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02. The Fundamental Ethical Principles

After studying this module you will be able to:

- identify the key characteristics of each ethical principal and be able to explain the significance of each one;
- select which ethical principle(s) apply to a given scenario; and
- identify the strong link between the ethical principles and the role of a professional accountant

The Fundamental Ethical Principles

1. Overview
2. Integrity
3. Objectivity
4. Professional competence
5. Confidentiality
6. Professional Behaviour
7. Review

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2.1.1 Overview

As we saw in the previous module, the ICAEW Code of Ethics is a conceptual framework to help professional accountants with ethical issues.

This conceptual framework is based on the following five fundamental ethical principles:

1. **P**rofessional Competence and Due Care
2. **I**ntegrity
3. **P**rofessional Behaviour
4. **C**onfidentiality
5. **O**bjectivity.

You may find the mnemonic **PIPCO** useful to remember these.

Everything that you do should be based on these fundamental principles. If you or your firm find yourselves in a position where you are not complying with these principles then you will need to take appropriate action to ensure full compliance with the Code.

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2.1.2 Overview

Learning outcomes

After studying this module you will be able to:

1. identify the key characteristics of each ethical principle and be able to explain the significance of each one;
2. select which ethical principle(s) apply to a given scenario; and
3. identify the strong link between the ethical principles and the role of a professional accountant.

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2.2.1 Integrity

"I can resist everything except temptation" **Oscar Wilde**

Integrity underpins everything that you do. Being transparent and honest is key to helping ensure that the accountancy profession retains its reputation for the highest professional standards.

ICAEW thought leadership suggests that there are seven characteristics of integrity that professional accountants should adopt:

1. being fair;
2. complying with laws, regulations, and professional standards;
3. promoting community interests;
4. being honest;
5. being open and adaptable;
6. taking corrective action; and
7. showing consistency.

Real-life scenario

You went out to a bar with your friends on Saturday night to celebrate your birthday. You and you friends were all a bit drunk. One of your friends, who was particularly drunk, managed to get into an argument with a group of men at the bar and a fight between the two groups started. When the police arrived you were arrested, despite your protestations that you were not involved. When you are released from custody, pending charges, you don't know what to do. You are worried that you can't tell anyone at work in case they sack you and you can't face telling your family.

Although it is difficult, the best thing to do in this situation is to tell the truth. The consequences of keeping this to yourself would be far worse if the truth ever came out. In this situation it is a case of mistaken identity, and therefore is extremely likely to be resolved without any charges being faced.

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2.2.2 Integrity

In some instances, the ICAEW Code of Ethics works in conjunction with relevant legislation. One of the seven characteristics of integrity mentioned above is compliance with laws, regulations and professional standards. The UK, for example, has laws for bribery and money-laundering, and their requirements are briefly summarised below.

Bribery Act 2010. Under this Act both individuals and commercial organisations can be found guilty of the criminal offence of bribery. For an individual it is a criminal offence to offer, or to receive a bribe in the form of a financial or other advantage. It is also a criminal offence to offer a bribe to a foreign public official. A commercial organisation can be found guilty of bribery if an employee, agent or subsidiary bribes another person. The Bribery Act is wide in its scope: UK citizens are liable to criminal penalties for actions committed both within and outside the UK.

Money laundering refers to the 'laundering' of the proceeds of crime, so that money obtained from illegal sources is made to appear to be derived legally. The legislation contains a duty to report suspected money laundering to the police.

If you are a professional accountant subject to the ICAEW Code of Ethics, but you are not a UK citizen or working in the UK, you may nevertheless be subject to similar laws in your own national jurisdiction. Even where such laws do not exist, the fundamental ethical principle of integrity should, of course, ensure that you do not commit acts of bribery or money laundering.

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2.2.3 Integrity

VIDEO – Seven characteristics of integrity

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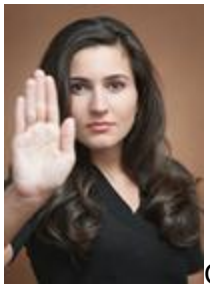
2.3.1 Objectivity

 Objectivity is a state of mind which relates to all considerations relevant to the task in hand but no other.

