

ETHICS FOR ACCOUNTANTS

STUDY TEXT

Qualifications and Credit Framework

AQ2016

This Study Text supports study for the following AAT qualifications:

AAT Advanced Diploma in Accounting – Level 3

AAT Advanced Certificate in Bookkeeping – Level 3

AAT Advanced Diploma in Accounting at SCQF Level 6

British Library Cataloguing-in-Publication Data

A catalogue record for this book is available from the British Library.

Published by
Kaplan Publishing UK
Unit 2, The Business Centre
Molly Millars Lane
Wokingham
Berkshire
RG41 2QZ

ISBN: 978-1-78740-514-1

The text in this material and any others made available by any Kaplan Group company does not amount to advice on a particular matter and should not be taken as such. No reliance should be placed on the content as the basis for any investment or other decision or in connection with any advice given to third parties. Please consult your appropriate professional adviser as necessary. Kaplan Publishing Limited and all other Kaplan group companies expressly disclaim all liability to any person in respect of any losses or other claims, whether direct, indirect, incidental, consequential or otherwise arising in relation to the use of such materials.

© Kaplan Financial Limited, 2019

Printed and bound in Great Britain.

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior written permission of Kaplan Publishing.

CONTENTS

	<i>Page number</i>
Introduction	P.5
Unit guide	P.9
Unit link to the synoptic assessment – The assessment	P.22
Study skills	P.24
STUDY TEXT	
<i>Chapter</i>	
1 Ethics – The principles	1
2 Professional considerations	35
3 Legal considerations – I	59
4 Legal considerations – II	89
5 The accountant in practice	111
6 Sustainability	135
Practice Assessment Questions	161
Practice Assessment Answers	171
Index	I.1

INTRODUCTION

HOW TO USE THESE MATERIALS

These Kaplan Publishing learning materials have been carefully designed to make your learning experience as easy as possible and to give you the best chance of success in your AAT assessments.

They contain a number of features to help you in the study process.

The sections on the Unit Guide, the Assessment and Study Skills should be read before you commence your studies.

They are designed to familiarise you with the nature and content of the assessment and to give you tips on how best to approach your studies.

STUDY TEXT

This Study Text has been specially prepared for the revised AAT qualification introduced in September 2016.

It is written in a practical and interactive style:

- Key terms and concepts are clearly defined.
- All topics are illustrated with practical examples with clearly worked solutions based on sample tasks provided by the AAT in the new examining style.
- Frequent practice activities throughout the chapters ensure that what you have learnt is regularly reinforced.
- 'Test your understanding' activities are included within each chapter to apply your learning and develop your understanding.

ICON

The study chapters include the following icons throughout. They are designed to assist you in your studies by identifying key definitions and the points at which you can test yourself on the knowledge gained.



Definition

These sections explain important areas of knowledge which must be understood and reproduced in an assessment.



Example

The illustrative examples can be used to help develop an understanding of topics before attempting the activity exercises.



Test your understanding

These are exercises which give the opportunity to assess your understanding of all the assessment areas.

Quality and accuracy are of the utmost importance to us so if you spot an error in any of our products, please send an email to mykaplanreporting@kaplan.com with full details.

Our Quality Co-ordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.

Progression

There are two elements of progression that we can measure: first how quickly students move through individual topics within a subject; and second how quickly they move from one course to the next. We know that there is an optimum for both, but it can vary from subject to subject and from student to student. However, using data and our experience of student performance over many years, we can make some generalisations.

A fixed period of study set out at the start of a course with key milestones is important. This can be within a subject, for example 'I will finish this topic by 30 June', or for overall achievement, such as 'I want to be qualified by the end of next year'.

Your qualification is cumulative, as earlier papers provide a foundation for your subsequent studies, so do not allow there to be too big a gap between one subject and another.

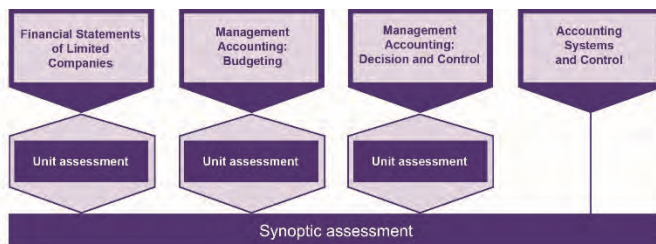
We know that exams encourage techniques that lead to some degree of short term retention, the result being that you will simply forget much of what you have already learned unless it is refreshed (look up Ebbinghaus Forgetting Curve for more details on this). This makes it more difficult as you move from one subject to another: not only will you have to learn the new subject, you will also have to relearn all the underpinning knowledge as well. This is very inefficient and slows down your overall progression which makes it more likely you may not succeed at all.

In addition, delaying your studies slows your path to qualification which can have negative impacts on your career, postponing the opportunity to apply for higher level positions and therefore higher pay.

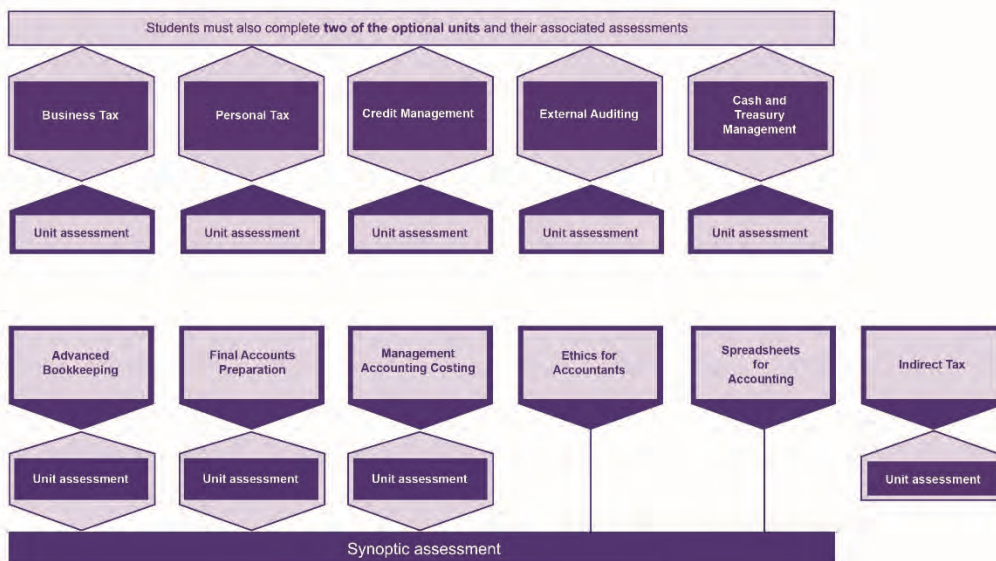
You can use the following diagram showing the whole structure of your qualification to help you keep track of your progress.

