temporary staff assignments
- Recent service with an audit client
- Serving as a director or officer of an audit client

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Long association of senior personnel

Audit clients that are Public Interest Entities:

- An individual may not be a key audit partner (includes EQCR and partners responsible for significant subsidiaries) for more than seven years (regulators can set lower time limits or require rotation of firms)
- In rare cases may be extended by one year
- Cooling off period of two years with no involvement

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Non-assurance services provided to an audit client

General principles

- Auditor cannot assume managerial responsibilities, e.g.:
  - Setting policies and strategic direction
  - Hiring or dismissing employees
  - Directing the actions of the entity's employees
  - Authorising transactions
  - Controlling bank accounts
  - Taking responsibility for the preparation of financial statements
  - Taking responsibility for designing an implementing internal control
- Activities that are routine and administrative, or insignificant, are generally acceptable

Non-assurance services provided to an audit client

Preparing financial statements

- For public interest entities:
  - A firm shall not provide to an audit client accounting and book-keeping services, including payroll services, or prepare financial statements on which the firm will express an opinion
- For non-PIES, services of a routine or mechanical nature are allowed, such as:
  - Provide payroll services based on client-originated data
  - Posting transactions coded by the client
  - Posting client approved entries
  - Prepare financial statements based on information in the trial balance

Non-assurance services provided to an audit client

Valuation services

- For all entities:
  - A firm shall not provide valuation services to an audit client if the valuations would have a material effect, separately or in aggregate, on financial statements on which the firm will express an opinion

Non-assurance services provided to an audit client

Tax services

- For public interest entities:
  - A firm shall not prepare tax calculations of current and deferred tax liabilities/assets for the purpose of preparing accounting entries that are material
- For non-PIES, it may be possible to reduce the threat to an acceptable level by applying safeguards such as:
  - Using professionals who are not members of the audit team to provide the service
  - Using a partner or manager who is not a member of the team to review the tax calculations

Non-assurance services provided to an audit client

Tax services (continued)

- Tax return preparation services are normally acceptable, provided management take responsibility for the returns including significant judgements
- Tax planning advice supported by tax law or regulation, or other precedent may be acceptable, but where tax advice depends on a particular accounting treatment or presentation and the team has reasonable doubt as to the appropriateness of the related treatment and the outcome might be material, no safeguards could reduce the threat to an acceptable level

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Non-assurance services provided to an audit client

Internal audit services

- For public interest entities:
  - A firm shall not provide internal audit services in areas that are significant to a client's financial statements

- For non-PIES, it may be possible to reduce the threat to an acceptable level by applying safeguards provided the firm's personnel do not assume management responsibility

Non-assurance services provided to an audit client

IT Systems services

- For public interest entities:
  - A firm shall not provide services involving the design or implementation of IT systems that generate information that is significant to the client's financial statements

- For non-PIES, it may be possible to reduce the threat to an acceptable level by applying safeguards provided the firm's personnel do not assume management responsibility

Non-assurance services provided to an audit client

Recruiting services

- It may be possible to reduce the threat to an acceptable level by applying safeguards provided the firm's personnel do not assume management responsibility

Non-assurance services provided to an audit client

Other services dealt with

- Litigation support services
- Legal services
- Corporate financial services

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Fees

Relative size

- There should not be too much dependency on an audit client
- An audit client that is a public interest entity should not represent more than 15% of the total fee income of the firm, but it might be possible to apply safeguards, such as a pre-issuance review by an independent professional accountant

Fees

Overdue fees

- Overdue fees represent a self-interest threat, and might be regarded as a loan to a client. It may not be appropriate to accept reappointment.

Fees

Contingent fees

- Contingent fees should not be charged to an audit client

Other self-interest threats

- Compensation to audit staff for selling non-assurance services
- Gifts and hospitality – should not be accepted unless trivial and inconsequential
- Actual or threatened litigation

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Other assurance (non-audit) services

- The code deals with the same topics but is generally more ‘lenient’

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PROFESSIONAL ACCOUNTANTS IN BUSINESS

Fundamental principles

- A professional accountant in business shall not knowingly engage in any business, occupation, or activity that impairs or might impair integrity, objectivity, or the good reputation of the profession.

- The fundamental principles are the same as they are for professional accountants in practice

Conflicts of interest

Conflicts of interest that may arise include:

- Serving in, say, a governance position in two employing organisations and acquiring confidential information
- Undertaking a professional activity for each of two partners in a firm to assist them to dissolve their partnership
- Being asked to make decisions that could affect the value of the personal investments of the professional accountant or an immediate family member

Conflicts of interest

Possible safeguards could include:

- Restructuring or segregating certain responsibilities
- Obtaining appropriate oversight
- Withdrawing from a decision-making process
- Consulting with a third party
- Disclosing the nature of the conflict to the relevant parties

Preparation and reporting of information

- A professional accountant in business who has responsibility for the preparation or approval of general purpose financial statements shall be satisfied that those financial statements are presented in accordance with the applicable reporting framework

- Information for which a professional accountant in business is responsible should:
  - Describe clearly the nature of transactions, assets or liabilities
  - Classify and record information in a timely and proper manner
  - Represent the facts accurately and completely in all material respects

Acting with sufficient expertise

- A professional accountant in business shall not intentionally mislead an employer as to the level of expertise or experience possessed, nor fail to seek appropriate expert advice when required. Threats include:
  - Insufficient time
  - Inadequate information
  - Insufficient experience or training
  - Inadequate resources

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Acting with sufficient expertise

- Safeguards may include:
  - Obtaining advice or training
  - Obtaining assistance
  - Consulting superiors or a professional body

