

# Ethical Basis of Audit Practice and Accountability of Auditors

Ethics and Audit Workshop

Melbourne

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*Channa Wijesinghe*  
ACMA(UK), CPA, CA  
Technical Director  
APESB

APESB   
Accounting Professional & Ethical Standards Board

# Overview

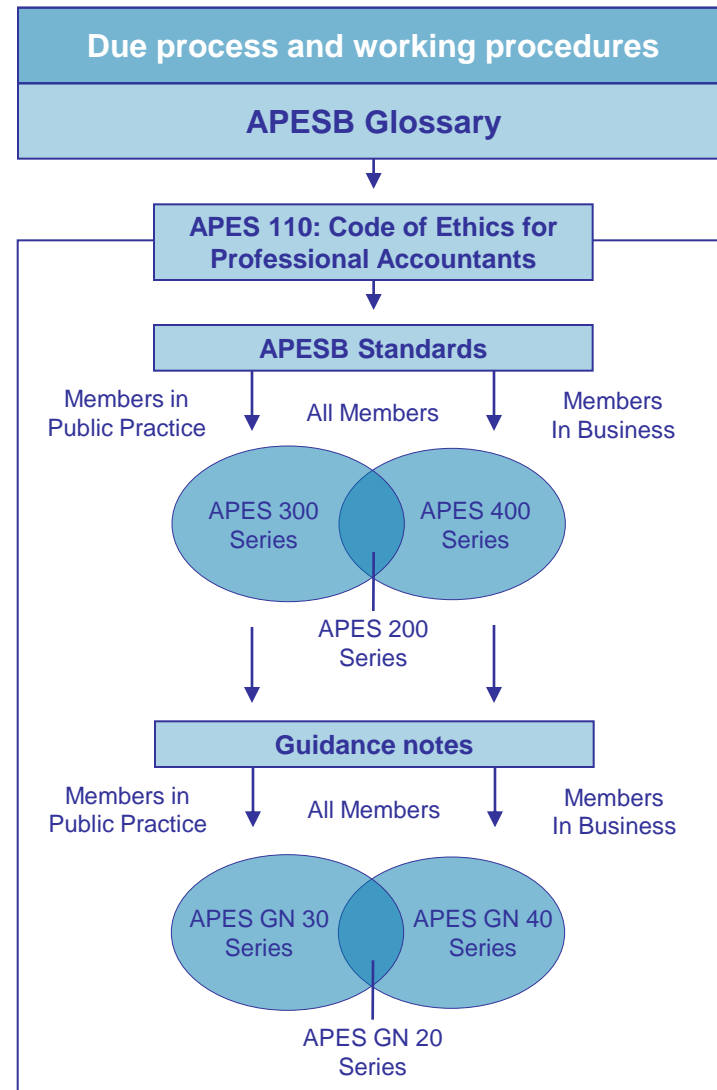
- **APESB and its pronouncements**
- **Issued Standards that impact on Auditors**
- **APES 110 – Code of Ethics**
- **Section 290 – Independence**
- **Accountability of Auditors**

# APESB History

- **Established in February 2006 as an initiative of ICAA & CPA Australia**
- **NIA became a Member in December 2006**
- **Previously professional and ethical pronouncements were developed by the professional bodies**
- **Members of the three bodies are required to comply and subject to disciplinary procedures of the relevant professional body**

# Structure of APESB pronouncements

- **Conceptual Framework**
  - Principles based
  - Mandatory for professional accountants
  
- **Standard**
  - Introduces principles
  - Mandatory requirements in black letter
  - Guidance and/or explanation in grey letter
  
- **Guidance notes**
  - Do not introduce new principles
  - Guidance on a specific matter on which the Principles are already stated in a Standard
  - Guidance is only in grey letter



# APESB Pronouncements to date

## All members

- APES 110 Code of Ethics
- APES 205 Conformity with Accounting Standards
- APES 210 Conformity with Auditing Standards
- APES 215 Forensic Accounting Services
- APES 220 Taxation Services
- APES 225 Valuation Services

# APESB Pronouncements to date

## Members in Public Practice

- APES 305 Terms of Engagement
- APES 315 Compilation of Financial Information
- APES 320 Quality Control for Firms
- APES 330 ED Insolvency Services
- APES 345 Reporting on Prospective Financial Information

# Standards issued by APESB that primarily impact Auditors

- APES 110 – Code of Ethics
- APES 320 – Quality Control for Firms
- APES 210 – Conformity with Auditing and Assurance Standards

# APES 110 Code of Ethics

- **Part A: General Application**
- **Part B: Members in Public Practice**
- **Part C: Members in Business**



# APES 110 Code of Ethics

## Part A: General Application

- Fundamental Principles
  - Integrity
  - Objectivity
  - Professional competence and due care
  - Confidentiality
  - Professional behaviour