This means that you should not allow yourself to be biased or unduly influenced in any way for the service that you are performing.

Being objective can become difficult if you have a personal or financial relationship with the client. This will be examined in more detail in Module 3.

Real-life example:

Harry has been the engagement partner on a particular client for many years. He has a good working relationship with the board of directors but has always been very mindful of not getting too close to his clients and so has always politely refused offers to socialise with the client.

Harry is certain that he still adopts an objective mind-set towards this client; being a man of integrity he would step down immediately if he suspected otherwise. However the fact that he has worked with the client for so long means that there is a risk that he may no longer be independent from the client in the eyes of others, and could therefore be perceived to not be objective. As such Harry should seriously consider whether he can continue as engagement partner for this client.

What is the difference between objectivity and independence?

Objectivity and independence are very closely related but they are two different things.

Objectivity is a mindset where you don't allow yourself to be unduly influenced or biased in any way.

Independence means that you should avoid circumstances where you may be perceived by a third party to not be independent from your client or employer.

The Auditing Practice Board's Ethical Standard 1 makes the distinction between the two for auditors as follows:

"… Independence is related to and underpins objectivity. However whereas objectivity is a personal behavioural characteristic concerning the auditor's state of mind, independence relates to the circumstances surrounding the audit, including the financial, employment, business and personal relationships between the auditors and their client."

So it is not enough for you as an accountant to have an objective mindset, you must also be seen to be independent.

This case study explores the issues surrounding integrity and objectivity at work, along with due care, professional competence and professional behaviour.

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Ask yourself the following questions as a business professional:

1. What does integrity mean for you?
2. Is integrity the core principle in professional behaviour?
3. How is integrity instilled in your audit firm or your organisation? Does it always work?

Objectives

Having completed this case study, you should be able to:

1. Recognise your responsibilities as a professional when working as an employee of a company.
2. Know where to go in the guidelines for guidance on what action to take.
3. Transfer what you have learned to your own work situation.

All organisations, individuals and events in this case study are entirely fictitious and do not refer to actual organisations, individuals or events.

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SuperScraper is a company with global property interests. One of the stars of its property portfolio, a huge office block named "Central 1", in a major European city, is in urgent need of its five-yearly renovation. Four companies have tendered for the contract, covering all aspects of the renovation. The chartered accountants from Fraser Jennings have been asked by the Managing Director, James Delfino, to quantify each alternative in order to work out the most cost-effective solution, possibly using more than one company.

Characters

Ranjit Desai: Accountant

Sarah Symington: Financial Accounting Manager

(Both Ranjit and Sarah are Chartered Accountants)

James Delfino: Managing Director

SCENE 1:

James: Hi Ranjit, how are you doing working on those cost estimates? I really need them by the end of today!

Ranjit: Yes, I've been collating the numbers for about a week now. Nearly there!

James: Why on earth has it taken you so long? The Board needs to make its decision and I want to make sure that it is the right one.

Ranjit: Well, I've had to get information from all over the world from the various tendering companies to make sure that all of the tenders are comparable, and its taken a lot of time coping with time zones etc – what their quotes cover, exchange rate issues, how long they'll take and therefore how much rent we'll lose etc etc... Lots of assumptions in there!

James: OK, OK. Who is looking the best at the moment?

Ranjit: Difficult to give you a definitive answer, but OfficeBlox from the US looks competitive. We may also use Batiment from France for certain aspects.

James: OfficeBlox is a great company. I trust them. I own quite a few shares…anyway, I look forward to your report. Get it to me by the end of the day.

Ranjit: I'll try, but it will be hard to get it all done. There may be quite a few bits missing.

1

Question

Should Ranjit be suspicious of the way that the conversation started turning?

Note down reasons for your answer

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Answer

The correct answer is: YES

Ranjit needs to be on alert that there appears to be a threat to objectivity on the part of the MD. He owes a duty of integrity and objectivity to the company and the board as a whole, not just the MD. In addition, it seems that he is being pressured to finish the work quickly, which may compromise the accuracy and dependability of the report.

