Institute of Business Ethics

Is the IESBA Code of Ethics sufficient to help solve ethical dilemmas facing the accounting profession?

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Introduction

The most recent Code of Ethics for Professional Accountants published in 2018 jointly by the IFAC and IESBA was updated from its previous version in order to help mitigate the current ethical predicaments accounting professionals face. The aim of this study is to critically analyse the revised Code's capacity to solve these recurring dilemmas. To begin, a brief look into the ethical dilemmas facing the accounting profession will be shown with case examples appearing throughout the essay. Following this will be the main discussion of changes to the 2018 Code of Ethics from its previous version in 2016, analysing what implications these alterations have for the Code's capacity to mitigate the occurrence of ethical issues.

Historically, accounting has been viewed solely as a 'bean-counting' profession (Beard 1994). This put other important areas of the traditional line of work in the dark, paving the way for a few notable cases of immoral action involving Enron (The Economist 2002), WorldCom (Beltran 2002), Tesco (Cox 2017), and Tyco (BBC 2003). These events emphasise that the accounting profession has an important role to play in both quantitative and qualitative terms (Fleischman and Funnell 2007), further stressing the necessity of a reliable Code of Ethics for the Professional Accountants.

Ethical dilemmas

Professional accountants face a number of key professional dilemmas: corruption and bribery; misrepresentation of financial statements; conflict of interest; and tax avoidance and evasion. These events occur all over the world and according to the Corruption Perception Index (Transparency International 2019) the top 3 most corrupt countries were Somalia, South Sudan, and Syria. Although most cases of unethical behaviour will go unnoticed or unreported, those that do reach the headlines, as seen in Appendix B of this essay, involve placing some blame on the related accounting and auditing firms. Allegations have been made about not carrying out sufficient checks, covering up bribery allegations, and not adhering to independence principles (Appendix B).

The IESBA 2018 Code of Ethics: analysis of new and updated sections

The updated Code of Ethics has several noticeable changes from its previous counterparts, including a change of name from 'Handbook of the Code of Ethics for Professional Accountants' (IESBA 2016) to 'Handbook of the International Code of Ethics for Professional Accountants (including International Independence Standards)' (IESBA 2018a). Supporting the new Code of Ethics is the addition of a new web-based tool which involves interactive features covering the full Code (IESBA 2019). Accessible to a wide variety of users and free to use, the digital code has colour-coded sections to differentiate between various sections with hyperlinks attached to interlink related components thus allowing all applicable information to be considered together (Pieters 2019). Below will begin the discussion of changes made to the revised Code of Ethics followed by general points to consider when analysing the Code as a whole.

NOCLAR – Non-Compliance with Laws and Regulations

NOCLAR has been an ongoing project of the IESBA which came into effect in July 2017 (IAASB 2016). The standard considers laws and regulations which directly impact on material figures in financial statements and those which are central to 'the operating aspects of the client's business, to its ability to continue its business or to avoid material penalties' (IESBA 2018a). The areas under the scope of NOCLAR are:

- Fraud, corruption, and bribery
- Money laundering, terrorist financing, and proceeds of crime
- Securities markets and trading
- Banking and other financial products and services
- Data protection
- Tax and pension liabilities and payments
- Environmental protection
- Public health and safety

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This new global standard provides increased emphasis on the professional accountant's duty to act in the public interest and not just in the interest of themselves or those they work for. If professional accountants suspect or are knowledgeable of person(s) not complying with laws and regulations in place then this structure assists them in what steps they should be taking, found in Section 260 of the Code (IESBA 2018a). Whistleblowing has been a crucial part of uncovering accounting scandals in the past and after notable cases in the US the Sarbanes-Oxley (SOX) Act in 2002 was passed to give greater protection to corporate whistleblowers (Lee and Xiao 2018). In spite of these levels of safeguards for those unearthing the misconduct, people have been reluctant to disclose their findings or suspicions due to the risk and distress of reporting (Kaplan and Whitecotton 2001) but also the repercussions their organisation may inflict on them such as job termination (Hedin and Månsson 2012). Consequently, this NOCLAR standard in the updated IESBA Code of Ethics may lead to increased accountability in the professional accountant's line of work (Lee, Pittroff, and Turner 2018) but also may encourage whistle-blowers to speak up without fear of going against one of the fundamental principles, 'confidentiality' (Anonymous 2019).

