Professional Ethics

Chapter 4
Learning Objective 1

Distinguish ethical from unethical behavior in personal and professional contexts.
What Are Ethics?

Ethics can be defined broadly as a set of moral principles or values.

Each of us has such a set of values.

We may or may not have considered them explicitly.
Illustrative Prescribed Ethical Principles

- Core Ethical Values
  - Responsibility
  - Caring
  - Citizenship
  - Fairness
  - Respect
  - Trustworthiness
Need for Ethics

Ethical behavior is necessary for a society to function in an orderly manner.

The need for ethics in society is sufficiently important that many commonly held ethical values are incorporated into laws.
Why People Act Unethically

The person’s ethical standards are different from those of society as a whole.

The person chooses to act selfishly.
A Person Chooses to Act Selfishly – Example

**Person A** finds a briefcase containing important papers and $1,000.

He tosses the briefcase and keeps the money.

He brags to his friends about his good fortune.

This action probably differs from most of society.
A Person Chooses to Act Selfishly – Example

**Person B** faces the same situation but responds differently.

He keeps the money but leaves the briefcase.

He tells nobody and spends the money.

He has violated his own ethical standards and chose to *act selfishly*. 
Learning Objective 2

Resolve ethical dilemmas using an ethical framework.
Ethical Dilemmas

An ethical dilemma is a situation a person faces in which a decision must be made about appropriate behavior.

Auditors face many ethical dilemmas in their business careers.
Rationalizing Unethical Behavior

- Everybody does it
- If it’s legal, it’s ethical
- Likelihood of discovery and consequences
Resolving Ethical Dilemmas

1. Obtain the relevant facts
2. Identify the ethical issues from the facts
3. Determine who is affected
Resolving Ethical Dilemmas

4. Identify the alternatives available to the person who must resolve the dilemma

5. Identify the likely consequence of each alternative

6. Decide the appropriate action
Relevant Facts

A staff person has been informed that he will work hours without recording them as hours worked.

Firm policy prohibits this practice.

Another staff person has stated that this is common practice in the firm.
Ethical Issue

Is it ethical for the staff person to work hours and not record them as hours worked in this situation?

Who is affected?

How are they affected?

What alternatives does the staff person have?
Learning Objective 3

Explain the importance of ethical conduct for the accounting profession.
Special Need for Ethical Conduct in Professions

Our society has attached a special meaning to the term “professional”.

Professionals are expected to conduct themselves at a higher level than most other members of society.
Difference Between CPA Firms and Other Professionals

CPA firms are engaged and paid by the company issuing the financial statements.

Primary beneficiaries of the audit are statement users.
CPAs Encouraged to Conduct Themselves at a High Level

- CPA examination
- GAAS and interpretations
- Continuing education requirements
- Quality control
- Conduct of CPA firm personnel
- Peer review
- Legal liability
- PCAOB and SEC
- AICPA practice sections
- Code of Professional Conduct
- Conduct of CPA firm personnel
Learning Objective 4

Describe the purpose and content of the AICPA *Code of Professional Conduct*. 
**FIGURE 4-3** Code of Professional Conduct

<table>
<thead>
<tr>
<th>Principles</th>
<th>Ideal standards of ethical conduct stated in philosophical terms.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>They are not enforceable.</td>
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</table>

<table>
<thead>
<tr>
<th>Rules of conduct</th>
<th>Minimum standards of ethical conduct stated as specific rules.</th>
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<tbody>
<tr>
<td></td>
<td>They are enforceable.</td>
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</table>

<table>
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<tr>
<th>Interpretations of the rules of conduct</th>
<th>Interpretations of the rules of conduct by the AICPA Division of Professional Ethics.</th>
</tr>
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<td>They are not enforceable, but a practitioner must justify departure.</td>
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</table>

<table>
<thead>
<tr>
<th>Ethical rulings</th>
<th>Published explanations and answers to questions about the rules of conduct submitted to the AICPA by practitioners and others interested in ethical requirements.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>They are not enforceable, but a practitioner must justify departure.</td>
</tr>
</tbody>
</table>
Ethical Principles

1. Responsibilities:
Professionals should exercise sensitive and moral judgments in all their activities.

2. The public interest:
Members should accept the obligation to act in a way that will serve and honor the public.
Ethical Principles

3. Integrity:
Members should perform all responsibilities with integrity to maintain public confidence.

4. Objectivity and independence:
Members should be objective, independent, and free of conflicts of interest.
5. **Due care:**
Members should observe the profession’s standards and strive to improve competence.