SCENE 2:

James: It's 7.00pm, Fraser, where on earth are those numbers?

Ranjit: Well, if you really need it now, I've got most of it done…. as you can see, based upon certain assumptions on time taken and exchange rates, the tender from Batiment looks the best. They are quoting $3 million. OfficeBlox would take longer, and it would end up costing nearer $4 million.

James: Hmmmm…not sure that I agree with you there. Surely if we change some of these assumptions on the US dollar exchange rate, and make it clear to OfficeBlox that they must complete the renovation within 6 months, then we should go with them? That would bring the cost down to more like $2 million.

Ranjit: Well, the project manager from Batiment says that there is no way that the work can be completed in much less than 9 months.

James: Way too pessimistic. I want you to change those assumptions and make sure that the OfficeBlox tender is the one that you recommend to the Board. Go with a cost of $2 million. I will back you up.

Ranjit: Can't I have a bit more time to work on this?

2

Question

Is Ranjit in breach of the guidelines on integrity and objectivity if he complies with James' request?

Note down reasons for your answer

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Answer

The correct answer is: YES

Ranjit is under a duty to ensure that the Board gets accurate information, but James has sought to influence his recommendations. His objectivity and integrity are under direct threat. He may decide to inform the Board of James' attempts to persuade him to alter his assumptions. At the very least he must make it clear that the figures he presents are based upon numerous assumptions, and he must state those very clearly.

SCENE 3:

James: Hi Sarah, I need a word with you about the disclosures in the year end accounts.

Sarah: Oh OK. Is it about the renovations on Central 1?

James: Yes, I've had a long discussion with Ranjit and we think that the probable cost is $2 million. Look at these numbers that Ranjit prepared.

Sarah: Are we sure that's going to be enough? There are some pretty hefty assumptions here. I think $4 million or even $5 million looks more like it. I thought that Batiment was the favoured option.

James: Why are you accountants so pessimistic? It's not like we don't pay you a huge salary; I'd have thought you'd be easier to work with. Look, I'm off to talks with the bank soon about a new loan facility, and quite frankly I can't afford to have huge spending commitments disclosed in the financial statements. The auditors don't need to know.

Sarah: Well, if you're sure...

3

Question

Is Sarah in breach of any guidelines she complies with James' request?

Note down reasons for your answer

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Answer

The correct answer is: YES

Sarah is a well paid member of staff, so she has a position to protect. However, she has a clear duty to the users of the accounts to present accurate information – this includes the banks. They need to know about significant costs that are coming up when they make their decision about whether or not to lend. Remember that "a professional accountant should act diligently and in accordance with applicable technical and professional standards" and "should comply with relevant laws and regulations and should avoid any action that discredits the profession".

Sarah should remind the Board that they have a duty to present a true and fair view to users of the financial statements.

You have now completed this case study. Review your responses to the questions raised and then click the forward or back arrow in the navigation bar to continue the course.

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2.4.1 Professional competence

The principle of professional competence and due care is based on the idea that you should never undertake to perform work that you are not able to perform competently.

This isn't perhaps as straightforward as it sounds. For example, consider the following questions:

- how do you know if you are competent to undertake a piece of work for a client?
- does having the ACA qualification mean that you are able to carry out a specialist engagement competently?
- can your business afford to turn down work?

Competent professional service means you should use sound judgement when applying professional knowledge and skill in the performance of the service.

When determining whether an engagement can be accepted, consider the following areas:

- Do I have the appropriate qualifications to enable me to diligently perform this piece of work? Sometimes the ACA qualification is not sufficient in itself to carry out a piece of specialist accountancy work.
- Do I have any recent experience of carrying out similar work?
- Do I have the available time and resources to carry out the work to a competent standard?
- Is there any expertise within my firm that I can draw upon?

If the answer to any of the above questions is "no" then you should seriously consider whether you can accept the work. Remember, if in doubt it's always best to consult with your firm or ICAEW.

