Chapter 20
Ethical Issues During Engagement

Full chapter infographic: Part A (LO 1-2) and Part B (LO 3-13)

1 Part A: Fundamental principles of ethics

1 Integrity
- Truthfulness and fair dealing; straightforward and honest
- Do not associate with reports that omit required information, contain false or misleading statements, or are prepared recklessly
- If later aware, take steps to disassociate

2 Objectivity
- No bias, conflict of interest or undue influence on professional judgment
- Do not perform a service where a relationship may unduly influence judgment; do not compromise because of personal interest or pressure

3 Confidentiality
- Protect all information from professional or business relationships
- Do not disclose to third parties or use for personal advantage
- Applies to current, former and prospective clients, within the firm, social settings, staff and advisors

4 Competence, due care
- Maintain knowledge and skills per current laws and standards
- Act diligently; staff properly trained and supervised
- Make clients aware of limits of the services

5 Professional behavior
- Comply with all laws and regulations
- Avoid any action that discredits the profession
- Example: misleading tender (claiming best service, undercutting fees by 10%) is unethical

Confidentiality exceptions
- Client authorizes disclosure
- Law or court requires it (reporting non-compliance, evidence in legal proceedings)
- Professional right or duty: quality control review, regulator investigation, compliance with standards, protecting own interests in legal proceedings

Check before disclosing
- Could disclosure harm any party?
- Are all facts known and substantiated?
- Type of communication
- Intended recipients appropriate?

2 Conceptual framework approach

Step 1: Identify threats
- Identify and explain threats to compliance with the principles

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Step 2: Evaluate
- Evaluate significance of the threat (quantitative and qualitative factors); re-evaluate if new information arises

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Step 3: Apply safeguards
- Apply safeguards, eliminate the circumstances, or decline or end the engagement if no safeguard works

1 Self-interest
- Judgment influenced by personal or financial interest
- e.g. shares in the client

2 Familiarity
- Long or close relationship makes the accountant too sympathetic or accepting of the client's work

3 Self-review
- Evaluating work previously done by self or the firm
- e.g. reviewing tax services prepared for same client

4 Intimidation
- Deterred from acting objectively due to pressure or undue influence

5 Advocacy
- Promoting the client's position until objectivity is compromised

Skepticism and ethics
- Skepticism = questioning attitude to stay alert to misstatement, bias or misleading information
- Integrity: honesty and straightforwardness
- Objectivity: avoid bias or conflicts
- Competence and due care: apply knowledge, design suitable procedures, evaluate evidence carefully

Several threats at once
- Example: audit fee is 40% of partner's fees: self-interest and intimidation, possibly self-review
- Remember the scenario exam pattern: name threat, name principle, give safeguard

Part B: Application of ethics

3 Financial interests

Threats	Affected principle	Factors to evaluate	Safeguards
• Self-interest: audit team member or relative holds shares in the audit client	• Objectivity: may not remain impartial if wealth depends on the client	• Role of the individual • Relationship • Materiality	• Notify the firm • Dispose of the interest • Remove from the audit team • Independent review

4 Loans and guarantees

Threats	Affected principle	Safeguards
• Self-interest: financial dependence between auditor and client	• Objectivity: may hesitate to report issues that could harm repayment	• Loan from client that is a bank: immaterial none; material, normal terms plus reviewer • Loan from client that is not a bank: immaterial none; material, repay loan, remove member or withdraw • Loan to client: immaterial none; material, cannot be given

5 Family and personal relationships

Threats	Affected principle	Factors to evaluate	Safeguards
• Familiarity: reduced skepticism • Self-interest: shared financial interest • Intimidation: pressure to protect personal ties	• Objectivity: may overlook misstatements to protect personal ties	• Closeness of relationship • Client's position • Audit member's role	• Restructure responsibilities • Independent reviewer • Remove the individual

6 Long association of personnel

Threats	Affected principle	Factors to evaluate	Safeguards
• Familiarity: close ties reduce skepticism • Self-interest: job security, firm dependence on client	• Objectivity: may hesitate to challenge the client	• Length of time • Role of the individual • Closeness with management	• Rotate personnel with a cooling-off period • Restructure responsibilities • Independent reviewer • Independent quality control review (QCR)

