

Chapter 3 Professional ethics, independence and audit quality

Review questions

3.11 How does ethics apply to auditors?

Ethics are concerned with the evaluation of choices where the options are not clear or where there is no absolute right or wrong answer. The study and practice of ethics are important to enable accountants to examine critically a situation in which there is a conflict of loyalties and interests, involving issues that relate to roles and responsibilities, both as an individual and a professional. The practice of ethical behaviour requires an understanding of ethical issues, a framework within which a responsible decision can be made, and awareness of the consequences of such decisions. Ethics therefore not only encompasses professionalism and the code of professional conduct which accountants should adhere to, it relates to the numerous decisions accountants make, as a professionally responsible accountant, safeguarding the public interest, and the underpinning system which helps the accountant to manage difficult situations. Ethics consists of moral principles and standards of conduct, which includes professional and organisational ethics. They include standards of behaviour for professional accountants and are incorporated into the Code of Ethics for Professional Accountants (APES110) issued by the Accounting Professional Ethics Standards Board established by the CPA Australia and The Institute of Chartered Accountants in Australia.

In regard to auditors, there is an additional requirement that they must also comply with the Auditing Standards in relation to audit independence, quality control procedures and ensuring that the audit engagements are carried out objectively. Auditors are also expected to comply with various requirements of common law when the duty of care and diligence is applied to their professional services.

3.12 What are the ethical threats to professional independence? What are the safeguards for managing such threats?

Threats	Safeguards
Self-interest threats	Prohibition of providing non-audit services, fees based on reasonable estimates of time and expertise required, stringent independence guidelines and monitoring by firms, legislative restrictions on auditors regarding independence.
Self-review threats	Stringent quality review procedures within firms, prohibition of retired partners joining clients within cooling period, confidentiality of information, prohibition of personal relationships with clients.

- Auditors provide independent assurance to the financial state of an disinterested entity. Stakeholders rely on the expertise and objectivity of the audit opinion. A person without the necessary qualifications and ethical conduct may expose these stakeholders to unnecessary risks.

3.17 Why did Arthur Andersen have so many audit failures, leading to its implosion in 2002?

It is often thought that the collapse of Enron was the one event that brought Arthur Andersen down. However, as Barbara Toffler observes in her book on “The Rise and Fall of Arthur Andersen” the collapse of Enron was just “the final nail in the coffin of Arthur Andersen” Andersen had a number of audit failures (eg., Waste Management, Global Crossing, WorldCom and HIH Insurance), but none of these were technical failures – they were ethical failures. Andersen, competing against its offshoot Andersen Consulting (that was to become Accenture), had developed a culture that was all about making money, rather than maintaining its independence and conducting high quality audits. This set in train a culture that was to be Andersen’s downfall.

3.18 Is regulation good for the audit profession? Discuss

Key regulatory provisions include those concerning independence, conflict of interest, the audit report, right of access, independent reporting, eligibility of appointment, terms of appointment, entitlement of fees and expenses, and qualified privilege.

Regulation enhances the status of the audit profession and provides a framework whereby the profession and its firms use it as bases of operation. It also sets the minimum standards of behaviour for the practising accountants.

3.19 What are the major ways in which audit quality can be assured?

Every profession is concerned about the quality of its services, and the public accounting profession is no exception. Quality audits are essential to ensure that the profession meets its responsibilities to clients, to the general public and to regulators who rely on independent auditors to maintain the credibility of financial information. To help assure quality audits, the profession and the regulators have developed a multilevel regulatory framework. This framework encompasses many of the activities of the private and public sector organisations associated with the profession (described earlier in this chapter). For the purpose of describing the framework, these activities may be organised as follows:

- *Standard setting:* The AUASB issues standards, guidance notes and other guidances to provide clear standards for auditing and assurance services, and for review and other related services. The professional bodies and IFAC issue ethical codes to establish and monitor the performance of professionalism and ethical behaviour of professional accountants.
- *Firm regulation:* Each public practice entity adopts policies and procedures to ensure that practising accountants adhere to professional standards.

3.29 Audit quality

Required

- (a) Discuss the significance of audit quality control.**
- (b) Do you think it is adequate just to ask for more time? Why or why not?**
- (c) If your manager told you to simply follow a standard audit program for the audit, what would you do? Explain in full what your actions would be and why.**

(a) Audit quality control is important because:

- It provides the basis for the exercise of professional responsibilities with due care and competence in the public interest, as a characteristic of a professional person;
- When auditors face pressures whereby their work and objectivity may be compromised, quality control procedures may help the auditors to manage such threats;
- Technical competence and ethical competence require respective frameworks. Audit quality control procedures, along with professional standards and legislative requirements, are crucial elements to underpin the competence to be demonstrated by auditors.

(b) Asking for more time so that you can be more familiar with the audit and its requirements is certainly the first action to be taken. However, as you may not have the required specialised knowledge, there should be provision for more supervision and perhaps on the job training from an audit manager. Just asking for more time may not alert the partners that there is a deficiency in the skills or experience required.

The auditor should discuss fully with the audit partners or manager the situation and request more information to be provided, if necessary.

If you are convinced an inadequate amount of audit work had been performed in the previous year, then you should consider raising it with the audit partner concerned.

(c) If the manager requires you only to follow a standard audit program, you should discuss the matter in more detail with the manager, explaining that the standard audit program may be insufficient for the purpose. You should identify the key areas of the audit, which may not be covered in the standard audit program. You should also seek for suggestions to improve the audit by obtaining more information and devising your special audit tasks to be performed, and then discuss them with the manager concerned.