Shades of Grey
Ethical Dilemmas
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*It should be noted that the members of the Committee were acting in their personal capacity and were not representing the organisations for which they work.*
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Foreword

In May 2008, the Institute published a research monograph by the late David Molyneaux, entitled “What do you do now? Ethical Issues Encountered by Chartered Accountants”, which featured a series of 28 ethical dilemmas faced by chartered accountants. The foreword of that publication commenced with:

“Ethics and integrity lie at the heart of the qualities expected of chartered accountants”.

That message has been at the heart of the Institute of Chartered Accountants of Scotland since its founding by Royal Charter in 1854 and indeed the current ICAS strategy “Clearly Ahead” encapsulates that ethics and integrity must always be at the forefront of how chartered accountants behave in their professional roles.

The launch of David’s research monograph was attended by Richard George, the Chairman of the International Ethics Standards Board for Accountants (IESBA), and the publication was very well received around the world. Material from the publication has been used in many places and David personally used it whilst working on an international project for ICAS in Vietnam.

Indeed, such was the level of positive feedback received that David decided to undertake a follow up publication which would focus more specifically on the ethical dilemmas faced by chartered accountants in business. Sadly, David fell ill before he could commence this project and following a brave battle against his illness passed away in April this year.

In recognition of the work done by David, the Ethics Committee decided to undertake this project to produce a further series of case studies to try and illustrate the practical application of the principles contained in the ICAS Code of Ethics. David was a great promoter of the need for accountants to display ethical courage in their actions. Recent events have vindicated that view. It is essential that professional accountants and others in business are able to display ethical courage.

The case studies are specifically designed to raise discussion amongst members and to hopefully further embed ethical values and thinking into the day to day work of chartered accountants. They are also valid for senior people in business or in the public eye. As such, we will be making all the case studies available on the ICAS website. Values in themselves are nothing unless they are adhered to in practice. This might sometimes result in a chartered accountant having to follow a course of action that is difficult, but the easy option is rarely the most appropriate.

The case studies work best when they are used by a group of members to discuss the dilemmas faced. Some of the scenarios may appear more black and white than others but the dilemmas are intended to cover a wide range of situations that might be faced by chartered accountants in business or in practice. In line with requests received, the majority of the case studies cover dilemmas likely to be faced by members in business although the scenarios in my view are relevant to all members and students. The dilemmas used are mostly based on real-life scenarios faced by members although some scenarios have been specifically written for the purpose of this publication. In either case, the aim is to try and bring ‘ethics to life’ and illustrate that members are exposed to such dilemmas far more that most members probably thought.
The Ethics Committee would like to express its thanks to those who have been involved in this project and, in particular, the CAs in Business Committee, which reviewed the case studies and provided valuable feedback. The Ethics Committee is also keen to receive feedback on this publication from the wider membership and beyond.

The section headed “scenario analysis” for each case study is not intended to give definitive solutions to the dilemmas posed but merely to illustrate the main points that should be considered. The possibility also exists that the reader may well have other points which are not covered in the analysis. Whatever, the aim is to try and bring ‘ethics to life’ by means of scenarios that members may face at some stage in their careers.

Members are also reminded that they can contact the Institute to discuss ethical dilemmas that they may face. Members should contact the Legal Services team at ICAS on 0131 347 0271.

The Committee is also keen to hear from members who have an interest in ethical matters.

Members who would like to be considered for membership of the Ethics Committee should contact James E Barbour, Director, Technical Policy, ICAS, who acts as secretary to the Committee (jbarbour@icas.org.uk).

Finally, but most importantly, the Ethics Committee would like to dedicate this publication to David Molyneaux. David inspired the Committee to undertake this piece of work and was a tremendous asset to the Institute. His much valued contribution is sorely missed.

We trust that those who read this publication will display the same strength of integrity and professional courage displayed by David during his career.

*Ian Paterson Brown – Convener to the ICAS Ethics Committee.*

December 2009
Introduction

The rationale of this project was to follow up the work of the late David Molyneaux’s research report entitled “What do you do now? Ethical Issues Encountered by Chartered Accountants” which featured a series of 28 ethical dilemmas faced by chartered accountants, published in May 2008. The success of that document led to a demand for additional case studies particularly from chartered accountants working in industry. The majority of the new case studies are therefore designed to meet that demand. The dilemmas featured are largely based on real-life ethical issues encountered by chartered accountants, although some scenarios have been specifically written for the purpose of this publication.

The commentaries which follow each scenario should not be viewed as solutions but rather as a means of drawing out the main issues and identifying ways in which these might be addressed. Unlike David Molyneaux’s publication, this project although subject to proper due process, has not been subject to the rigours of the ICAS Research department’s review process.

The same style as used in David’s publication has been adopted. Each scenario is focused on ‘you’ and at the end of each scenario the requirement is for ‘you’ the reader, to make a decision and do something – although a valid option may be for ‘you’ to decide, consciously to do nothing. The purpose of this approach is to deliberately push readers to engage. Your opinions matter; the problem has been made yours, not someone else’s. This approach is adopted to try and reinforce the importance of such issues and the need for the respective individual to carefully analyse the dilemma that they are faced with.

Regulations

Emphasis throughout this publication is given to ‘principles’ and significantly less to citing ‘regulations’. This is not to diminish the importance of specific requirements, such as The Terrorism Act 2006, the Proceeds of Crime Act 2002, the Money Laundering Regulations 2007 or the Serious Organised Crime and Police Act 2005 that might impact on readers working in the UK. Clearly, in considering the relationship of law and ethics a significant feature is the fact that the principle of ‘confidentiality’ is not always sacrosanct but subject to modification in some statutorily-determined circumstances. Hence the legislation has specific obligations such as the need to send ‘suspicious activity reports’ to a national criminal intelligence service (currently for the UK the Serious Organised Crime Agency), whilst taking care to avoid ‘tipping off’. Members need to be aware of any statutory or other respective reporting responsibilities that they are subject to.

Fundamental Principles

In analysing each of the scenarios, core consideration has been given to the five fundamental principles set out in the ICAS Code of Ethics, adopted in November 2006 (Part D – Insolvency Practitioners – updated in January 2009), which follows closely the IFAC Code of Ethics that serves as the model on which national ethical guidance is based. Reference has not been made to the ethical pronouncements
of other specific bodies such as, for example, the Ethical Standards for Auditors issued by the UK Auditing Practices Board. By adopting a highest level, principles-only, approach the emphasis is on the global and enduring nature of the issues that arise for individuals’ experiences.

**Institute Assistance**

Although not referred to in any of the scenarios, one option that is always available when a member is faced with an ethical dilemma is to contact the Institute to discuss the matter on a confidential basis. Members with any such queries should contact the Legal Services team at ICAS on 0131 347 0271. Members are also reminded to be aware that their actions will reflect on how the Institute is perceived by the world at large.