Why don't small accountancy practices audit FTSE 100 firms?

Most multi-national companies are generally audited by larger accountancy firms. One reason why a very small firm would be unlikely to submit a tender for a multi-national company audit is that, while they may have the appropriate expertise and experience, they might not be able to commit sufficient staff resources to such a large piece of work. This is particularly the case if the client has operations in more than one country.

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2.4.2 Professional competence

You are working in the tax department of a public practice firm. While at university you organised computer upgrades and data backup solutions for fellow students. Your computer expertise has become widely known. Having been approached by a couple of people recently you decide you would like to continue with your services, and decide to make a charge for them.

Question:

Which of the Fundamental Principles should you consider in reaching this decision?

a) Integrity
b) Objectivity
c) Professional Competence and Due Care
d) Confidentiality
e) Professional Behaviour

Answer

The main Fundamental Principle of which you should be aware is Professional Behaviour, and the need to avoid doing anything that may discredit the profession. If you are involved in an additional business activity you should always consider whether or not it is consistent with the dignity of the profession, whether it conflicts with or distracts from your employment and is properly organised - complying with any applicable regulations, insurance requirements etc. You should also consider the implications on your integrity and whether or not you have the necessary competence to continue with this activity. You should also check with your employer that they are happy for you to run such a business.

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Question:

When considering whether to start the business which are the main issues for you to consider?

a) Your qualifications and experience
b) Whether you have the time
c) Getting permission from your employer
d) Legal and regulatory requirements
e) Ensuring that everything is 'official'

Answer

All of these issues are important if you are considering such a step. There is nothing to prevent you from undertaking an activity of this kind, but it is important to ensure that you inform your employer and also that you check your contract of employment to find out if such an activity is allowed. Before making this decision you should have undertaken sufficient research to ensure that you understand the legal and regulatory requirements, that everything is run properly and that you satisfy yourself in relation to your competence and time commitments.

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2.5.1 Confidentiality

In essence this principle is very simple: you should never discuss your client's affairs with anyone outside your immediate team. Moreover you should also actively take all reasonable steps to preserve confidentiality.

These steps include:

- training staff
- password protecting electronic information
- physically protecting documents (ie, under lock and key)
- destroying sensitive information once it's no longer required.

You have a duty to comply with the confidentiality principle even after your relationship has ended with a client or their employer.

There are, however, some circumstances where it is permissible for you to disclose confidential information.

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2.5.2 Confidentiality

Whistle-blowing

Whistle-blowing means ‘making a disclosure in the public interest’ and occurs when a worker raises a concern about danger or illegality that affects others, for example members of the public. In many countries, including the UK, employees and workers who make a ‘protected disclosure’ are protected from being treated badly or being dismissed. For example in the UK the key piece of whistle-blowing legislation is the Public Interest Disclosure Act 1998 (PIDA) which applies to almost all workers and employees.

VIDEO – The public interest

Confidentiality can be broken in these circumstances:

- Disclosure is required by law
- Client permission
- Protecting professional reputation
- Public interest

Disclosure is required by law

You are never above the law! If a court of law requires an accountant to disclose information about a client then they can do so without recourse.

This is common in cases of money laundering or terrorism.

Real-life example
During the trial of an individual suspected of a serious crime, the Court asks the defendant’s accountant to provide evidence on the recent activities of their client. As this is a court order the accountant is permitted to break their duty of confidentiality.

Client permission

If the client gives their permission to you, then it is fine to break the duty of confidentiality. You should get permission from the client in writing to avoid potential legal issues later on.

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Protecting professional reputation

If you need to defend yourself or your reputation in a court of law then you can break the duty of confidentiality.
This includes the following circumstances:

- to comply with a quality review or inquiry by ICAEW or a regulator;
- to comply with technical standards.

Public interest

Disclosing in the public interest is a subjective issue, with no definitive guidelines included in the ICAEW Code of Ethics.