ETHICS FOR ACCOUNTANTS

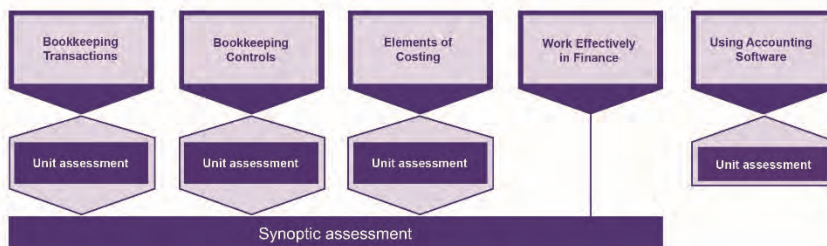
Professional Diploma
Level 4



Advanced Diploma
Level 3



Foundation Certificate
Level 2



UNIT GUIDE

Ethics for Accountants is a Level 3 mandatory unit that is examined as part of the synoptic assessment.

Purpose of the unit

This unit is about professional ethics in an accounting environment. It seeks to ensure that students have an excellent understanding of why accountants need to act ethically, of the principles of ethical working, of what is meant by ethical behaviour at work, and of when and how to take action in relation to unethical behaviour and illegal acts.

This unit supports students in:

- working within the ethical code applicable to accountants and accounting technicians
- ensuring the public has a good level of confidence in accounting practices or functions
- protecting their own and their organisation's professional reputation and legal liability
- upholding principles of sustainability.

Students will learn the core aspects of the ethical code for accountants, as it relates to their work as accounting technicians and as exemplified in AAT's Code of Professional Ethics. They will understand the ethical principles of integrity, objectivity, professional competence and due care, professional behaviour and confidentiality, and will learn to apply these principles to analyse and judge ethical situations at work.

They will also understand that acting ethically derives from core personal and organisational values, such as honesty, transparency and fairness, as well as from professional ethics. Understanding the conceptual framework of principles, threats and safeguards contained in the ethical code, plus its process for ethical conflict resolution, will enable students to apply a systematic approach to ethical problems that they may encounter.

Students will, therefore, develop skills in analysing problems, and in judging between 'right' and 'wrong' behaviour in a given context. They will also be able to identify alternative courses of action to resolve an ethical problem, and select the most appropriate action in the circumstances.

Money laundering regulations mean that accountants can be exposed to legal liability for keeping quiet in certain circumstances, or for telling the wrong person about suspected wrongdoing. Students will learn when and how the money laundering regulations apply, and their responsibilities in respect of them. They will also learn about reporting to the authorities in respect of suspected money laundering. In certain other circumstances, it may be appropriate for an accountant to report, 'speak up' or blow the whistle on unethical behaviour.

Finally, students will understand the basis and nature of the accountant's ethical responsibilities to uphold sustainability in their organisation.

Ethics for Accountants is a mandatory unit. It links with Work Effectively in Finance at Level 2, and with Accounting Systems and Controls at Level 4. There are opportunities to include aspects of acting ethically at work when delivering the other mandatory units at Level 3.

Ethics for Accountants is a **mandatory unit** in this qualification.

Learning outcomes

On completion of this unit the learner will be able to:

- understand the need to act ethically
- understand the relevance to the accountant's work of the ethical code for professional accountants
- recognise how to act ethically in an accounting role
- identify action to take in relation to unethical behaviour or illegal acts.

Scope of content

To perform this unit effectively you will need to know and understand the following:

		Chapter
1	Understand the need to act ethically	
1.1	Explain why it is important to act ethically	
	Students need to know:	
	<ul style="list-style-type: none"> • that the accountant acting ethically: supports the level of confidence that the public has in accountants, enhances the organisation's probity and reputation, enhances the accountant's own professional reputation, protects the accountant's legal liability 	Throughout
	<ul style="list-style-type: none"> • that it is important for an accountant to comply with the ethical code and act ethically at all times 	Throughout
	<ul style="list-style-type: none"> • that the accountant has a public interest duty to society as well as to the client or employer 	2
	<ul style="list-style-type: none"> • that maintenance of the reputation of accountancy as a profession is one of the objectives of the ethical code 	1, 5
	<ul style="list-style-type: none"> • that the accountant's compliance with the ethical code is a professional not a legal obligation 	1, 2
	<ul style="list-style-type: none"> • that members of professional accountancy bodies are held to account by those bodies for breaches of their ethical codes 	2, 3
	<ul style="list-style-type: none"> • when disciplinary action by the relevant professional accountancy body may be brought against the accountant for misconduct, and the possible penalties that can arise 	2, 3
	<ul style="list-style-type: none"> • that internal disciplinary procedures may be brought against the accountant by the employer for unethical or illegal behaviour 	2
	<ul style="list-style-type: none"> • that organisations may suffer fines or reputational damage as a result of unethical behaviour and non-compliance with values, codes and regulations. 	3

UNIT LINK TO THE SYNOPTIC ASSESSMENT THE ASSESSMENT

AAT AQ16 introduced a Synoptic Assessment, which students must complete if they are to achieve the appropriate qualification upon completion of a qualification. In the case of the Advanced Diploma in Accounting, students must pass all of the mandatory assessments and the Synoptic Assessment to achieve the qualification.

As a Synoptic Assessment is attempted following completion of individual units, it draws upon knowledge and understanding from those units. It may be appropriate for students to retain their study materials for individual units until they have successfully completed the Synoptic Assessment for that qualification.

This unit is solely assessed within the Synoptic assessment so all learning objectives are relevant.

Test specification for this unit assessment

Assessment type	Marking type	Duration of exam
Computer-based synoptic assessment	Partially computer/partially human marked	2 hours 45 minutes, composed of two components (plus an additional 15 minutes to upload evidence)

Assessment objective	Weighting
A01 Demonstrate an understanding of the relevance of the ethical code for accountants, the need to act ethically in a given situation, and the appropriate action to take in reporting questionable behaviour	15%
A02 Prepare accounting records and respond to errors, omissions and other concerns, in accordance with accounting and ethical principles and relevant regulations	15%

ETHICS FOR ACCOUNTANTS

A03

Apply ethical and accounting principles when preparing final accounts for different types of organisation, develop ethical courses of action and communicate relevant information effectively 15%

A04

Use relevant spreadsheet skills to analyse, interpret and report management accounting data 25%

A05

Prepare financial accounting information, comprising extended trial balances and final accounts for sole traders and partnerships, using spreadsheets 30%

Total 100%

NB Of the above, AO1; AO2 and AO3 specifically relate to EFTA but will form part of the overall assessment.

STUDY SKILLS

Preparing to study

Devise a study plan

Determine which times of the week you will study.

Split these times into sessions of at least one hour for study of new material. Any shorter periods could be used for revision or practice.

Put the times you plan to study onto a study plan for the weeks from now until the assessment and set yourself targets for each period of study – in your sessions make sure you cover the whole course, activities and the associated questions in the workbook at the back of the manual.

If you are studying more than one unit at a time, try to vary your subjects as this can help to keep you interested and to see the relationships between different subjects.

When working through your course, compare your progress with your plan and, if necessary, re-plan your work (perhaps including extra sessions) or, if you are ahead, do some extra revision/practice questions.

Effective studying

Active reading

You are not expected to learn the text by rote, rather, you must understand what you are reading and be able to use it to pass the assessment and develop good practice.