**Ethics Matters**

This publication is the latest in a series of ethics publications that ICAS has issued in recent years. The overriding objective of this publication as with the others is to ensure that chartered accountants and others in business are aware of the importance of behaving ethically.

1 To follow the style and re-emphasise the key messages of David Molyneaux’s research publication, “What do you do now? Ethical Issues Encountered by Chartered Accountants” published by ICAS in 2008, the wording in the above sections has largely been reproduced from this 2008 report.
## 1. Scenarios at a glance

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2. The Case Study Scenarios

**Scenario 1: The creeping FD**

You are the Financial Controller in a manufacturing business, Sundance & Cassidy Ltd, which like many businesses in the UK is beginning to feel the impact of the credit crunch. The business is a large private company with 270 employees and has a turnover of £50 million. You prepare the quarterly management accounts and provide these to Robert, the Financial Director (FD), for his comments. A few months ago you had noted that the balance sheet position was slightly below that required by the covenant over the company’s long-term bank loan and you made Robert aware of this. He thanked you for your vigilance and for raising the issue but told you not to worry.

A few days later, a set of quarterly management accounts were sent to the bank. Robert provided you with a set of accounts for the file. You noted that the stock figure on the balance sheet had been increased by £1,850,000. Without this adjustment the banking covenant would have been breached that particular quarter. Whilst you trust Robert and have a good working relationship with him, you found the stock adjustment surprising as you had made all the usual checks to ensure that the cut-off and valuation procedures were properly adhered to. Such an adjustment had never been made in previous quarters. You thought about questioning Robert on this issue but as you have a great deal of respect for him and he is a very busy man, you decided not to say anything.

At the end of the next quarter, the same thing happened again, although the adjustment on this occasion had risen to £2,770,000. This time you asked Robert why the stock adjustment was necessary. He advised you that, at the quarter-end the company held stock at external premises, which was not included in the stock count. You found this strange as Robert had never mentioned this to you before and it would have been helpful if he had informed you of any stock held externally before you finalised the quarterly stock figures for the management accounts. However, you decided not to pursue this matter any further.

At the end of the next quarter, things are even worse and you once again highlight to Robert that the company is failing to comply with the terms of the bank covenant. Robert tells you not to worry and a few days later you note that the set of accounts sent to the bank has again been altered to include a higher stock figure: this time an additional £5,500,000 has been added to the figure that you supplied which ensures that the company meets its banking covenant. You ask Robert to properly explain the stock adjustments which have been made in recent months but he tells you to:

"Mind your own business and get on with your own job."

He also informs you that if you ever question his judgment again then:

"You won’t have a job to go to!"
ETHICAL DILEMMAS

What do you do now?
Scenario 1: Analysis

What are the readily-identifiable ethical issues for your decision?

For you personally

Can you allow this situation to continue without seeking a full explanation from the FD? If you do not believe that you can raise the matter with him again, then who can you discuss it with within the organisation? Does the company have a policy for such matters? Is there another director that you could approach?

For the Company

Is there a supportive environment for open discussion of practical dilemmas without a recriminatory, or ‘blame’, culture?

Is the FD putting through these adjustments on his own behalf or is someone else exerting pressure on him to do so?

Who are the key parties who can influence, or will be affected by, your decision?

‘You’; the FD; the other directors; the shareholders; the employees; customers and suppliers; and the bank.

What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?

<table>
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<tr>
<th>Integrity</th>
<th>Can you retain your integrity by ignoring this issue? Have you already done enough by raising the issue with the FD? (He has warned you not to raise the issue with him again) What will happen if the external auditors start to ask questions about the stock adjustments?</th>
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<td>Objectivity</td>
<td>The ability to be able to question senior personnel when there is something which does not appear right.</td>
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<td>Assumed.</td>
</tr>
<tr>
<td>Confidentiality</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Professional behaviour</td>
<td>The need to display professional courage by getting to the bottom of the matter.</td>
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</tbody>
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**Is there any further information (including legal obligations) or discussion that might be relevant?**

The possibility exists that the FD is telling the truth and that Sundance & Cassidy Ltd does have stock located at another company’s premises. However, if this is the case then why is he not providing evidence to justify his stock adjustments?

**Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?**

If the FD is falsifying the quarterly management accounts then he is bowing to the commercial pressure to ensure that Sundance & Cassidy Ltd is satisfying the funding conditions placed on it by the bank. If the bank covenant terms were breached, the bank could of course take action and the risk would be that Sundance and Cassidy Ltd might be put out of business if the funding package was withdrawn or not renewed. The requirements of the ‘Guardian’ role are for the accountant to ensure that the monthly management accounts are a fair representation of the company’s financial performance and position.

**Based on the information available, is there scope for an imaginative solution?**

No.

**Are there any other comments?**

None.
Scenario 2: Double your money

You are the newly appointed financial controller in Rubymax Ltd, a large private engineering company. This is your first appointment in industry having undertaken your training at a large accountancy firm where most of your experience was gained in the audit of large FTSE 350 clients. Rubymax Ltd makes components which are used in the manufacture of various household products and it has a wide customer base from large household names through to small local private businesses.

One of your first tasks is to undertake a review of aged debtors. Whilst undertaking your review you find that a small number of customers have credit balances on their sales ledger accounts. Whilst most of these are for small amounts, two of these are for sums of £21,234 and £34,456 respectively. The amounts relate to invoices which are now over 9 months old and which appear to have been paid twice. You find this odd and decide to raise the issue with your boss, Del, the Financial Director, at your next meeting.

The following morning, Del calls you into his office and asks you how you are settling into your position. You respond that, although you are still finding your feet, you have been making a major effort to get up to speed with the company’s business and systems and controls. Del appreciates your enthusiasm and is pleased that he has managed to recruit someone so enthusiastic.

“So much for the ill informed stories of Generation Y.” - he advises.

Del then asks whether anything has come to your attention so far. You advise him of what you have found in relation to the customers who appear to have paid twice. Del laughs and advises:

“It did not take you long to show your auditing skills - but remember that an auditor is a watchdog not a bloodhound. This sort of situation is commonplace in industry and as with refereeing decisions in football, some you win, some you lose, but at the end of the day it all balances itself out, or so the experts say.”

Furthermore, he produces copies of letters from a file which are addressed to the Financial Directors at the respective customers informing them of their company’s overpayment.

“There, everything is above board and you have no need to worry. If these idiots cannot act on such letters then who are we to do anything further. If they ask for the money then they can have it back.”