The "public interest" relates to a matter that it would be in the interests of society to be aware of. There is therefore a scale between very obvious scenarios, such as a client intentionally polluting a local river in order to save costs, to much more subjective situations where it could be argued either way that the matter is in the public interest.

In cases such as the latter it is always best to adopt the following approach.

- Consider whose interests could be affected by the disclosure – could any third party interests be harmed?
- Consider whether all relevant information is known and substantiated. This will affect what is disclosed.
- Consider the legal and regulatory obligations, and the possible implications of disclosure on yourself.

As a general rule it is advisable that you seek legal advice before making a disclosure in the public interest.

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2.5.3 Confidentiality

The same Fundamental Principles and standards of behaviour apply, irrespective of whether you work in business or public practice. You are required to consider whether actions or relationships might constitute threats to adherence of the fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. Where these threats are significant, you must implement safeguards to eliminate the threat to an acceptable level.

Professional accountants in business have a responsibility to further the legitimate aims of their employing organisation. There are occasions, however, when this creates a conflict with their requirement to comply with the fundamental ethical principles. The ICAEW's Code of Ethics provides guidance on some of these areas including conflicts of interest, preparation and reporting of information, acting with sufficient expertise, financial interests and inducements (icaew.com/ethics).

As a professional accountant in business you cannot be fully independent of your employer. You must, however, strive for objectivity and behave with integrity in your work and refuse to be involved in any unlawful activities. If you become aware that your employer has committed an unlawful act you should seek to persuade them not to continue the unlawful activity and to correct the matter. If there is no indication that such a change will be forthcoming you would need to consider your own position and whether or not you are happy to continue working for such an organisation. Further guidance on defaults or unlawful acts and anti-money laundering is available in the Members' Handbook (icaew.com/membershandbook).

If you are in doubt about your ethical position, you may seek advice from the ICAEW's Advisory Services helpline. This is a free, confidential service to students and members free from the duty to report professional misconduct within ICAEW. You can contact the helpline by calling +44 (0)1908 248 025 or email your enquiry to ethics@icaew.com. Further information on the ethics helpline, including helpsheets and answers to frequently asked questions is available at icaew.com/ethics

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2.6.1 Professional Behaviour

Professional behaviour imposes an obligation on you to act at all times in a way that avoids discrediting the profession. This includes:

- complying with relevant laws and regulations;
- conducting yourself with courtesy and consideration towards all with whom you come into contact in a professional context; and
- behaving with integrity.

While the concept of professional behaviour is focused on your behaviour in the workplace, bear in mind that it's possible to discredit the profession through actions in your personal life, such as criminal behaviour. In such circumstances you could still face disciplinary action from your firm and ICAEW.

If in doubt always apply the newspaper test!

Real-life scenario

You receive a phone call from a journalist asking for your opinion on one of your ex-clients, a professional football club which has recently been placed into administration. The journalist is particularly keen for your views on the club's outspoken chairman who has just resigned in the wake of the administration.

While it may be possible to offer a personal opinion without breaching your professional accountant's duty of confidentiality, think how your other clients would feel if they saw their accountant giving their personal opinions to the press. Would you be happy to keep using a professional accountant's services if you knew that they could do the same thing to you in the future?

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2.7.1 Review

This module has covered the five fundamental ethical principles:

Professional competence; Integrity; Professional behaviour; Confidentiality; Objectivity. You may find the mnemonic **PIPCO** helpful to remember this.

This module is linked to section 100 of Part A of the ICAEW Code of Ethics.

The key learning points of this module are summarised below.

- Professional competence means that the professional accountant should never undertake to perform work that they are not able to perform competently.
- Integrity means that the professional accountant should be transparent and honest in everything that they do.
- Professional behaviour imposes an obligation on professional accountants to act at all times in a way that avoids discrediting the profession.
- The duty of confidentiality bounds professional accountants to not disclose information about clients to anyone outside of their immediate team. However there are some significant exceptions to this rule.
- Objectivity is a mind-set which relates to all considerations relevant to the task in hand but no other.

You have now reached the end of this module. Press the 'Exit' button to close this window.

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