A good technique is to use SQ3Rs – Survey, Question, Read, Recall, and Review:

1 Survey the chapter

Look at the headings and read the introduction, knowledge, skills and content, so as to get an overview of what the chapter deals with.

2 Question

Whilst undertaking the survey ask yourself the questions you hope the chapter will answer for you.

3 Read

Read through the chapter thoroughly working through the activities.

Ethics – The principles

Introduction

In this chapter we look at the fundamental principles of integrity, objectivity, professional and technical competence, due care, confidentiality and professional behaviour.

These underpin the whole syllabus so it is vital that you know, understand and can apply the principles.

The Ethics for Accountants syllabus does **not** require you to have a detailed knowledge of the AAT Code of Ethics and other AAT regulations. However, you are expected to know the key aspects of the underpinning IFAC Code of Ethics for Professional Accountants:

- The purpose of the code.
- The fundamental principles and the conceptual framework.

ASSESSMENT CRITERIA

- 1.1 Explain why it is important to act ethically
- 1.2 Explain how to act ethically
- 1.3 Explain the importance of values, culture and codes of practice/conduct
- 2.1 Explain the ethical code's conceptual framework of principles, threats, safeguards and professional judgement
- 2.2 Explain the importance of acting with integrity
- 2.3 Explain the importance of objectivity
- 2.4 Explain the importance of behaving professionally
- 2.5 Explain the importance of being competent and acting with due care
- 2.6 Explain the importance of confidentiality and when confidential information may be disclosed
- 2.7 Explain the stages in the ethical code's process for ethical conflict resolution
- 3.1 Distinguish between ethical and unethical behaviour
- 3.2 Analyse a situation using the conceptual framework and the conflict resolution process
- 3.3 Develop an ethical course of action
- 3.5 Explain the ethical responsibilities of accountants in upholding the principles of sustainability.

CONTENTS

- 1 Introduction to business ethics
- 2 Fundamental principles
- 3 Threats and safeguards
- 4 Dealing with ethical conflicts

1 Introduction to business ethics

1.1 What do we mean by ‘ethics’?



Definition – Ethics

Ethics can be defined as the “moral principles that govern a person’s behaviour or the conducting of an activity”.

The Oxford English Dictionary

Ethics is thus concerned with how one should act in a certain situation, about ‘doing the right thing’ and is ultimately about morality – the difference between right and wrong.



Example 1 – Ethical choices

Consider the following ethical dilemmas:

- You buy something in a shop and later discover that they have under-charged you for an item. Do you go back and tell them?
- You want a new designer label tee-shirt but think it is too expensive. Would you buy a cheap fake copy if you saw one for sale while on holiday?
- Have you ever told your employer that you were sick when the truth was you simply wanted a day off?
- Would you stop buying a particular product if you found out that the working conditions in the factories where they are made were far below UK standards (e.g. concerning hours worked, pay rates, sickness policy, discrimination, use of child labour, etc)?
- Have you ever ‘exaggerated’ an expense claim?

Does the fact that you are a (student) member of a professional body affect your answers?

1.2 Business ethics

Business ethics is the application of ethical principles to the problems typically encountered in a business setting.

There is no separate ‘business ethic’ that puts it beyond the range of normal moral judgements.



Example 2 – Typical issues in business ethics

Some typical issues addressed in business ethics include:

- 'creative accounting' to misrepresent financial performance
- misleading advertising
- aggressive personal selling (e.g. insurance or double glazing)
- unfair terms in contracts (e.g. cancelling a gym membership)
- data protection and privacy
- the difference between corporate hospitality and bribery
- the difference between business intelligence and industrial espionage
- political contributions to gain influence
- corporate governance
- corporate crime, including insider trading and price fixing
- employee issues, such as discrimination or unfair dismissal
- whistleblowing
- environmental issues and related social concerns
- marketing, sales and negotiation techniques
- product issues such as patent and copyright infringement, planned obsolescence, product liability and product defects
- using legal loopholes to avoid paying tax.

When ethical values get distorted or compromised, the impact can be enormous. Ethics and ethical standards have thus become the focus of greater attention by organisations, especially in the area of reputation management. Greater emphasis is now placed on accountability, ethics, codes of conduct and monitoring and reporting of violations.

1.3 Ethical influences

Each of us has our own set of values and beliefs that we have evolved over the course of our lives through our education, experiences and upbringing. We all have our own ideas of what is right and what is wrong and these ideas can vary between individuals and cultures.

There are a number of factors that affect ethical obligations.

(i) **The law**

For example, deceptive advertising is illegal and violators of this law are liable to large fines, court action and/or loss of goodwill.

Legislation hopefully makes it very clear what is acceptable as a minimum standard. However, ethics is more than just obeying the law.

For example, using legal loopholes to minimise a global firm's tax bill may not be illegal but is increasingly viewed as unethical.

(ii) **Government regulations**

For example, regulations set standards on issues such as unfair competition, unsafe products, etc. Failure to comply with these regulations could lead to criminal charges, or fines etc.

Unfortunately, some firms will still find ways to get round such regulations.



Example 3 – Artificial sweeteners

In 1970 cyclamates (a type of artificial sweetener) were banned in the USA following evidence that they were carcinogenic.

Following the ban a major US food manufacturer still sold 300,000 cases of cyclamate sweetened food overseas instead.

(iii) **Ethical codes**

Many organisations have codes that clearly state the ethical standards and principles an employee or member should follow.

For example, as an AAT student you are expected to follow the AAT Code of Professional Ethics.

Generally, written codes clarify the ethical issues and principles but leave the resolution to the individual's conscience.

Ethical codes are usually followed if written down and enforced – say by disciplinary procedures. However, many companies have 'unwritten' codes of practice and/or have no method of enforcement.

(iv) **Social pressure**

Many people draw their values from what they see other people doing, whether on the news or people they know. However, social pressure can change, just as society changes.

For example, many politicians comment on a decline in family values in the UK.

Many protest groups and activists hope to change public values with the long term hope that new values become reflected in law. A good example of this is the change in discrimination legislation over the last hundred years.

(v) **Corporate culture**



Definition – Corporate culture

Corporate culture is defined as “the sum total of all the beliefs, attitudes, norms and customs that prevail within an organisation” or “the way we do things around here”.

Ideally we want a culture that supports and encourages ethical behaviour.

For example, if everyone else is exaggerating expense claims or covering up mistakes, then this can quickly become a norm of behaviour that new employees soon adopt.

Of particular importance is the example set by senior management – sometimes referred to as the ‘tone at the top’.

It is important to note that there can often be tension between personal standards and the goals of the organisation.

Suppose you work for a company selling banned substances overseas. It is not illegal, but it may be against your personal values to sell these products to unsuspecting overseas clients. What would you do if this action were a direct order from a superior? Does this take away your responsibility?

1.4 The costs and benefits of business ethics

It can be argued that the primary purpose of a business is to try and earn a profit. In a company, for instance, the directors have been employed in order to earn the owners of the business a return on their investment.

Some have concluded from this that going beyond the **legal** minimum standard of behaviour is contrary to the directors’ duty to make money and that behaving ethically increases costs and reduces profits.