Del then thanks you for popping in and you return to your desk - rather bewildered by his comments. Customers have overpaid and he knows this to be the case, yet he has no intention of returning their money unless prompted by the customer. You also think of the finance staff within the respective customers and how they managed to process a payment for the same invoice twice and even worse, why the Financial Directors of these respective customers have not sought payment having been advised by Del. You decide to put this all down to the rather steep learning curve of adjusting to life in industry: it is most unlikely that this scenario will repeat itself. You also decide to review the company’s sales
system. What you discover is that the company does not actually send statements to customers but rather a list of any outstanding invoices on a monthly basis.

A couple of months pass when, whilst undertaking another review, you notice that a customer, Nocontrols Ltd, has once again paid the amount due by them twice. You decide to discuss this with Del with a view to issuing an immediate repayment or, at the very least, a credit note, as the company is a regular customer. Del advises you that he will deal with this by personally writing to the Financial Director at Nocontrols Ltd – he advises you that at this stage there is no need to issue a credit note or make a repayment. He adds that:

“Rubymax did not ask to be paid twice – it is the customer’s own stupid fault for doing so and they would be wise to employ better people in their finance department but are probably not willing to spend sufficient cash to attract the right quality of person – however I will deal with it – don’t you be wasting time working for our customers – remember they do not pay your salary.”

What do you do now?
Scenario 2: Analysis

What are the readily-identifiable ethical issues for your decision?

For you personally

Can you continue to ignore these overpayments without contacting the customers personally? Is it sufficient that your boss has informed you that he has informed the respective customers? How do you know that the Financial Director actually sent the letters to the customers?

Is the company’s policy of merely sending a list of outstanding invoices transparent? Does the company’s sales system need a detailed review?

How have these payments been treated in the financial statements – are they included in the list of trade creditors or lost within the overall trade debtors balance?

Is there anyone else in the company that you could discuss this matter with? Does your company have a code of conduct that may provide guidance on such matters?

For the Company

Is there a supportive environment for open discussion of practical dilemmas without a recriminatory, or ‘blame’, culture?

Who are the key parties who can influence, or will be affected by, your decision?

‘You’, the FD; the other directors; the employees; the shareholders; and the respective customers.

What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?

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<th>Scenario</th>
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<td>If such matters continue to occur, and at a later date come to light, will you be held to have been in complicit agreement with your boss?</td>
</tr>
<tr>
<td>Objectivity</td>
<td>Assumed, but can you continue to be objective if nothing is done?</td>
</tr>
<tr>
<td>Professional competence and due care</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Confidentiality</td>
<td>Can you discuss this matter with someone else in the organisation? Does your company have a policy of supporting people to do so?</td>
</tr>
<tr>
<td>Professional behaviour</td>
<td>The need to ensure that the company is complying with all applicable legislation and regulations.</td>
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Is there any further information (including legal obligations) or discussion that might be relevant?

Did the Financial Directors at the respective companies actually receive the letters sent by your Financial Director i.e. have they actually been informed of their double payments? If not, the company may be in breach of legal requirements.

Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?

Commercially, the company is better off in the shorter-term not repaying these amounts. However, from the point of view of the company’s reputation and the accountant’s ‘Guardian’ role, is this type of corporate behaviour acceptable?

Based on the information available, is there scope for an imaginative solution?

Possibly encouraging your boss as to the benefits of sending monthly statements to your customers rather than mere lists of outstanding invoices.

Are there any other comments?

No.
Scenario 3: To be, or not to be a NED?

You have recently retired from your position as the Financial Director of Builditbig plc, a listed company. Builditbig plc operates in the heavy engineering industry and you worked there for over 12 years. Prior to this, you had spent 10 years as an audit partner in a large accountancy firm.

Subsequent to leaving your position at Builditbig plc, you receive a phone call from Alan, a headhunter with an executive recruitment agency acting on behalf of a company’s nominations committee. You had approached Alan some months before you had finished up at Builditbig plc, with a view to positioning yourself should any suitable roles become available. After the usual small talk, Alan cuts to the chase:

“You have been recommended to me as a suitable candidate for a very prominent non-executive role that is available at the moment. The company, which is in the financial services sector is seeking a non-executive director who will also serve as the Chair of its audit committee. Does this role interest you and if so can we meet to discuss it in more detail?”

You advise Alan that you will consider the proposal and get back to him. You hang up the phone and then consider the matter in greater detail. Your first instinct was just to say “yes”, however, you were somewhat surprised that the role in question was at a financial services company and your prudent nature decided that it would be wise to give yourself some time to properly consider the issues before making your mind up.

You are not struggling financially, you have a reasonable pension but the extra cash from this role would come in handy. Additionally, you are finding it difficult to fully unwind after years working to tight deadlines and coping with difficult challenges on a daily basis. This is why you had approached Alan in the first place as you knew even before you finished up at Builditbig plc that you would miss the buzz, the excitement and the challenge. A round of golf no longer has the same appeal when it becomes a daily occurrence.

You are therefore keen to put yourself forward for this role but you have a nagging doubt at the back of your mind – you have no work experience in the financial services sector. Eighteen months ago your doubts may not have been as acute but recent events have certainly raised your awareness of the complexities of the transactions which many financial services companies undertake. You are caught between two stools: on one hand, there is little doubt that your financial acumen will be of benefit to the company concerned; on the other hand you have concerns that your lack of expertise in this sector may impact on your performance. What should you do in the circumstances?

What do you do now?
Scenario 3: Analysis

What are the readily-identifiable ethical issues for your decision?

For you personally

As per the ICAS Code of Ethics a key principle is that:

“A professional accountant has a continuing duty to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques. A professional accountant should act diligently and in accordance with applicable technical and professional standards when providing professional services.”

You therefore have to assess your position very carefully. The issues which you have to consider are:

(i) if you decide to be put forward for the role then you must be open and transparent in your discussions with the head-hunter. The client may well be looking for someone not familiar with the financial services industry in order to bring a fresh perspective to the workings of its audit committee. You should also ask the head-hunter for a detailed role specification which should be available.

(ii) you have to satisfy yourself that you can meet the requirements of the above principle if you are ultimately successful in getting the position. In this respect it would be helpful to find out whether the company provides a comprehensive induction programme for its new non-executive directors as this might help to alleviate your concerns.

Ultimately, you have to exercise professional judgment in this matter. If you do not feel comfortable being put forward for this role then you should of course inform the head-hunter accordingly. You may of course decide to be put forward for the role and if your concerns are not adequately addressed, then even if you are offered the role you should decline the appointment at that stage.

Who are the key parties who can influence, or will be affected by, your decision?