# APES 110 Code of Ethics

## Part B: Members in Public Practice

- Section 210 – Professional Appointment
- Section 220 – Conflicts of Interest
- Section 230 – Second opinions
- Section 240 – Fees and Other Types of Remuneration
- Section 250 – Marketing Professional Services
- Section 260 – Gifts and Hospitality
- Section 270 – Custody of Client Assets
- Section 280 – Objectivity All Services
- Section 290 – Independence Assurance Engagements

# APES 110 Code of Ethics

## Part C: Members in Business

- Section 300 – Introduction
- Section 310 – Potential conflicts
- Section 320 – Preparation and Reporting of Information
- Section 330 – Acting with Sufficient Expertise
- Section 340 – Financial Interests
- Section 350 – Inducements

# Section 290 Independence

- **Independence requires:**
  - Independence of Mind
  - Independence of Appearance

(S. 290.8 and definitions)

# Section 290 Independence

- **Threats to Independence:**
  - Self interest threat
  - Self review threat
  - Advocacy threat
  - Familiarity threat
  - Intimidation threat

(S. 290.28 to 290.28.9)

# Section 290 Independence

- **Safeguards**
  - created by the profession, legislation or regulation
  - within the Assurance client
  - within the firms own systems and procedures

(S. 290.28.10 to 290.29)

# Section 290 Independence

- **Auditor's responsibility**
  - Identify threats to independence
  - Evaluate whether these threats are clearly insignificant
  - If not identify and apply appropriate safeguards
- **When safeguards are not available**
  - Eliminate activity or interest creating the threat
  - Refuse to accept or continue the Assurance Engagement

# Future developments that impact the Code

- **International**
  - Revised Code in March/April 2009
  - Impact of clarity project (Should/Shall)
- **Australian**
  - Taskforce working on revised Code



# Accountability of Members

- Regulators such as ASIC and APRA
- Professional bodies
- Clients
- Shareholders

# Why accounting ethics matter?

- Collapse of Arthur Anderson
- Arthur Anderson's problem clients (refer table 1)
- Increased regulations such as CLERP 9 in Australia and Sarbanes & Oxley in the US
- Recent corporate collapses brought on by the global credit crunch (refer table 2)

# Table 1: Arthur Anderson's Audit Clients and their problems

AA Client	Problem	Losses to shareholders	Job losses
WorldCom	US \$ 4.3 billion overstatement of earnings	\$ 179.3 billion	17,000
Enron	Inflation of income, assets, bankrupt 2001	\$ 66.4 billion	6,100
Waste Management	Overstatement of income by US \$ 1.1 billion, (1992 -96)	\$ 20.5 billion	11,000
Sunbeam	Overstatement of 1997 income by US \$ 71 million then bankruptcy	\$ 4.4 billion	1,700

Source: "Fall from grace," *Business Week*, 2002

# Table 2: Recent Corporate collapses due to the Global Credit Crunch

Company	Problems	Business/Social impact
Lehman Brothers	<ul style="list-style-type: none"> <li>- Derivatives :- MBS and ABS</li> <li>- Downgrading of credit ratings</li> <li>- Toxic commercial real estate assets</li> <li>- High leverage ratios</li> </ul>	<ul style="list-style-type: none"> <li>- Majority of the 26,000 worldwide staff may be made redundant?</li> </ul>
Bear Stearns	<ul style="list-style-type: none"> <li>- Derivatives :- MBS and ABS</li> <li>- High leverage ratios</li> <li>- Unrealistic fair value accounting of assets</li> </ul>	<ul style="list-style-type: none"> <li>- Approximately 9,000 employees lost their jobs</li> <li>- Shareholder lawsuits?</li> </ul>
ABC Learning	<ul style="list-style-type: none"> <li>- Revenue recognition</li> <li>- Gearing</li> <li>- Weak corporate governance</li> </ul>	<ul style="list-style-type: none"> <li>- 241 unprofitable day care sites for sale</li> <li>- Unemployment</li> <li>- Child care services at risk?</li> </ul>
Opes Prime	<ul style="list-style-type: none"> <li>- Cash and share movement irregularities</li> <li>- Failed margin calls</li> </ul>	<ul style="list-style-type: none"> <li>- Losses of AUD 600 million?</li> </ul>

Source: [www.google.com](http://www.google.com)

# The Seven Signs of Ethical Collapse

1. Pressure to maintain those numbers
2. Fear and silence
3. Young 'uns and a bigger than life CEO
4. Weak Board
5. Conflicts
6. Innovation like no other
7. Goodness in some areas atoning for evil in others

**Jennings, M M 2006**, *The seven signs of ethical collapse: how to spot moral meltdown in companies .....before it's too late*

For more information visit:

[www.apesb.org.au](http://www.apesb.org.au)

**Contact:**

**Channa Wijesinghe**

**Technical Director**

**APESB**

**Tel: 03 96424372**

**Email: [channa.wijesinghe@apesb.org.au](mailto:channa.wijesinghe@apesb.org.au)**