For example:

- Increased cost of sourcing materials from ethical sources (e.g. Fairtrade products or free range eggs).

- Having to turn away business from customers considered to be unethical (e.g. an 'ethical' bank may choose not to invest in a company that manufactures weapons).
- The management time that can be taken up by planning and implementation of ethical practices.

However, as well as the moral argument to act ethically, there can be commercial benefits to firms from acting ethically:

- Having good ethics can attract customers.
This can be because good ethics tend to enhance a company's reputation and therefore its brand. Given the choice, many customers will prefer to trade with a company they feel is ethical.
- Good ethics can result in a more effective workforce.
A reputation for good business ethics is likely to involve good working conditions for employees, allowing the business to attract a higher calibre of staff.
Avoiding discrimination against workers is likely to give the company access to a wider human resource base.
- Ethics programmes can cultivate strong teamwork and improve productivity.
- Ethics can give cost savings.
Avoiding pollution will tend to save companies in the long run – many governments are now fining or increasing taxes of more polluting businesses.
- Ethics can reduce risk.
Many firms have failed due to unethical practices within them.



Example 4 – Enron

Enron, a major US energy company, filed for bankruptcy in 2001. Among the many reasons for its failure were dubious accounting practices (for example, in how they recognised revenue), poor corporate governance and failure by their external auditors, Arthur Andersen.

There were even attempts to hide the problems, with workers being told to destroy all audit material, except for the most basic work papers.

1.5 The Institute of Business Ethics – Simple test

According to the Institute of Business Ethics, a simple ethical test for a business decision could be reached in answering the following three questions:

Question	Explanation
Transparency	Do I mind others knowing what I have decided?
Effect	Does my decision affect or hurt anyone?
Fairness	Would my decision be considered fair by those affected?

2 Fundamental principles

2.1 The Code of Ethics for Professional Accountants

The Code of Ethics for Professional Accountants, published by The International Federation of Accountants (IFAC), forms the basis for the ethical codes of many accountancy bodies, including the AAT, ICAEW, ACCA and CIMA.

The code adopts a principles-based approach. It does not attempt to cover every situation where a member may encounter professional ethical issues, prescribing the way in which he or she should respond. Instead, it adopts a value system, focusing on fundamental professional and ethical principles which are at the heart of proper professional behaviour.

The five key principles are as follows:

- (a) **Integrity**
- (b) **Objectivity**
- (c) **Professional competence and due care**
- (d) **Confidentiality**
- (e) **Professional behaviour**

These are discussed in more detail below.

2.2 A conceptual framework

Professional accountants may face a range of specific threats to compliance with the fundamental principles.

It is impossible to define every situation that creates such threats and specify the appropriate action. In addition, the nature of engagements and work assignments may differ and consequently different threats may exist, requiring the application of different safeguards.

A conceptual framework requires a member to identify, evaluate and address threats to compliance with the fundamental principles, rather than merely comply with a set of specific rules which may be arbitrary.

It also requires that if identified threats are not clearly insignificant, a member shall, where appropriate, apply adequate safeguards to eliminate the threats or reduce them to an acceptable level, so that compliance with the fundamental principles is not compromised.

2.3 Compliance with ethical codes

A professional accountant's responsibility is not just to satisfy the needs of an individual client or employer. It should also be to act in the public interest.

In acting in the public interest a professional accountant should observe and comply with the fundamental ethical requirements shown in the IFAC Code.

AAT members should note that disciplinary action may be taken for non-compliance with the AAT code where the member's conduct is considered to prejudice their status as a member or to reflect adversely on the reputation of AAT. For the purposes of this paper, you do not need to be concerned with the differences between the IFAC code and the AAT code.

Where professional accountants are members of more than one professional body, there may be differences in some areas between the professional and ethical conduct requirements of the different bodies. Where there are differences, members should follow the more stringent provision.

Unethical and dishonest behaviour (and its legal consequences) creates powerful negative public relations within the profession, the wider community and the organisation itself.

2.4 Integrity



Definition – Integrity

Integrity means that a member must be straightforward and honest in all professional and business relationships. Integrity also implies fair dealing and truthfulness.

Accountants are expected to present financial information fully, honestly and professionally and so that it will be understood in its context.



Example 5 – Integrity

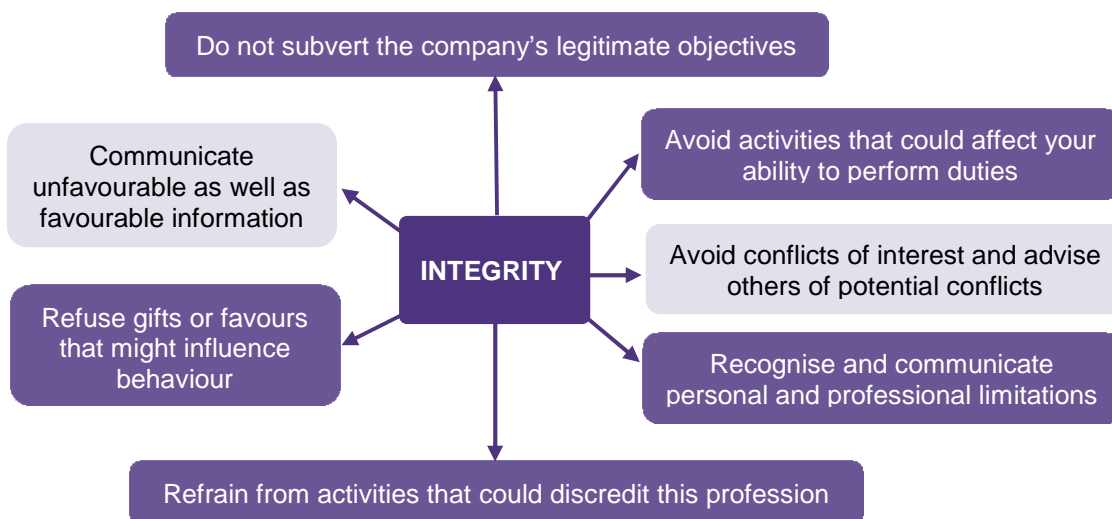
A professional accountant should not be associated with reports where the information:

- contains a materially false or misleading statement
- contains statements or information furnished recklessly
- has omissions that make it misleading.

Accountants should abide by relevant law and regulations and remember that, as well as legal documents, letters and verbal agreements may constitute a binding arrangement.

Accountants should strive to be fair and socially responsible and respect cultural differences when dealing with overseas colleagues or contacts. Promises may not be legally binding but repeatedly going back on them can destroy trust, break relationships and lose co-operation.

To maintain integrity, members have the following responsibilities:



2.5 Objectivity



Definition – Objectivity

Objectivity means that a member must not allow bias, conflict of interest or undue influence of others to override professional or business judgements.



Example 6 – Objectivity

Suppose you are part of the audit team at a major client:

- If you also own shares in the client company, then this could be viewed as a conflict of interest.
- If you receive excessive hospitality and discounts from the client then this could be seen as an attempt to influence (bribe?) you and compromise your objectivity.