‘You’; the head-hunter; the company and its directors; the shareholders; and potentially other stakeholders of the company.
What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?

| Integrity | You must ensure that your integrity is safeguarded by being open and honest with yourself and only allowing your name to be put forward for positions where you believe that you have (or can readily attain) the technical skill set (and other skill sets, if required), or where you can serve effectively as a member of the board, where the board is balanced by the presence of other technical experts. |
| Objectivity | The ability to make an informed impartial decision. The potential financial rewards are obviously a threat to your objectivity but ultimately you should not let these factors cloud your judgement in considering the interest of shareholders and other stakeholders. |
| Professional competence and due care | Can you quickly acquire adequate knowledge of the commercial, strategic, technical and regulatory requirements of the proposed role? |
| Confidentiality | Assumed. |
| Professional behaviour | Your decision should be based on whether, after having considered all available information, you do believe that you would be a suitable candidate for the position. |

Is there any further information (including legal obligations) or discussion that might be relevant?

It would be helpful to obtain details of the various regulatory requirements which will have an impact on the proposed role at the company concerned. If you advise the head-hunter that you are interested he will ask to meet with you and inform you of the name of the company concerned at that stage. At this meeting you will be able to enquire as to what form of induction programme/ongoing training does the company provide? You also need to establish exactly what the company is looking for. The company should have produced a detailed specification of the role and the skill set of the person that they are looking for. Ask the head-hunter why, in his opinion, you were “recommended” to him as a suitable candidate. You also need to ensure that you are aware of the responsibilities involved in being a non-executive director of a listed company.

It would also be appropriate for you to undertake your own due diligence on the company and on your prospective fellow directors if you decide to express your interest in the position e.g. what is its financial position, what is the culture of the organisation? Some information will be publicly available but other information may require referring to business contacts etc. Do you believe that even if you have, or can acquire the necessary skill sets, this is a company on whose board you would wish to serve and do you believe that the board would have the correct composition and balance?

Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?

Care has to be taken to ensure that the potential commercial gains from taking up this appointment do not cloud your judgment as to whether you could meet the ‘guardian’ aspects of this role.
Based on the information available, is there scope for an imaginative solution?

No.

Are there any other comments?

None.
Scenario 4: A bridge too far

Over a number of years, Seancon Ltd, of which you are now Finance Director, has adopted an aggressive growth strategy via targeted acquisitions together with an organic growth plan. This has significantly enhanced earnings per share through fully integrating the businesses, creating economies of scale and paying close attention to cost control.

Seancon Ltd and its numerous subsidiaries are fully owned by Cainmich plc, a listed company, and as such your half-year and year-end reporting are governed by the listing rules and the timetable laid down by your parent.

The opportunity recently arose for Seancon Ltd to make an acquisition which would transform your business in regard to geographic exposure, revenues and profits and move you into the position of being a top five player. The target company was Caanja Ltd and its various subsidiaries. When the proposed acquisition was presented to your parent company, it received a very warm response and your parent agreed to provide the necessary financial support to make the acquisition happen.

During the negotiation process, issues arose surrounding management structure, value and due diligence. While you had concerns, there was nothing tangible that you could point to (partially through lack of due diligence data and lack of access to management).

While your concerns were noted by the board and minuted, your parent and other board members were keen to proceed with the acquisition. A deal was concluded with adequate warranties and indemnities but the new board and management is heavily weighted towards the acquired business – a cost your parent was willing to pay for the prize of concluding what, on the face of it, looked a very attractive acquisition.

Post completion, the problems started to emerge – and the lack of data provided in due diligence reflected the fact that it either didn’t exist or was at best incomplete.

The timing of the acquisition meant that the preparation of the year-end group accounts for Seancon Ltd included the last few weeks of your new acquisition. It became clear that you would need to disclose your findings to your auditors, as for some of the acquired companies, there were incomplete accounting records and incorrect exchange rates had been used historically for converting foreign exchange transactions and year-end balances.

In short, the preparation of audited, unqualified year-end accounts was a significant challenge. You and your team achieved this through recreation of complete financial records, full reconciliations and seven day working for a period of some four months. To summarise: your auditors’ sign off, the audit committee is satisfied and your parent is grateful for your efforts.

Your parent’s results are due to be approved in 3 days time and all is well, until you discover a branch of an overseas subsidiary, Hackgene, which hasn’t been disclosed in due diligence, and for which no accounting records exist. You investigate the limited available information on this branch and
tentatively conclude that it is not material. What do you do on the basis that disclosure of this to your auditors may delay your parent company’s results announcement to the market?

What do you do now?
Scenario 4: Analysis

What are the readily-identifiable ethical issues for your decision?

For you personally

The need to consider whether disclosure of your findings has to be made known immediately to your fellow directors, the board of the parent company and the auditors.

What is the likely impact on your company’s (Seancon Ltd) accounts which have already been finalised?

For the company and group

Is there a supportive environment for open discussion of practical dilemmas without a recriminatory, or ‘blame’, culture? Is there someone within the group with whom you can discuss this dilemma?

Does your company have a Code of Conduct that provides guidance on such matters?

Was sufficient due diligence undertaken on this acquisition and will this issue impact on potential future acquisitions?

Who are the key parties who can influence, or will be affected by, your decision?

‘You’; your fellow directors in Seancon Ltd; the directors of Cainmich plc; the directors of Caanja Ltd; the directors or equivalent of Hackgene; the shareholders of Cainmich plc; the auditors of Cainmich plc (assumed same auditors as Seancon Ltd and Cainja); financial analysts; HMRC; and possibly foreign tax authorities.
What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?

<table>
<thead>
<tr>
<th>Integrity</th>
<th>Can you retain your integrity by doing anything other than immediately informing your fellow board members and the Board of your parent company? Or, as your initial brief review indicates that the recently uncovered branch’s results are likely to be immaterial to the overall group can you possibly delay releasing the information until after the auditors have signed off on your parent company’s accounts? Does the possibility exist that there are other components of the acquired subsidiary which have not yet been discovered?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objectivity</td>
<td>The likely adverse consequences of delaying your parent company’s results announcement should not interfere with the decision which you have to make.</td>
</tr>
<tr>
<td>Professional competence and due care</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Confidentiality</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Professional behaviour</td>
<td>The need to ensure that the board of the parent company and then subsequently the auditors have all of the information required to allow them to perform their respective duties in relation to the group’s annual financial statements. The directors of the parent company are responsible for ensuring the truth and fairness of the group’s financial statements and the auditors are responsible for issuing an opinion on this. You also have to consider the consequences of this discovery on Seancon Ltd’s accounts which have already been finalised.</td>
</tr>
</tbody>
</table>

Is there any further information (including legal obligations) or discussion that might be relevant?