Inducements

A framework has been provided to guide both professional accountants in business (PAIBs) and those in public practice (PAPPs) on 'inducements' together with an updated definition of the term itself. There are a variety of inducements under the scope of this provision including gifts, hospitality, and political or charitable donations, amongst others (IESBA 2018a). There is a limit to what inducements are allowed to be offered and accepted, along with a new test to establish 'intent' which "prohibits offering or accepting of inducements where there is actual or perceived intent to improperly influence behaviour of recipient or of another individual" (IESBA 2018a). The guidance given to accountants who become aware of an offered inducement that meets the "intent" level include, but are not limited to, terminating the business relationship with the offeror, declining the offer or reimbursing the cost of the inducement received (IESBA 2018a). Although categorising inducements may be difficult, depending on a case by case basis, the IESBA Code of Ethics has included a sturdy basis of guidance. By supplying a list of factors to consider when measuring the level of intent and numerous examples of suggested actions to address threats against fundamental principles, it makes it harder for professionals to conduct unethical behaviour mistakenly or actively.

Independence

The subject of 'independence' is not new but has now been given its own separable section named 'International Independence Standards' forming part 4 of the Code. Applying to all types of Non-Assurance Services (NAS) to audit clients is the overarching prohibition of taking on management responsibilities but there are also detailed prohibitions included. In part 4a guidance is included for recruiting services that come under NAS when engaged with an audit client. Previously, certain prohibitions on providing recruitment services to audit clients were only placed on Public Interest Entities (PIEs), such as listed companies, credit institutions, insurance companies, and pension funds (IESBA 2006). In the updated code these recruitment prohibitions, "searching for or seeking out candidates" and "undertaking reference checks of prospective clients", now apply to all audit clients and not just those in the PIE category (IESBA 2018a). This allows for a more unified guidance on when NAS should not be provided to audit clients, to reduce threats to 'independence'. In part 4b the partner rotation regime for audits of PIEs has also been updated to lengthen the "cooling-off" period required during audit engagements. Previously, a key audit partner would have to wait a mandatory two years before returning to that arrangement but now they must wait five years if they are engagement partners and three years if they are an Engagement Quality Control Reviewer (ECQ) (IESBA 2018a). Introducing these enhanced obligations is not surprising as long partnerships formed with audit parties has been shown to be a central part of the problem in several past ethical scandals, such as the KPMG and Carillion case (2018). When Carillion collapsed after several profit warnings, it came to light that KPMG, who had audited the construction company for over eighteen years, had signed off on largely optimistic profit and revenue forecasts (Jolly 2019). Potentially this strengthened provision may prevent loyalty coming before ethical duty when parties find themselves in conflicting situations (Sonnerfeldt and Loft 2018). However, there are still some issues identified by stakeholders in response to the release of the current Code.

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Questions were immediately raised by stakeholders once the Code was released in 2018 on provisions related to NAS and auditor independence (IESBA 2018b). The independence of auditors is essential to maintain public trust in their work and relates directly to one of the fundamental principles, 'Independence'. The central question is whether an auditor can perform both audit and NAS simultaneously for the same company without threatening this fundamental principle (IESBA 2018b). Although improvements were made to the Code of Ethics, scandals continued to occur and it was seen that firms such as BHS (Morrison 2018), Carillion (Wearden 2018), and Thomas Cook (BBC 2019) collapsed and their auditors were also heavily scrutinised. As a result, the Financial Reporting Council (FRC) ultimately prohibited audit firms from conducting a number of advisory services to "listed companies and financial institutions" to try to improve auditor independence. Accounting firms were also prohibited by the FRC from conducting "recruitment and remuneration services and due diligence, tax advice, advocacy and acting in any management role" from the PIEs they provide auditing services to (Kinder 2019). Following in the FRC's footsteps and taking on board the comments of concern from stakeholders, the IESBA has updated their proposed changes to NAS provisions this year. Updates include clearer guidance on the relevance of the "materiality" concept when applying NAS provisions. However, for audit clients that are PIEs, firms and network firms will no longer be allowed to provide NAS to audit clients solely on the grounds that the "outcome or the result of the NAS will not be material to the financial statements" (IESBA 2020). This has added fuel to the debate on whether the Big Four accountancy firms should break up their consultancy and auditing services to increase independence and create greater transparency, despite greater restrictions already being placed on their line of work (Kleinman 2020).