Objectivity can also be defined as ‘the state of mind which has regard to all considerations relevant to the task in hand but no other.’ It is closely linked to the concept of independence:

- **Independence of mind** is the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgement, allowing an individual to act with integrity and exercise objectivity and professional scepticism.
- **Independence of appearance** is 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 that a firm's or a member's integrity, objectivity or professional scepticism had been compromised.

Whatever capacity members serve in, they should demonstrate their objectivity in varying circumstances.

Objectivity is a distinguishing feature of the profession. Members have a responsibility to:

- Communicate information fairly and objectively.
- Disclose fully all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, comments, and recommendations presented.

2.6 Professional competence and due care



Definition – Professional competence

Professional competence means that a member has a continuing duty to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques.



Definition – Due care

Due care means a member must act diligently and in accordance with applicable technical and professional standards when providing professional services.

In agreeing to provide professional services, a professional accountant implies that there is a level of competence necessary to perform those services and that his or her knowledge, skill and experience will be applied with reasonable care and diligence.



Example 7 – Professional competence

Suppose you are an accountant in practice. A new client asks you to perform their tax computations but it would involve aspects of inheritance tax that you have not looked at for many years.

Unless you have other people with the required tax expertise in the practice, you should decline the tax work as you are not competent to do it.

Professional accountants must therefore refrain from performing any services that they are not competent to carry out unless appropriate advice and assistance is obtained to ensure that the services are performed satisfactorily.

Professional competence may be divided into two separate phases:

- 1 Gaining professional competence – for example, by training to gain the AAT qualification.
- 2 Maintaining professional competence – accountants need to keep up to date with developments in the accountancy profession including relevant national and international pronouncements on accounting, auditing and other relevant regulations and statutory requirements.

Members have a responsibility to:

- Maintain an appropriate level of professional competence by ongoing development of their knowledge and skills.
- Maintain technical and ethical standards in areas relevant to their work through continuing professional development.
- Perform their professional duties in accordance with relevant laws, regulations, and technical standards.
- Prepare complete and clear reports and recommendations after appropriate analysis of relevant and reliable information.

Members should adopt review procedures that will ensure the quality of their professional work is consistent with national and international pronouncements that are issued from time to time.

Due professional care applies to the exercise of professional judgement in the conduct of work performed and implies that the professional approaches matters requiring professional judgement with proper diligence.

Keeping knowledge up to date is covered in more detail in Chapter 2.

2.7 Confidentiality



Definition – Confidentiality

A member must, in accordance with the law, respect the confidentiality of information acquired as a result of professional and business relationships and not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose.

Confidential information acquired as a result of professional and business relationships must not be used for the personal advantage of the member or third parties.

Note that confidentiality is not only a matter of disclosure of information – it also concerns using information for personal advantage or for the advantage of a third party.



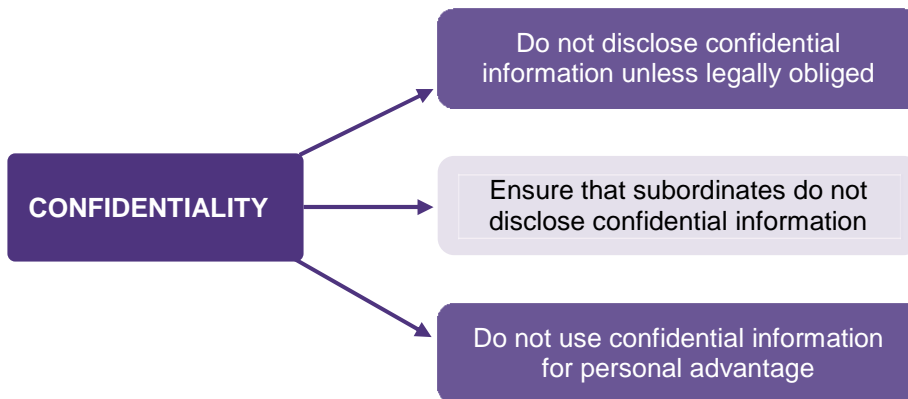
Example 8 – Confidentiality

Suppose you are an accountant in practice and you discover that the client has just won a major contract. This has yet to be publicised but when a press release is made, then the share price will go up significantly.

If you then buy the (undervalued) shares, then you have breached the principle of confidentiality – not because you told someone but because you used confidential information with the expectation of making a personal gain.

Members should:

- be prudent in the use and protection of information acquired in the course of their duties. (Please note that the duty of confidentiality continues even after the end of the relationship between the member and the employer or client.)
- not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organisation.
- inform subordinates as appropriate regarding the confidentiality of information acquired in the course of their work and monitor their activities to assure the maintenance of that confidentiality.



A member must take care to maintain confidentiality even in a social environment. The member should be alert to the possibility of inadvertent disclosure, particularly in circumstances involving close or personal relations, associates and long established business relationships.



Test your understanding 1

You visit a client who is a dealer in sports cars. He sells one of his cars to a customer for £16,000; however he later tells you that the car has a faulty braking system.

What should you do?

- Nothing.
- Tell the customer.
- Tell the client you believe he acted unethically, but that you are bound by confidentiality therefore cannot tell anyone.
- Report your client to the authorities.

The problem with confidentiality is that there are times when disclosure may be permitted or even mandatory.

The following are circumstances where members are or may be required to disclose confidential information or when such disclosure may be appropriate:

- (a) where disclosure is permitted by law and is authorised by the client or the employer
- (b) where disclosure is required by law, for example:
 - (i) production of documents or other provision of evidence in the course of legal proceedings or
 - (ii) disclosure to the appropriate public authorities (for example, HMRC) of infringements of the law that come to light or
 - (iii) disclosure of actual or suspected money laundering or terrorist financing to the member's firm's MLRO (Money Laundering Reporting Officer) or to NCA (National Crime Agency) if the member is a sole practitioner, or
- (c) where there is a professional duty or right to disclose, which is in the public interest, and is not prohibited by law. Examples may include:
 - (i) to comply with the quality review of an IFAC member body or other relevant professional body
 - (ii) to respond to an inquiry or investigation by the AAT or a relevant regulatory or professional body
 - (iii) where it is necessary to protect the member's professional interests in legal proceedings or
 - (iv) to comply with technical standards and ethics requirements.

In deciding whether to disclose confidential information, members should consider the following points:

- whether the interests of all parties, including third parties, could be harmed even though the client or employer (or other person to whom there is a duty of confidentiality) consents to the disclosure of information by the member
- whether all the relevant information is known and substantiated, to the extent that this is practicable. When the situation involves unsubstantiated facts, incomplete information or unsubstantiated conclusions, professional judgement should be used in determining the type of disclosure to be made, if any
- the type of communication or disclosure that may be made and by whom it is to be received; in particular, members should be satisfied that the parties to whom the communication is addressed are appropriate recipients.