More detailed information on the newly discovered branch would be required to allow a proper assessment, both in qualitative and quantitative terms of its materiality. Does the possibility exist that there are further components of the group that have not yet been discovered?

Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?

In this case, in the short-term there is the potential for conflict. If the parent fails to meet its reporting deadline this is likely to have a negative impact on its short-term share price. However, how would the market react if the parent company reported as planned and then concluded that it had to disclose a newly discovered branch at a later date?

Based on the information available, is there scope for an imaginative solution?

No.

Are there any other comments?

None.
Scenario 5: Keep it in the family

You are a non-executive director and Chairman of the audit committee at Darklightning plc, a major heavy engineering company which is a listed company. The company has recently been visited by a firm of consultants, Identifyandresolve LLP, at the request of your Chairman, Waylon, who has been reviewing the company’s IT systems and procedures with a view to trying to make them more efficient and effective. It is planned that after Identifyandresolve LLP’s review, a contract will be awarded to another organisation to take forward the recommendations included in their report. The Chairman does not believe it would be a good idea to allow the same organisation to undertake the work on which they had reported as this would possibly provide an incentive for them to overstate the level of work required.

You had been instrumental in getting the Chairman to take this project forward based on recent reports given by the external auditors to the audit committee. You had been surprised that the Chairman had readily agreed to the need for such a review without a detailed discussion on the likely cost – the Chairman did not like spending money unless it was absolutely necessary - and had advised you to leave it with him. He had certainly not hung about and Identifyandresolve LLP had been appointed within a few days of your conversation.

Whilst visiting one of the company’s factories you bump into Kenny, the company’s head of IT. Kenny is not a board member. You get round to discussing the current IT project and are surprised to find out that Kenny is a bit annoyed by the whole process. You would have thought that he would have been pleased with this review because, if anything, his life will become easier and hopefully his extensive workload will be reduced. You ask him why he is unhappy. He advises you that it is a dead cert that a company called Extravagant Solutions Ltd will be awarded the contract by Identifyandresolve LLP. You ask Kenny how he arrives at this conclusion. He advises you that the Chairman is very friendly with Don, the senior consultant at Identifyandresolve LLP, and that the Chairman’s son-in-law is a director of Extravagant Solutions Ltd. Kenny adds that, although they are always very expensive, they do not necessarily represent the best solution. You thank Kenny for the information and remember to take a mental note to see what develops in the future. It is only natural after all, that management do not like consultants breathing down their necks and this might explain Kenny’s unusually sharp comments.

At the next meeting of the board, Don is present and asked to present the findings of Identifyandresolve LLP’s review of Darklightning’s IT systems and procedures. He is a very experienced presenter and provides a very informative overview of what has been discovered by his staff. Ultimately, he comes to the recommendations section. He advises that normally his firm would not recommend a specific contractor to undertake the work but merely a list of the work which requires to be undertaken. However, on this occasion he had been specifically asked by the Chairman to recommend the most suitable supplier. He then advises that Extravagant Solutions Ltd would appear to be the most suitable choice to undertake work of this nature, although he adds the usual legal caveats to his
recom mendation. Waylon thanks Don for his firm’s insightful work and then asks for comments around the table. You remember Kenny’s comments and decide to probe as to whether there are any conflicts of interest /related parties with respect to Extravagant Solutions Ltd. No-one declares an interest. You think to yourself that maybe Kenny was misinformed but he has been right so far. Should you raise this issue at a board meeting with only hearsay as evidence as to the Chairman’s link to Extravagant Solutions Ltd?

The Chairman advises that unless anyone says anything to the contrary a motion to award the contract to Extravagant Solutions Ltd will be approved.

What do you do now?
**Scenario 5: Analysis**

What are the readily-identifiable ethical issues for your decision?

*For you personally*

Can you raise the issue based on what was said to you by the company’s head of IT? Kenny was feeling aggrieved and possibly was merely speculating to whom the contract would be awarded. The Chairman never admitted to any conflict when you broached the issue – haven’t you done enough already?

Is there a need to ask for a postponement of the decision to allow you to have a chat with the Chairman and/or the senior non-independent director? Is there a need to consult with the auditors/legal advisors re the alleged conflict of interest? If the decision is postponed, you could undertake a search at Companies House to determine whether the Chairman’s son-in-law is a director of Extravagant Solutions Ltd.

*For the Company*

Does the company maintain a register of related parties?

Are conflicts of interest a standing board agenda item?

Does the company have a policy of undertaking a competitive tender for any such contracts?

*Who are the key parties who can influence, or will be affected by, your decision?*

You; the Chairman; the other directors; shareholders; employees; the partners in Identifyandresolve LLP; and the directors and shareholders of Extravagant Solutions Ltd.
**What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?**

<table>
<thead>
<tr>
<th>Principle</th>
<th>Question/Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Integrity</strong></td>
<td>Is there a need for you to pursue this matter by asking the Chairman directly if he has any connections with Extravagant Solutions Ltd? Could the decision on the contract be postponed to allow you to discuss this matter privately with the Chairman/senior independent director?</td>
</tr>
<tr>
<td><strong>Objectivity</strong></td>
<td>Assumed, but one needs to remain objective and challenge fellow board members as and when appropriate.</td>
</tr>
<tr>
<td><strong>Professional competence and due care</strong></td>
<td>Assumed.</td>
</tr>
<tr>
<td><strong>Confidentiality</strong></td>
<td>Did you receive the information in confidence from the head of IT? If so, there is a potential conflict between integrity/professional behaviour and confidentiality.</td>
</tr>
<tr>
<td><strong>Professional behaviour</strong></td>
<td>As per above, the need to ensure that you satisfy yourself that the process for awarding the IT contract has not been distorted.</td>
</tr>
</tbody>
</table>

**Is there any further information (including legal obligations) or discussion that might be relevant?**

As mentioned above, it would be useful to know whether the board has a standing agenda item which requires any conflicts of interest to be disclosed and whether it has a competitive tendering policy. Additionally, seeking feedback from previous customers of Extravagant Solutions Ltd in relation to the quality of their work would be useful.

**Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?**

No.

**Based on the information available, is there scope for an imaginative solution?**

No.

**Are there any other comments?**

None.
Scenario 6:
Man or mouse?

You are a non-executive director of GIGUS plc, a listed company. You joined the company 8 months ago and viewed yourself as very fortunate to obtain a role with this rapidly growing biotech company. The company has been performing well and the most recent trading update statement was met with much approval by market analysts and the company’s share price rose accordingly. On the face of it, everything appears rosy. Robert, the Chief Executive, was recruited by the current Chairman two years ago and by all accounts is a big favourite with the analysts. The two of them had previously worked together at a smaller listed company.