Enhanced Conceptual Framework and structure

The updated framework now involves a 3-stage process of identifying, evaluating, and addressing threats to compliance with the fundamental principles (IESBA 2018a). Emphasis is now placed on how to address threats which are to: "eliminate circumstances, interest or relationships creating the threat; apply safeguards, where available and capable of being applied, to reduce the threats to an acceptable level; or declining or ending the specific professional activity or service". Additionally, there are revised definitions of Reasonable and Informed Third Parties test (RITP), which is the test to determine an "acceptable level" of threat from the view of an outside party, and "safeguards" which are then put in place to try rid of those threats identified (IESBA 2018a).

Figure 1: Structure of the 2018 Code of Ethics (IESBA 2018a)

A completely new structure has been adopted for the current Code as shown in Figure 1 and clear distinctions have been made between 'requirements' and 'application material' which was not available before (IESBA 2018a). Those labelled as 'requirements' have the letter 'R' as the first digit in reference, e.g. R510.4, and are

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specific rules that the professional accountant must follow to adhere to the specific fundamental principles. Whereas those labelled as 'application material' contain the letter 'A' in their reference, e.g. 510.4A1, and allows for context and additional guidance (see Appendix A). These distinctions are provided across all areas of the Code which will assist regulators and professional accountants to identify what is compulsory and provide illustrations to contextualise situations in order to improve compliance with ethical conduct. If a user of the Code comes across a certain section that may seem confusing or requires further clarification, for example identifying inducements, then the application material provided will allow them to pinpoint similarities to their situation. In particular, IESBA has made clear who are the persons responsible for particular scenarios, which was not always apparent in previous versions, thus assigning obligation and improving accountability (Sonnerfeldt and Loft 2018).

Other Issues

Not all professional accountants will follow the IESBA Code of Ethics precisely line for line because one size does not fit all when talking about the needs and requirements of businesses and individuals. As an example, the ICAEW have comprised their code of ethics to include the IESBA version as a base framework with additions of their own because they believe the revised Code is insufficient for certain areas (ICAEW 2020). Having variations in codes of ethics will diminish the harmonisation of practice by all professional accountants and may cause confusion potentially allowing ethical problems to slip through without being robustly checked. Also, the IESBA Code of Ethics currently in use is translated into 39 different languages (IESBA 2018a) to accommodate all those who choose to use it worldwide. This has the obvious benefit of seeing to individual users' need. However, definitions can be difficult to translate, especially if there is no exact equivalent (Evans 2004). This may cause, albeit sometimes small, an element of confusion when interpreting the Code of Ethics, especially for global businesses that have establishments in multiple countries. Although one harmonious code of ethics would be easy to implement, there is difficulty in balancing the needs of all aspects of the accounting profession due to religious and cultural differences, developed and developing countries, and differentiating between PAPPs and PAIBs.

The Code of Ethics for Professional Accountants can continue to be adapted and corrected to improve ethical behaviour, but there will always be the element of human behaviour which is impossible to eliminate. Self-interest, an identified threat to fundamental principles in the code, is apparent in a recent case where a former chief executive of Wirecard was arrested due to suspected balance sheet inflation and revenue to give the appearance that the firm was performing better than it actually was (Sky News 2020). During times of pressure those in professional accounting may relax their ethical conduct in order to remain loyal to their clients and employers, usually through 'creative accounting' means. In times of financial distress, for example the recession we now face globally due to repercussions of Covid-19, there will be a greater fight for economic survival across all sectors and companies will be feeling the financial pressure. Studies have also shown that codes of conduct do not always have a positive effect on ethical behaviour (Peterson 2002; Trevino, Weaver and Reynolds 2006), highlighting that individual values do occasionally take precedence over professional values, which is a significant part of the ethical misconduct dilemma. Having a strong ethical leadership to follow increases the likelihood of employees carrying out ethical business (Arel, Beaudoin and Cianci 2011)

Conclusion

In summary, while the Code of Ethics has some emancipatory insights in preventing or solving ethical dilemmas to some extent, this may not lead to a greater improvement in eliminating unethical practices. The addition of the NOCLAR standard along with clearer provisions relating to 'inducements', 'independence' and in particular 'NAS' have given professional accountants more in-depth information to consult during ethical practice. However, there are a number of weaknesses to take note of. There is still the issue of whether NAS provided to audit clients should be permitted altogether as accounting and auditing scandals continue to surface, causing rifts between the accounting and political communities. Ultimately, the Code of Ethics can only go so far in preventing ethical

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misconduct and at the end of the day the issue comes down to a person's decisions. There is also a fundamental problem of a one-size-fits-all approach and difficulty in managing unethical human behaviour.