7 Inducements (gifts and hospitality)

Threats	Affected principle	Safeguards
• Self-interest: favoring clients to retain benefits • Familiarity: close ties reduce skepticism • Intimidation: pressure, fear of exposure of accepted benefits • Inducements = gifts, hospitality, entertainment, donations, appeals to loyalty, preferential treatment	• Objectivity: independence lost to bias or pressure • Integrity: accepting undue benefits compromises honesty	• Do not accept significant inducements • Disclose and document all offers • If accepted: return or reimburse, remove individual from team, appoint independent reviewer

8 Employment with audit client

Client to firm
- Self-interest: future employment or financial ties
- Self-review: auditing own past work
- Familiarity: close ties with former colleagues
- Factors: position held, role on team, time since leaving
- Safeguards: exclude individual if served in audit period; if service was earlier, restructure and use independent reviewer

Firm to client
- Self-interest, familiarity, intimidation
- Principles: objectivity; confidentiality of prior clients
- Factors: current client position, former firm position, time since leaving, involvement in audit team
- Safeguards: no significant ongoing ties; modify audit plan; experienced staff; extra review

Negotiations, loaned staff
- Team member considering joining client: self-interest. Safeguards: disclose intention, remove member, appoint reviewer
- Loaned staff to client: self-review, advocacy, familiarity; competence risk. Safeguards: short-term, client supervises, no management role, exclude from audit team, independent review of their work

9 Audit fees

1 Lower fee
- Self-interest; undercutting is unethical
- Principles: competence and due care; professional behavior
- Fee lower only if scope or workload is significantly different
- Safeguards: adjust fee or scope; independent reviewer

2 Overdue: initial
- Confirm predecessor auditor's fee is paid before accepting

3 Overdue: recurring
- Large unpaid fees before next report: self-interest; may avoid reporting misstatements
- Safeguards: collect payment before report; independent reviewer; if long overdue, assess whether balance is like a loan and decide on continuing

4 Contingent fees
- Depend on outcome (profits, opinion, tax savings)
- Strong self-interest; no safeguard works
- Prohibited for all assurance engagements and non-assurance services to audit clients
- Court or regulator-set fee is not contingent

5 Referral fees
- Self-interest
- Safeguards: disclose the arrangement to the client; obtain prior client agreement

10 Purchase of goods and services and business relationships

Purchases from client
- Self-interest if auditor or relative buys from the client
- Objectivity: decisions may favor the client
- Factors: arm's length? tendering? favors accepted? significance?
- Safeguards: reduce or eliminate transaction, or remove auditor from team

Business relationships
- Self-interest: bias to keep financial ties
- Intimidation: fear of harming business relationship
- Principles: objectivity; professional behavior
- Safeguards: insignificant none; significant: reduce relationship, remove individual, or withdraw

11 Actual or threatened litigation with audit client

Threats	Affected principle	Factors to evaluate	Safeguards
• Self-interest: firm financially affected by the outcome • Intimidation: legal pressure or management coercion	• Objectivity: fear of legal consequences affects impartiality	• Materiality of litigation • Does it relate to a past audit engagement?	• Remove affected auditor or decline the engagement • Independent reviewer

12 Provision of non-assurance services to an audit client

Core issue
- Self-review threat if the auditor later audits the same work
- Objectivity principle affected

Accounting and bookkeeping
- Listed clients and public interest entities: prohibited
- Unlisted clients: routine or mechanical services allowed (recording approved transactions, posting, preparing F/S from approved records)
- Safeguards: separate staff; independent reviewer

Tax services
- Preparing or reviewing tax returns: no significant threat
- Tax calculations for accounts: self-review, especially if material or listed client
- Assisting in tax disputes: self-review and advocacy
- Safeguards: separate staff; independent reviewer

13 Compensation and evaluation policies

Threats	Affected principle	Safeguards
• Self-interest: staff rewarded for selling non-assurance services to audit clients may put sales over audit quality	• Objectivity: decisions may favor sales over independence	• Revise the compensation policy • Remove the individual from the audit team