However, the more time you spend at the company, the more you become concerned over the way it is run. The Chairman appears to be the Chief Executive’s “poodle” and the board is actually run by the Chief Executive. The roles of Chairman and Chief Executive, although held by separate individuals and hence in accordance with the requirements of the Combined Code, are effectively held by the same individual. Furthermore, there is a lack of debate at board meetings, which in your eyes appear to be more of a rubber-stamping exercise rather than a forum to have some serious strategic discussions. You have heard rumours that your predecessor “resigned” because he was one of the few individuals to have challenged the Chief Executive. However, the official line is that he was a trouble maker and did not fit into the balance of the board. You also have concerns that the board papers are only sent out 5 days before the meeting, which in your opinion is not sufficient time to allow yourself and the other non-executives to thoroughly review them.

At the next meeting of the board you are very surprised to find out that the company is in discussions to purchase a major competitor based in the Far East. In the board papers this was only briefly mentioned and it appeared as though GIGUS plc was merely looking at a number of possible acquisition targets based primarily in the UK. You are surprised - both by the location of the target company - but even more by what it is likely to cost.

The Chief Executive proceeds to give a powerful presentation on the pros and cons of the proposed deal. His talk consists of an overview of the target company, the likely cost of acquisition and strongly highlights the benefits of “doing the deal”. Although mentioned briefly, the risks attached to the deal are significantly downplayed. The price mentioned is in the region of £250 million, although the price will be paid in US dollars which is a very significant sum for GIGUS plc and which confirms your earlier fears. Although GIGUS plc has performed very well in recent years, in order to finance this type of deal, considerable debt capital will be required and the company’s level of gearing will be significantly increased. You have to hand it to the Chief Executive though, he is very enthusiastic and it would take a brave person to question what is clearly his pet project. It has always been clear that he wants to be in charge of a much larger entity.

The problem though, as explained by Robert, is that there will not be time to do a great deal of due diligence, because:
“The value of the pound is falling against the US dollar by the day.”
A fact he repeats to give added impetus:

“By the day, and the longer we as a board spend dithering, the higher the price will become”.

The Chief Executive then issues his rallying call to the board:

“Cometh the hour, cometh the man – this is the time for this board to show its mettle and deliver true shareholder value.”

The Chairman applauds loudly, followed by the rest of the board, it is like sitting in the House of Commons as roars of “Hear, hear!” echo around the table. That is from everyone except you – and this is noticed by all of the other board members.

It should be the Chairman who addresses you, but you are not surprised to find that the first person to question your apparent lack of enthusiasm for the proposed deal is Robert.

“You appear rather quiet. At this moment in time there is no room for non-believers on this board. We stand at the most crucial point in this organisation’s history and time is of the essence.”

Robert then adds ominously:

“Are you with us?”

What do you do now?
Scenario 6: Analysis

What are the readily-identifiable ethical issues for your decision?

For You Personally

Can you allow this proposed acquisition to go ahead without raising your concerns? Everything is happening very fast and it appears as though the board has not had sufficient time to analyse the proposed costs and benefits of this deal in detail. Could the company not purchase a currency option or similar type instrument which would remove the risk of the price increasing due to currency fluctuations? This would then allow time for the deal to be considered in greater detail and further due diligence to be undertaken if required. Obviously, there would be a cost attached to purchasing such an option. However, the costs of an ill thought through acquisition would be significantly higher.

You appear unhappy with the performance of the Chairman. Have you considered raising your reservations with the senior independent director? Additionally, have you raised your concerns at the late delivery of the board papers?

The annual board appraisal process will also provide you with the opportunity to raise any reservations you may have with the manner in which the board is run.

If the board decides to go ahead with this acquisition without further due diligence etc should you ensure that your reservations are minuted? Where would this leave you if the board does decide to go ahead?

Who are the key parties who can influence, or will be affected by, your decision?

‘You’; the other board members; the shareholders; the employees; and potentially other stakeholders.
What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?

<table>
<thead>
<tr>
<th></th>
<th>Can you allow this proposed acquisition to go ahead without raising your concerns and asking for additional time for the board to consider this proposed acquisition in more detail?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Integrity</td>
<td>Assumed – you are fairly new to the company. Whilst you were obviously pleased to get this role you must ensure that you properly challenge the board as and when necessary.</td>
</tr>
<tr>
<td>Professional competence and due care</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Confidentiality</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Professional behaviour</td>
<td>This is a major strategic decision for the board - can you satisfy the criteria as to why you were appointed to this role if you do not voice your concerns and encourage the board to have a full and proper debate and advocate that all board members are given sufficient time to properly assess the available information on the target company?</td>
</tr>
</tbody>
</table>

Is there any further information (including legal obligations) or discussion that might be relevant?

What due diligence has been performed on this proposed acquisition?

Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?

No.

Based on the information available, is there scope for an imaginative solution?

No.

Are there any other comments?

None.
Scenario 7: Research and development

You are the Finance Director of Kaka Radiators Limited, a large private company. Kaka Ltd, has a long established accounting policy for the treatment of any expenditure on research and development, on which it spends £1m to £2m each year. The company’s policy effectively splits expenditure on research and development into one of two categories.

(i) long-term research funding - undertaken for the general strategic benefit of the organisation (which may develop into ideas for specific products, although this cannot be assumed); and

(ii) specific research funding - undertaken in order to develop new products or enhance existing products which is reasonably expected to result in material revenue streams in the short-term.

In the former case, this is budgeted as revenue expenditure each year. In the latter case, the process has been successful in recent years and the auditors have been content with the company’s accounting - to defer the relevant expenditure and include it as an asset on the balance sheet and to then subsequently amortise it (usually over a period of 2 to 3 years) against the associated revenue stream. For audit purposes, the auditors would want to see hard evidence of an appropriate business case (with all the relevant assumptions) having been approved by the management team and budgeted for in the new financial year.

Recently, you have become aware that an investment of £0.5m made in each of the last two years in relation to a new research and development programme has not been properly assessed. Although in aggregate £1m has been committed and spent, your enquiries are leading you to conclude that there are little or no success criteria against the investment, that the project management of the research has not really been thought through and that there will be little to show for this investment. When you challenge the director of the relevant team, Ronaldo, he says:

"Don’t worry. We’ll knock up some numbers to keep the auditors happy."

Deep down, you are aware that it is most unlikely that there will be any revenue stream in practice and that any business case which was concocted for the purposes of satisfying the auditors would be wildly optimistic at best. However, the financial year-end is only two months away and a £1m write-off at this late stage in the financial year would cause you real difficulties with your chief executive and the board. It would also compromise severely your professional relationship with your fellow director, Ronaldo, who would then be put in a very exposed position with the board.