The unprecedented current Coronavirus pandemic will impact all areas of business, including the accounting profession, but it is unknown exactly what this impact will be. What we do know is that due to the UK being largely dominated by service industries we have already seen several firms forced to close, cut jobs or drastically change the way they do business. The furlough scheme created by the government to help diminish unemployment has already come under fire with over three thousand allegations of furlough fraud being reported since April (Mahy and Warhurst 2020). Going concern will also be an area of focus for professional accountants and auditors as companies will be seeking ways of staying afloat to the next financial year, and some may use 'creative accounting' to fulfil this. The Code of Ethics for Professional Accountants has never been more important and will be under intense scrutiny in the aftermath of the wreckage the Covid-19 virus leaves behind.

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Appendix A

Requirement	*Application*
R510.4. Subject to paragraph R510.5, a direct financial interest or a material indirect financial interest in the audit client shall not be held by: **a)** ***The firm or a network firm;*** **b)** ***An audit team member, or any of that individual's immediate family;*** **c)** ***Any other partner in the office in which an engagement partner practices in connection with the audit engagement, or any of that other partner's immediate family; or*** **d)** ***Any other partner or managerial employee who provides non-audit services to the audit client, except for any whose involvement is minimal, or any of that individual's immediate family***	*510.4A1 The office in which the engagement partner practices in connection with an audit engagement is not necessarily the office to which that partner is assigned. When the engagement partner is located in a different office from that of the other audit team members, professional judgement Is needed to determine the office in which the partner practices in connection with the engagement*

Figure 2: Illustration of "Requirement" and "Application Material" (IESBA 2018a)

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Appendix B

Key Professional Dilemmas	Examples
Corruption and bribery	• Isabel Dos Santos and PwC (2017) She made her wealth by exploiting her country and making corrupt deals. A number of suspicious payments were approved by her to companies that she had a shared interest in. PwC under criminal investigation due to conflict of interest concerns during their time as auditor (BBC Panorama 2020). • Rolls Royce & KPMG (2017) KPMG investigated after Rolls Royce admitted to several corruption and bribery violations. KPMG audits of Rolls Royce between 2010 -2013 were under scrutiny (Jolly 2019). • EY & Kaloti (2020) EY made to pay compensation to a former partner in audit, Rihan. This was in relation to whistleblowing claims by Rihan of a suspected client (Kaloti) involved in money laundering and smuggling gold. The High Court found that EY had breached its professional duties when performing audit of the said client (BBC 2020). • KPMG & Gupta (2015) KPMG continued to audit Gupta accounts despite concerns over illegal financial transfers and campaign funding (Smith 2019).
Misrepresentation of financial statements	• Patisserie Valerie & Grant Thornton (2018) Suspected £40m fraud involved finance employees and a supplier to create false invoices. Serious Fraud Office investigating after Patisserie Valerie collapsed including the work provided by Grant Thornton, the auditor (Ahmed 2019). • Carillion & KPMG (2018) Carillion collapsed after a series of issued profit warnings. KPMG had been auditor of the firm since 1999. The construction company had declared revenue and profits largely on optimistic forecasts before the money was made which KPMG had signed off on (Jolly 2019). • BT & PwC (2017) BT Italian subsidiary found misstated profits by over £500m . FRC investigating the work carried out by PwC in its role as auditor (Jolly 2019).
Conflict of interest	• Deloitte & Comet (2019) ICAEW found that Deloitte and 2 ex-partners did not carry out sufficient checks to make sure that Deloitte's past work with Comet's owners would not form a conflict of interest with their current administrator role (Kinder 2020). • Sports Direct & Grant Thornton (2019) Sports Direct made a deal with Barlin Delivery (owned by the brother of Sports Direct's founder and controlling shareholder). Grant Thornton was auditor at the time (Jolly 2019). • Ted Baker & KPMG (2013/2014) KPMG provided services as an expert witness for Ted Baker during a court claim while acting as an auditor (Martin and Ralph 2018).
Tax avoidance/evasion	• Paradise Papers 'The Big Four' found to have helped individuals and companies in tax avoidance/evasion schemes. Deloitte and PwC assisted Blackstone with

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	investments in UK real estate, apparently to avoid paying stamp duty tax (Marriage 2017). • Golden Passport Schemes OECD published a blacklist which included 21 countries that threaten the combined effort to fight against tax evasion through 'golden passport' schemes. Foreign nationals can gain citizenship in countries they have never lived in through investments in property, government bonds or donations to sovereign trust funds. In some cases this can allow individuals to pay tax in lower taxed countries (Garside 2018).

Table 1: Ongoing ethical dilemmas

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