Financial interests, compensation and incentives

Self-interest threats include situations where the professional accountant in business:

- Holds a direct or indirect financial interest in the employing organisation
- Is eligible for a profit related bonus
- Holds share options in the employing organisation

Threats can also arise through pressure from superiors or peers in the employing organisation who hold similar interests

Financial interests, compensation and incentives

Possible safeguards could include:

- Policies and procedures for an independent committee to determine remuneration
- Disclosure of all relevant interests
- Consultation with superiors or those charged with governance
- Internal and external audit procedures

Inducements

Receiving offers

- Inducements may include:
  - Gifts
  - Hospitality
  - Inappropriate appeals to friendship or loyalty

- Threats are created when an inducement is made in an attempt to unduly influence actions or decisions, encourage illegal or dishonest behaviour, or obtain confidential information

Inducements

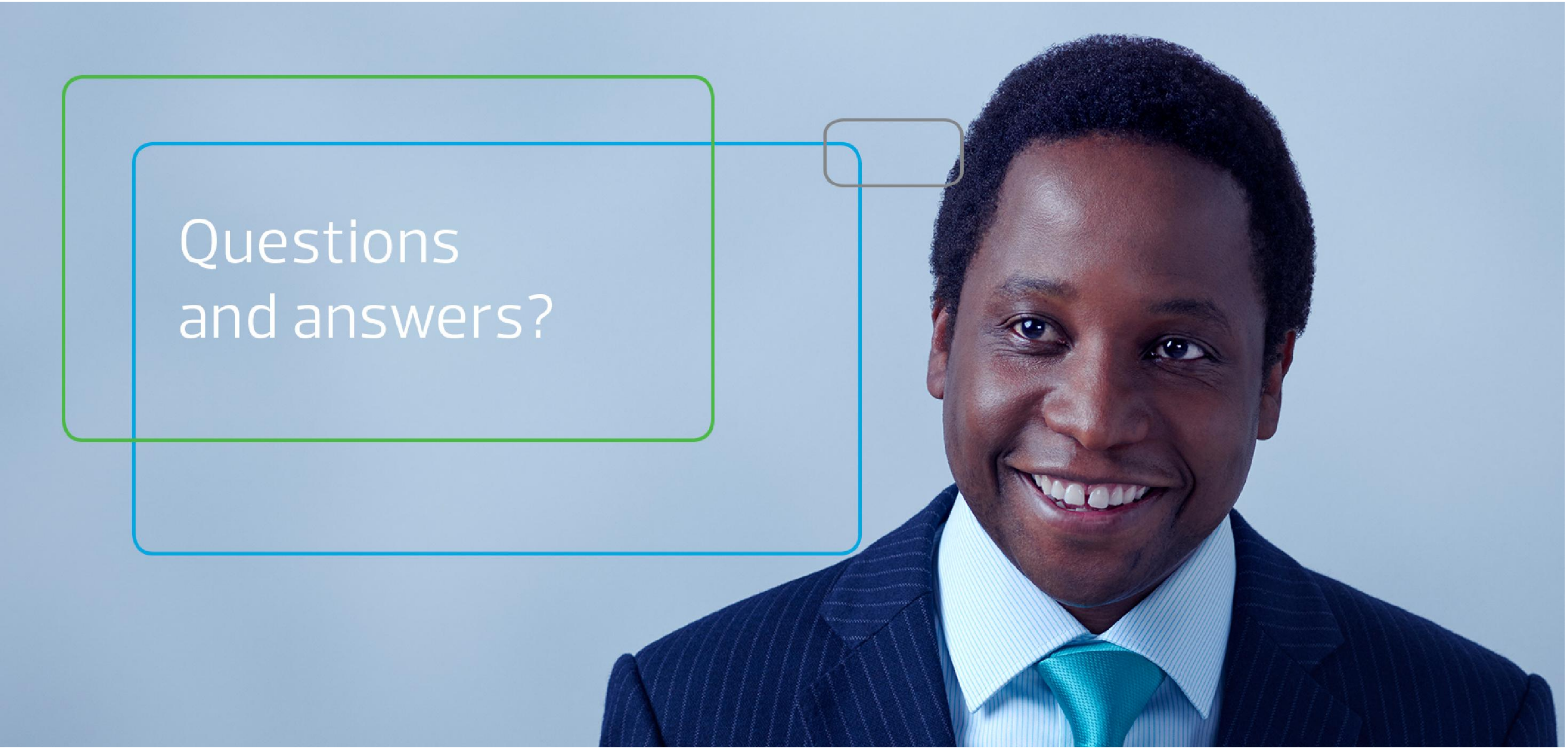
Safeguards may include:

- Informing higher levels of management or those charged with governance when such an offer has been made

Inducements

Making offers

- A professional accountant in business shall not offer an inducement to improperly influence professional judgement of a third party, or to obtain confidential information


Questions
and answers?

TEST!

Is this acceptable?

- An audit client sends the engagement partner a bottle of whisky at Christmas.
- You are the auditor of an oil company: you buy most of your petrol from their filling stations.
- You are the audit manager for a construction company. The client says business is slack and offers to build a garage on your land for the cost of materials only.
- Your parents own shares in a listed client for which you are a member of the audit team.
- You are a member of the audit team for a bank. You operate a current account at the bank and a credit card
- Your mother is the CFO of an audit client of your firm. You are a partner in the audit firm but have no involvement in the audit.
- An insurance company asks its auditor to prepare its deferred tax computation and tax reconciliation, because the CFO doesn't understand deferred tax

Thank you for your time and attention

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