You come to the conclusion that you have three options:

(a) You can probably convince the auditors that the costs are an asset and leave them on the balance sheet to buy yourself 12 months to write them off over the next financial year.

(b) You can sit down with your other directors to explain your reading of the situation and work through together how this is to be handled.
(c) By making the most advantageous use of available provisions and reserves, you can just about cover the right-off in a low key way: i.e. without a Board-level discussion. The balance sheet will be compromised somewhat, but not in a fundamental way and you believe that this can be put right quietly over the subsequent year.

What do you do now?
Scenario 7: Analysis

What are the readily-identifiable ethical issues for your decision?

For you personally

Can you retain your integrity by not bringing this matter to the board’s attention?
Should you discuss the matter with Ronaldo prior to taking the matter to the board?
What information will you disclose to the auditors?

For the Company

Is there a supportive environment for open discussion of practical dilemmas without a recriminatory, or ‘blame’, culture?
Is this matter evidence of a wider breakdown in company internal controls in relation to the correct treatment of expenditure on research and development? Is this an isolated incident?
Has there been any commercial pressure put on Ronaldo to treat revenue expenditure items as deferred expenditure items?

Who are the key parties who can influence, or will be affected by, your decision?

‘You’; Ronaldo; the other directors; the company’s employees; and the shareholders, if different from the directors.

What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?

<table>
<thead>
<tr>
<th>Integrity</th>
<th>The need to be honest, not just with yourself, but with the rest of your board and the auditors.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objectivity</td>
<td>The need to remain objective as to the true nature of the costs and their proper accounting treatment.</td>
</tr>
<tr>
<td>Professional competence</td>
<td>Assumed.</td>
</tr>
<tr>
<td>and due care</td>
<td></td>
</tr>
<tr>
<td>Confidentiality</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Professional behaviour</td>
<td>The need to ensure that your behaviour befits that of a chartered accountant. The company should only recognise assets on the balance sheet which satisfy the requirements of applicable accounting standards.</td>
</tr>
</tbody>
</table>
Is there any further information (including legal obligations) or discussion that might be relevant?

No.

Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?

In this scenario there may well be a conflict. There may be commercial pressures on you to defer expensing this expenditure, but the ‘Guardian’ responsibility would require transparent reporting of the economic substance of the transactions.

Based on the information available, is there scope for an imaginative solution?

No.

Are there any other comments?

None.
Scenario 8: Build them anyway!

You arrive in the office for another day’s hard work at Bildem Enneway Ltd. Since you arrived here three years ago you have found it hectic every day, but it has been fun too. You like the people you work with, and as Financial Controller you have access to what is going on across the whole business. You hadn’t worked in a construction business before, although you did the audit of one or two while training, but you feel that you have been really getting to grips with things over the last eighteen months. Even now with the year end looming and both internal and external audit visits due next week, you are upbeat.

It wasn’t always like this. For the first year or so you had thought you wouldn’t be able to cope. Your boss, Ken – the Financial Director – has been in the business ten years and knows it inside out. While undoubtedly brilliant, he is also pedantic and inflexible. You have often wondered if his attitude comes from fear of being held to account for a mistake or whether he genuinely expects perfection 24/7. His approach to dealing with anyone who makes a mistake, or even a commercial misjudgement, is draconian. You have witnessed many tears and a good few dismissals in those three years. Your boss seems to have accepted you, however, as being someone who will maintain his standards, and life has grown more pleasant at work as a result.

You were recently able to back up your boss when he was under pressure from the board regarding the security and controls around the business’ payment systems, following an Internal Audit of this area. Your boss was particularly pleased when you refused to weaken under great pressure from the Chairman, who wanted you to admit that the measures in place were inadequate and the systems were weak. This has been a “bee in the bonnet” of the Chairman for many years, without any specific reason, and he makes your boss’s life miserable on the topic at least once a year. Being able to back him up so strongly has greatly improved your relationship with your boss, and even the Chairman complimented you on your performance at the meeting.

Your door opens and your cashier, Gwen, enters along with one of the quantity surveyors, Bill. Both are well known to you, as your children attend the same school and you are constantly under pressure from them for “sleepovers”. They are clearly troubled. Gwen explains that she has received in today’s post a cheque for £12,500 from a plumbing contractor which regularly does work for your company. Gwen did not understand the accompanying paperwork so she phoned her counterpart at Honestman Ltd, the supplier. Gwen was told that, while reconciling their books in preparation for their year end, they had discovered that they had been overpaid on a recent job. They had done some investigation and found that they had been paid twice for one of the stages of the work and the cheque was a repayment. You ask how this could happen, and just as importantly, how it could go undiscovered. Bill explains that the duplicate payment was down to a simple human error on his part. He had checked and certified the work for the original stage payment, but, being under pressure had not adequately recorded the fact. When, by coincidence, a reminder had come from the supplier some 48 hours later he thought he had forgotten to make the payment, and had done the certification again. Because he
had thought the payment was now overdue, he had taken it directly to his boss, the Commercial Director, and obtained his signature for an “urgent payment” – thus bypassing one of the controls. This procedure is permissible in urgent cases.

Bill also explains that he is absolutely sure the double payment would have been picked up in the job reconciliation which is carried out when each job closes, but that it has not been done yet. As you are aware, this is not unusual as the workload has been very heavy for some months now.

Gwen and Bill reason that no harm has been done. The money has been refunded; the controls have not been compromised – the “urgent payment” route is, after all, an accepted variation; and the job reconciliation would have picked it up in a week or two anyway. They just wanted to be completely open and let you know, even though no damage has been done.

After they leave, you reflect. Internal Audit won’t visit this area for at least two years; the mistake wasn’t any kind of attempt to defraud; and the cash position is unaffected. This was a high profile issue with the board which would cause all sorts of damage (including to your reputation) if it were to be raised. And you can already think of an additional control which would prevent it ever occurring again. The company has not suffered any loss and this control will ensure that it never does.

What do you do now?
**Scenario 8: Analysis**

**What are the readily-identifiable ethical issues for your decision?**

**For you personally**

If you install a new control which mitigates the risk that has been exposed can you keep this matter to yourself? Do you need to raise the matter with the Financial Director? If you do, what happens if your boss advises you to say nothing and to merely ensure that such an occurrence does not happen again?

**For the Company**

Is there a supportive environment for open discussion of practical dilemmas without a recriminatory, or 'blame', culture?

**Who are the key parties who can influence, or will be affected by, your decision?**

'You; the financial director; the chairman; the other directors; the shareholders; and employees.'