2.8 Professional behaviour

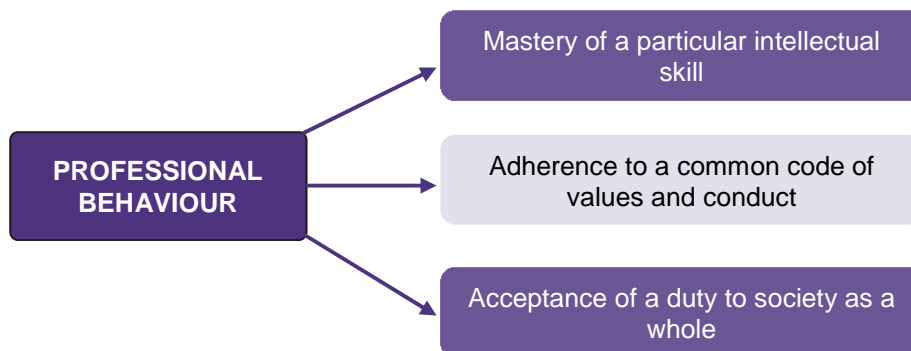


Definition – Professional behaviour

A professional accountant should comply with relevant laws and regulations and should avoid any action that discredits the profession.

A profession is distinguished by certain characteristics including:

- mastery of a particular intellectual skill, acquired by training and education
- adherence by its members to a common code of values and conduct established by its administering body, including maintaining an outlook which is essentially objective; and
- acceptance of a duty to society as a whole (usually in return for restrictions in use of a title or in the granting of a qualification).



The objectives of the accountancy profession are to work to the highest standards of professionalism, to attain the highest levels of performance and generally to meet the public interest requirement. These objectives require four basic needs to be met:

- (i) **Credibility** – there is a need for credibility in information and information systems.
- (ii) **Professionalism** – there is a need to be clearly identified by employers, clients and other interested parties as a professional person in the accountancy field.
- (iii) **Quality of services** – assurance is needed that all services obtained from a professional accountant are carried out to the highest standards of performance.
- (iv) **Confidence** – users of the services of professional accountants should be able to feel confident that there is a framework of professional ethics to govern the provision of services.

The most important privilege conferred on professionals is the right to a 'professional opinion'. Professionals can be distinguished from others in society by their right to form an opinion and to base their services and/or products on this opinion. Misuse of this privilege can result in serious harm, thus it is only granted to those who are able to show by education and experience the ability to properly exercise this right.

What is understood by the term 'professionalism' will depend on the context and culture of the organisation.

It should include:

- **Professional/client relationship:**
 - the client presumes his or her needs will be met without having to direct the process
 - the professional decides which services are actually needed and provides them
 - the professional is trusted not to exploit his or her authority for unreasonable profit or gain.
- **Professional courtesy** – this is a bare minimum requirement of all business communication.
- **Expertise** – professionalism implies a level of competence that justifies financial remuneration. Incompetence is bad PR.
- **Marketing and promoting services** – accountants should not make exaggerated or defamatory claims in their marketing. This is covered in more detail in Chapter 5.



Test your understanding 2

When it comes to ethical principles, discussions often reveal that many employees think it is:

- acceptable to borrow money from the petty cash system if they have access (or their friends have access) and they are short of cash
- fine to browse the Internet or use the work telephone for unlimited numbers of personal calls
- quite appropriate to take a 'sickie' if they need a day off
- fun to invent a good story for being late or going early, and
- use work materials and tools for personal use.

Which of the fundamental principles is being flouted in these examples?

3 Threats and safeguards

3.1 Threats

Threats to compliance with the fundamental principles can be general in nature or relate to the specific circumstances of an appointment.

General categories of threats to the principles include the following:

- **The self-interest threat** – a threat to a member's integrity or objectivity may stem from a financial or other self-interest conflict.
This could arise, for example, from a direct or indirect interest in a client or from fear of losing an engagement or having his or her employment terminated or as a consequence of undue commercial pressure from within or outside the firm.
- **The self-review threat** – there will be a threat to objectivity if any product or judgement of the member or the firm needs to be challenged or re-evaluated by him or her subsequently.
- **The advocacy threat** – there is a threat to a member's objectivity if he or she becomes an advocate for or against the position taken by the client or employer in any adversarial proceedings or situation. The degree to which this presents a threat to objectivity will depend on the individual circumstances. The presentation of only one side of the case may be compatible with objectivity provided that it is accurate and truthful.

- **The familiarity or trust threat** – is a threat that the member may become influenced by his or her
 - knowledge of the issue
 - relationship with the client or employer
 - judgement of the qualities of the client or employer to the extent that he or she becomes too trusting.
- **The intimidation threat** – the possibility that the member may become intimidated by threat, by a dominating personality, or by other pressures, actual or feared, applied by the client or employer or by another.

Each of the categories of threat may arise in relation to the member's own person or in relation to a connected person e.g. a family member or partner or person who is close for some other reason, for instance by reason of a past or present association, obligation or indebtedness.

Where members decide to accept or continue an engagement in a situation where any significant threat to objectivity has been identified, they should be able to demonstrate that they have considered the availability and effectiveness of safeguards and have reasonably concluded that those safeguards will adequately preserve their objectivity.



Test your understanding 3

Consider each of the following threats to independence and label them according to the classification given above.

- Accountancy firm does both management accounting services and auditing for the same client.
- Having audited the client firm for many years, the audit partner has become close friends with the Directors.
- Auditor owns shares in the client company.
- Directors threaten to change auditors if they do not get an unqualified audit report.
- Auditor promotes an audit client's position or opinion in an article.

3.2 Safeguards



Definition

Safeguards may eliminate or reduce such threats to an acceptable level.

They fall into two broad categories:

- (i) safeguards created by the profession, legislation or regulation and
- (ii) safeguards in the work environment.

Safeguards created by the profession, legislation or regulation include, but are not restricted to:

- (i) educational, training and experience requirements for entry into the profession
- (ii) continuing professional development requirements
- (iii) corporate governance regulations
- (iv) professional standards
- (v) professional or regulatory monitoring and disciplinary procedures
- (vi) external review of the reports, returns, communications or information produced by a member and carried out by a legally empowered third party.

Safeguards in the work environment include, but are not restricted to:

- (i) the employing organisation's systems of corporate oversight or other oversight structures
- (ii) the employing organisation's ethics and conduct programmes
- (iii) recruitment procedures in the employing organisation emphasising the importance of employing high calibre competent staff
- (iv) strong internal controls
- (v) appropriate disciplinary processes
- (vi) leadership that stresses the importance of ethical behaviour and the expectation that employees will act in an ethical manner
- (vii) policies and procedures to implement and monitor the quality of employee performance
- (viii) timely communication of the employing organisation's policies and procedures, including any changes to them, to all employees and appropriate training and education on such policies and procedures

- (ix) policies and procedures to empower and encourage employees to communicate to senior levels within the employing organisation any ethical issues that concern them without fear of retribution
- (x) consultation with another appropriate professional.

The nature of the safeguards to be applied will vary depending on the circumstances. In exercising professional judgement, a member should consider what a reasonable and informed third party, having knowledge of all relevant information, including the significance of the threat and the safeguards applied, would conclude to be unacceptable.



Test your understanding 4

From time to time, you may receive or give gifts that are meant to show friendship, appreciation or thanks from or to people who do business with your company. You know you should never accept or offer gifts or entertainment when doing so may improperly influence or appear to influence your or the recipient's business decisions. If you are involved in any stage of a decision to do business with another company or person, you also know that you must refrain from accepting or giving any gift or entertainment that may influence or appear to influence the decision to do business.