6. **Scope and nature of services:**
A member in public practice should observe the *Code of Professional Conduct.*
Standards of Conduct

**FIGURE 4-4** Standards of Conduct

<table>
<thead>
<tr>
<th>Ideal conduct by practitioners</th>
<th>Principles</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum level of conduct by practitioners</td>
<td>Rules of conduct</td>
</tr>
<tr>
<td></td>
<td>Substandard conduct</td>
</tr>
</tbody>
</table>
IESBA Code of Ethics for Professional Conduct

Part A
- Establishes five fundamental principles
- Evaluate and eliminate threats

Part B
- Describes how framework applies in certain situations
- Accountants in public practice

Part C
- Accountants in business
Learning Objective 5

Understand Sarbanes-Oxley Act and other SEC and PCAOB independence requirements and additional factors that influence auditor independence.
Independence

The AICPA and IESBA codes of ethics both define *independence* as consisting of two components

- Independence of mind
- Independence in appearance
SEC auditor independence rules strengthened in 2003 consistent with the Sarbanes-Oxley Act.

The Sarbanes-Oxley Act and revised SEC rules further restrict the type of nonaudit services that can be provided by auditors.
The PCAOB has also issued additional independence rules related to the provision of certain tax services.
Sarbanes-Oxley Act and SEC Provisions
Addressing Auditor Independence

Prohibited Services
1. Bookkeeping and other accounting services
2. Financial information systems design and implementation
3. Appraisal or valuation services
4. Actuarial services
5. Internal audit outsourcing
6. Management of human resource functions
7. Broker, dealer, or investment adviser or investment banker services
8. Legal and expert services unrelated to the audit
9. Any other service that the PCAOB determines by regulation is impermissible
Audit Committees

A selected number of members of a company’s board who help auditors remain independent.

Comprised of three to five independent directors.
Audit Committees

All members must be independent.

At least one audit committee member must be a financial expert.
Conflicts Arising from Employment Relationships

A one year “cooling off” period must occur before a member of the audit engagement team can accept a key management position at a client.
Partner Rotation

The Sarbanes-Oxley Act requires that the lead and concurring audit partner rotate off the audit engagement after a period of five years.
Ownership Interests

SEC rules on financial relationships take an engagement perspective.

SEC rules prohibit ownership in audit clients by those persons who can influence the audit.
Other Issues

- Shopping for accounting principles
- Engagement and payment of audit fees by management
- Can the auditor be truly independent if payment depends on company management?
Learning Objective 6

Apply the AICPA Code rules and interpretations on independence and explain their importance.
Rules of Conduct

Rule 101 – Independence

A member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by Council.
Financial Interests

Interpretations of Rule 101 prohibit covered members from owning any direct investments in audit clients.

- Covered members
- Direct versus indirect financial interest
- Material or immaterial
Related Financial Interests Issues

- Former practitioners
- Normal lending procedures
- Financial interests and employment of immediate and close family members
- Joint investor or investee relationship with client
- Director, officer, management, or employee of a company
Litigation Between CPA Firm and Client

A lawsuit or intent to start a lawsuit between a CPA firm and its client, the ability of the CPA firm and client to remain objective is questionable.

The interpretations regard such litigation as a violation of Rule 101.
Bookkeeping and Other Services

The AICPA **Code** permits a CPA firm to do both bookkeeping and auditing for a nonpublic client.
1. Client must accept full responsibility for the financial statements.

2. The CPA must not assume the role of employee or of management.

3. The audit must conform to use of auditing standards.
The SEC and AICPA rules do not allow audit firms to provide bookkeeping services to public company audit clients.

- Consulting and other nonaudit services
- Unpaid fees
Learning Objective 7

Understand the requirements of other rules under the AICPA Code.
Other Rules of Conduct

102 – Integrity and objectivity
201 – General standards
202 – Compliance with standards
203 – Accounting principles
301 – Confidential client information
Other Rules of Conduct

302 – Contingent fees
501 – Acts discreditable
502 – Advertising and other forms of solicitation
503 – Commissions and referral fees
505 – Form of organization and name
Learning Objective 8

Describe the enforcement mechanisms for the rules of conduct.
Enforcement

AICPA
Professional Ethics Division

State Board of Accountancy
End of Chapter 4