Jot down some work based safeguards that colleagues would find helpful in deciding whether to accept or reject a gift.

4

Dealing with ethical conflicts

Given the above principles, threats and safeguards, a process of resolving ethical conflicts can be given as follows:

Step 1: Gather information

Rumour and hearsay are insufficient evidence upon which to base a decision. The accountant should seek to gather further information to clarify the situation.

Step 2: Analysis

In analysing the scenario, the accountant should first consider the legal perspective – have any laws been broken?

Next they can look at each of the fundamental principles to see which apply and whether there is an ethical issue to resolve.

Step 3: Action

If it is clear that there is a problem to resolve, the accountant should weigh up the different courses of action:

- Is behaviour dictated by law?
- Who are the affected parties?
- Internal escalation – is there someone within the organisation who could/should be approached to discuss the matter further – for example, the Board of Directors or Audit Committee?
- If the matter is still unresolved, then they should seek professional advice without breaching confidentiality.
- External escalation – should you report the matter externally?
- Ultimately the accountant should consider resigning from the assignment.



Test your understanding 5

You are an accountant of a large multinational organisation and have gained information about a takeover bid to acquire a rival firm.

By coincidence, a family friend is considering selling shares in this rival organisation and has asked you, as an expert in the industry, for advice on this matter.

What would you do? Which principles are affected and how?



Test your understanding 6

You are the newly appointed accountant of a struggling manufacturing company. You have just discovered that tax benefits were wrongly claimed in previous years, reducing the tax bill and boosting profit.

You have told the Finance Director about the error but he is unwilling to disclose the misleading tax bill as by telling the tax authorities (as required by law) the organisation may go bust and 300 employees could lose their jobs.

What would you do? Which principles are affected and how?



Test your understanding 7

You are a trainee accountant in your second year of training within a small practice. A more senior trainee has been on sick leave, and you are due to go on study leave.

You have been told by your manager that, before you go on leave, you must complete a complicated task that the senior trainee was supposed to have done. The deadline suggested appears unrealistic, given the complexity of the work.

You feel that you are not sufficiently experienced to complete the work alone but your manager appears unable to offer the necessary support. You feel slightly intimidated by your manager, and also feel under pressure to be a 'team player' and help out.

However, if you try to complete the work to the required quality but fail, you could face repercussions on your return from study leave.

Required:

Analyse the scenario with particular reference to the following:

- (a) Which fundamental principles are involved?
- (b) Recommended action.

5

Summary

This chapter has introduced the concept of ethics in the business environment and has outlined the fundamental ethical principles that should be adhered to.

Also covered have been the independence threats and safeguards.

All three, the fundamental Principles, the independence threats and the safeguards to help prevent unethical behaviour are highly examinable and underpin the whole syllabus.

It is critical that you know and can apply the different principles.

6 Test your understanding answers



Test your understanding 1

Report your client to the authorities

Examples of the points that should be considered in determining the extent to which confidential information may be disclosed are:

When the law specifically requires disclosure, it could lead to a member producing documents or giving evidence in the course of legal proceedings and disclosing to the appropriate public authorities infringements of the law.



Test your understanding 2

In all of these examples, the employees are not being honest or straightforward – they are therefore operating against the principle of **Integrity**.



Test your understanding 3

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



Test your understanding 4

Possible safeguards when considering whether to accept a gift:

- Set up clear policies and guidance for staff stating the following:
 - Cash gifts should never be accepted.
 - Do not accept a gift if it could cause you to feel an obligation.
 - Do not accept a gift from a vendor if it may give the vendor, other suppliers or subcontractors the impression that they have to provide similar gifts or favours in order to obtain company business.
 - Do not justify accepting a gift by arguing, 'Everybody else does it,' 'I deserve a break today,' or 'No one will ever find out.'
- Establish a code of ethics in the workplace that bans gifts.
- Ensure senior management are not seen accepting gifts.



Test your understanding 5

The basic issue here is that you know that it is a bad time to sell, as the price will most likely rise when the bid is announced. However, should you tell a family friend?

- (a) **Integrity** – This situation has a clear impact on your integrity – fair dealing and truthfulness.
- (b) **Objectivity** – Your objectivity would be at risk if you allow a personal relationship to influence the ethical and legal responsibilities you have to your employer.
- (c) **Confidentiality** – You have an obligation to refrain from disclosure of information outside the firm or employing organisation.
- (d) **Professional behaviour** – You cannot compromise your professional judgement as a result of a personal relationship.

In this case, the main issue is confidentiality. In advising your family friend, you would not only risk losing your job, but are also compromising your professional judgement, integrity and future career.

You should decline to discuss the issue.



Test your understanding 6

The basic issue here is whether to cover up the tax problem to save the jobs of 300 employees.

- (a) **Integrity** – By not declaring the unlawful tax benefits your integrity is clearly compromised.
- (b) **Objectivity** – Firstly, you need to ascertain the facts. Your objectivity is threatened by the perceived threat of job losses. The short-term and unlawful actions to increase profit will not help the business model in the long-term.
- (c) **Professional competence and due care** – By not declaring you are undermining both your professional competence as well as not acting with due care and diligence as a professional accountant.
- (d) **Confidentiality** – In this case there is a legal and professional right and duty to disclose. The issue will not go away and you will be seen as complicit.
- (e) **Professional behaviour** – There is a need to comply with the relevant law and regulations on this matter. By failing to declare your actions both discredits the profession and put you in disrepute.

Firstly you must be clear that there is an issue and find out the facts. Should you find that tax benefits have been unlawfully declared you should take action.

In this situation, you have to think about the long-term effects of your actions.

By not declaring the misleading tax bill the organisation might keep afloat for the moment – but it will not make the issue go away, and it will not necessarily save the jobs at risk in the long run. Doing this would severely damage your integrity and professional competence, and risk your reputation and future career.

You are legally required to disclose all information. This is clearly a tough decision to make, as jobs are at risk, but by refraining from reporting you will only worsen the situation. In addition by self-declaring there may be ways to negotiate a reduced tax bill with the authorities.

The issue needs to be discussed further with the Finance Director and then with the Board of Directors.



Test your understanding 7

- (a) **Key fundamental principles affected**
- (i) **Integrity:** Can you be open and honest about the situation?
 - (ii) **Professional competence and due care:** Would it be right to attempt to complete work that is technically beyond your abilities, without proper supervision? Is it possible to complete the work within the time available and still act diligently to achieve the required quality of output?
 - (iii) **Professional behaviour:** Can you refuse to perform the work without damaging your reputation within the practice? Alternatively, could the reputation of the practice suffer if you attempt the work?
 - (iv) **Objectivity:** Pressure from your manager, combined with the fear of repercussions, gives rise to an intimidation threat to objectivity.

(b) **Possible course of action**

You should explain to your manager that you do not have sufficient time and experience to complete the work to a satisfactory standard.

However, you should demonstrate a constructive attitude, and suggest how the problem may be resolved. (Your professional body is available to advise you in this respect.) For example, you might suggest the use of a subcontract bookkeeper.

Explore the possibility of assigning another member of staff to supervise your work.

If you feel that your manager is unsympathetic or fails to understand the issue, you should consider how best to raise the matter with the person within the practice responsible for training. It would be diplomatic to suggest to your manager that you raise the matter together, and present your respective views.

It would be unethical to attempt to complete the work if you doubt your competence.

However, simply refusing to, or resigning from your employment, would cause significant problems for both you and the practice. You could consult your professional body. If you seek advice from outside the practice (for example legal advice), then you should be mindful of the need for confidentiality as appropriate.

You should document, in detail, the steps that you take in resolving your dilemma, in case your ethical judgement is challenged in the future.

7 Additional Test your understanding questions



Test your understanding 8

James, a member in practice, has been asked to assist a client with interviewing potential new recruits for the finance department. James has since discovered that a close personal friend of his has applied for the role.

Which fundamental principle needs to be safeguarded?



Test your understanding 9

Explain why each of the following actions appears to be in conflict with fundamental ethical principles.

- 1 An advertisement for a firm of accountants states that their audit services are cheaper and more comprehensive than a rival firm.
- 2 An accountant prepares a set of accounts prior to undertaking the audit of those accounts.
- 3 A director discusses an impending share issue with colleagues at a golf club dinner.
- 4 The finance director asks a trainee accountant to complete the company's taxation computation following the acquisition of some foreign subsidiaries.
- 5 A financial accountant confirms that a report on his company is correct, even though the report omits to mention some important liabilities.
- 6 You believe your colleague has asked you to include what you believe to be misleading information in your forecast.
- 7 Your analysis of a strategic proposal suggests that profitability will be improved by making 30 people redundant.
- 8 You can outsource your manufacturing to a country where labour costs are much lower.
- 9 Your company is allowed, legally, to dump its waste into a river. This will kill all aquatic life along a 50 mile stretch.



Test your understanding 10

Explain your response to the following ethical threats.

- 1 Your employer tells you that you will receive a large bonus for working overtime on a project to hide liabilities from the financial statements.
- 2 In selecting employees for a new division, you are advised to unfairly discriminate against one section of the workforce.
- 3 You have been asked to prepare the management accounts for a subsidiary located in South America in accordance with specific requirements of that jurisdiction. In response to your comment that you do not understand the accounting requirements of that jurisdiction, your supervisor states “no problem, no one will notice a few thousand dollars error anyway”.



Test your understanding 11

The IT Director of ABC Ltd has asked a junior accountant within the company to undertake a cost benefit analysis of a proposed new IT system. The IT Director will use this analysis to try and convince the Board of Directors of ABC that they should invest in the new system.

As part of his analysis, the junior accountant has discovered that the new system will not run properly on ABC’s existing computers. This means that ABC would have to replace the majority of their desktop computers and servers, leading to an excess of costs over benefits.

The IT Director has suggested that the junior accountant downplay the costs of replacing the IT infrastructure as he was sure that he “could find a workaround” that would allow the existing computers to use the new software, though he was currently uncertain how this would be done.

The IT Director has told the junior accountant that he ‘expects’ the cost benefit analysis to show a favourable result for the new system and has indicated that the junior accountant’s future promotion prospects may depend on this being the case.

Required:

Explain the fundamental ethical principles that the junior accountant would be breaching if he agrees to the IT Director's request.



Test your understanding 12

Michael, a member in practice, performs account preparation services to a client called Ying Ltd. A company called Yang Ltd approaches Michael's firm and requests to become a new client. The two businesses are direct competitors and both have trade secrets which they wish to keep a secret.

Which fundamental principles are threatened?

8

Additional Test your understanding answers



Test your understanding 8

James needs to safeguard the fundamental principle of objectivity. His friendship may colour his judgement in favour of his friend.



Test your understanding 9

- 1 Potential conflict with professional behaviour – audit services observe the same standards, therefore implying that a rival has lower standards suggests that a firm is not complying with professional standards.
- 2 The accountant is likely to lose objectivity because errors in the accounts made during preparation may not be identified when those accounts are reviewed.
- 3 As the information is likely to be confidential, discussing it in a public place is inappropriate.
- 4 The accountant needs to ensure that knowledge of the foreign country's taxation regime is understood prior to completing the return, otherwise there is the possibility that the appropriate professional skill will not be available.
- 5 There is an issue of integrity. The accountant should not allow the report to be released because it is known that the report is incorrect.
- 6 This is an issue of integrity. Accountants must not be associated with any form of communication or report that they know to be either materially false or misleading.

- 7 The reduction of the number of staff in an organisation in order to increase profit is not necessarily unethical. For example, if the business has an unnecessarily high number of employees, reducing this number may be appropriate. However, the accountant would need to ensure that the analysis was accurate, as it will impact on individual's livelihoods. If there is any uncertainty in the results, they may need to consider whether it should be disclosed. In addition, the accountant will need to be aware of the implications and should ensure that the decision makers are made aware of the potential ethical considerations.
- 8 Again, this is an operational decision. There are ethical concerns over the loss of current staff which the accountant should make the decision maker aware of along with the potential adverse impact on the reputation of the company.
- 9 Ethics involves avoiding negative impacts on the environment that the company operates in. Even though legal, the decision to dump pollution into a river is unethical due to the impact on marine life. Should an accountant be complicit in such an action, it is likely to bring the profession into disrepute.



Test your understanding 10

Threat 1

- Do not offer the inducement!
- If necessary, follow the conflict resolution process of the employer.
- Consider the impact of the financial statements being misrepresented.

Threat 2

- Obtaining advice from the employer, professional organisation or professional advisor.
- Legal advice.

Threat 3

- Obtaining additional advice/training.
- Negotiating more time for duties.
- Obtaining assistance from someone with relevant expertise.



Test your understanding 11

If the junior accountant agrees to the IT Director's demands, he will be in breach of several of the IFAC ethical principles:

Integrity

This requires members not to be associated with any form of communication or report where the information is materially false, provided recklessly or incomplete.

The junior accountant has identified a potential problem with the proposed new system that would involve a large outflow of cash to upgrade ABC's infrastructure.

Following the IT Director's suggestion would involve the junior accountant ignoring the issue without a firm idea of how it will be resolved (the IT Director is simply suggesting a vague 'workaround').

This means that the report will be incomplete and misleading to its users.

Objectivity

This requires accountants to ensure that their judgement is not compromised because of bias or conflict of interest.

The junior accountant is only likely to agree to the IT Director's demands because failing to do so could jeopardise his career. This would clearly be acting in his own self-interest.

Professional competence and due care

This requires accountants to follow all applicable technical and professional standards when providing services.

The junior accountant is aware that the cost benefit analysis, when undertaken properly, shows an unfavourable result for the new IT system.

Failing to use the correctly obtained result could be seen as a failure to meet professional and technical standards.

Professional behaviour

This principle requires accountants to avoid any activities that might bring the profession into disrepute.

If the junior accountant is found to have knowingly misled the Board of Directors into buying a system that is not cost effective, it would clearly damage confidence in the accountancy profession as a whole.