**What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?**

<table>
<thead>
<tr>
<th>Principle</th>
<th>Ethical Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Integrity</strong></td>
<td>The need to be truthful and honest. Who do you need to raise this matter with? Does the board need to know about this incident if a new control can remove the risk of it ever happening again?</td>
</tr>
<tr>
<td><strong>Objectivity</strong></td>
<td>Are you now too close to your Financial Director to be objective about this matter? You supported his defence of the company’s business’ payment systems.</td>
</tr>
<tr>
<td><strong>Professional competence and due care</strong></td>
<td>Assumed.</td>
</tr>
<tr>
<td><strong>Confidentiality</strong></td>
<td>Assumed.</td>
</tr>
<tr>
<td><strong>Professional behaviour</strong></td>
<td>The need to consider the implications of what this incident has revealed. Do you need to raise this matter with someone else within the company and if so whom?</td>
</tr>
</tbody>
</table>
Is there any further information (including legal obligations) or discussion that might be relevant?

Is this an isolated incident or do such incidents occur regularly? Although Bill says that he would have discovered this double payment at a later date (bill reconciliation stage) is this the case? Are job reconciliations regularly carried out as a matter of course and if not, then should they be? Is your boss and the rest of the board of directors aware of this urgent payments system? Is the Internal Audit department aware of this system and have they commented on it in the past?

Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?

No.

Based on the information available, is there scope for an imaginative solution?

No.

Are there any other comments?

None.
Scenario 9: Seeing the wood for the trees

You are the Chairman of Ruspay plc, a long-established specialist paper-making company. The company’s next board meeting is due to be held next month. Top of the agenda for the meeting is the possibility of changing the company’s source of raw materials.

This has come about because for some time now, the company has experienced falling profit margins. All of the directors had been tasked with identifying ways of reducing the cost base. One obvious target would be to reduce the level of the workforce but you only want to revert to this option as a last resort – the workforce has been loyal and hard working.

Patrick, the production director responsible for buying wood pulp, the primary raw material used in the production of paper, has recommended that the board considers shifting contracts away from existing Scottish suppliers in favour of lower cost overseas suppliers. Supporting this view, the Chief Executive, Caesar, has specifically identified Comy, a company based in Sangala, a developing country. It is known that his family have an involvement in this company and that Caesar personally has a 10% equity stake. Despite the obvious conflict of interest, there is no doubt that this direct link to the supplier would be of benefit to Ruspay plc if it decided to take up this option. It would reduce the risks of dealing with a new supplier, particularly one which is based overseas.

In conversations you have had with some of the other directors, they have expressed concern that the image of Ruspay plc in the home market will be damaged by withdrawing business from domestic suppliers. At present, most of the pulp is purchased from one particular Scottish supplier, Doowy Ltd, with the contract making up over 70% of that supplier’s business. The expected cost reductions for Ruspay plc are undeniable, but there is a fear that moving the contract will put the existing supplier out of business – and there would be the associated knock on effects in the local community – Doowy Ltd is based in a small town only a few miles from where Ruspay plc is based.

It is also well known that Sangala, the country from which it is proposed that the pulp be sourced in future, adopts indiscriminate policies towards deforestation (clearing forest areas), causing irreparable damage to the eco-system. Sangala’s government has consistently argued that the improvement in the quality of life of its people in rural areas must take priority over natural resources. Additionally, the political environment is fragile and the possibility of a coup is ever present.

Another factor is that only just under three years ago Ruspay plc received a regional development grant for £3,500,000 which was used towards the cost of renewing some of the company’s outdated equipment. This grant was partly awarded on the basis of retaining jobs in the local area. The qualifying period will expire in three months time and the local enterprise agency will not then be able to claw back any of the money – however, you are trying to square the logic of this with the undoubted damage it would do to another local town if Ruspay plc terminated its contract with Doowy Ltd.
ETHICAL DILEMMA

Having read all the board papers in readiness for the meeting, and having spoken to the other directors, you are contemplating what recommendations you will make.

What do you do now?
Scenario 9: Analysis

What are the readily-identifiable ethical issues for your decision?

For you personally

What are the ethical considerations relating to the proposal to switch from a domestic supplier to an alternative supplier in a developing country which has an unstable political environment?

Can the Chief Executive be objective in this decision as he has a clear conflict of interest due to his and his family’s financial interest in Comy?

As chairman, what will you advise the Board to do?

For the Company

Does the company have a set of ethical values which it can refer to when faced with difficult dilemmas such as this?

The company will have complied with the legal terms of the grant it received but is there a wider duty to be considered?

Is the company willing to accept the risks associated with dealing with a supplier which is located in a country which has an unstable political environment?

Is the company willing to accept the potential negative media coverage that might result if it terminates the contract with a local supplier?

Who are the key parties who can influence, or will be affected by, your decision?

You; the Chief Executive; the other directors of Rusppay plc; the employees of the various companies; the shareholders of Rusppay; the directors and shareholders of Doowy Ltd; the directors and shareholders of Comy; the local enterprise agency; and the local community.
What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?

<table>
<thead>
<tr>
<th>Integrity</th>
<th>The need for you to give balanced consideration to the likely impact on Ruspay plc of changing/not changing suppliers. Does your company have a clearly defined set of corporate values? If so, where do CSR type issues fit into these? How do you deal with the Chief Executive’s financial interest in the potential supplier?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objectivity</td>
<td>The need to objectively balance all the pros and cons of the decision, taking account of the longer-term and not just the shorter-term issues. Are the other members of the board able to be objective on this matter?</td>
</tr>
<tr>
<td>Professional competence and due care</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Confidentiality</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Professional behaviour</td>
<td>The need to explain your recommendation and allow the other board members to fully understand the ramifications of their decision.</td>
</tr>
</tbody>
</table>

Is there any further information (including legal obligations) or discussion that might be relevant?

Does your company have a set of values/Code of Conduct which may have a bearing on your decision?

Are there any other options open to the company in relation to potential cost savings?

If the contract was awarded to Comy, would Ruspay plc have a back up plan if any future political unrest hindered the supply of raw materials?

Are there any international embargos on trading with companies in Sangala?

Would transacting with a company in Sangala expose the company to foreign currency risk that could not easily be mitigated?

What other suggestions for reducing the company’s cost base have been received from board members?

Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?

No.

Based on the information available, is there scope for an imaginative solution?

Is there any scope for negotiating a price reduction with your existing supplier, Doowy Ltd? Could some, but not all of the raw material supplies be switched to a different supplier?

Are there any other comments?

None.
Scenario 10: Heroic efficiency target

You are the finance director of Fortunesareus plc, a large UK subsidiary of an internationally based financial services organisation, which has grown substantially in recent years. You have been in the role for 4 years and believe that there is a very real chance that you might be in line for promotion to the group finance director position within the next couple of years, as long as you play your cards right and do not rock the boat. You believe that such a promotion is merited. You have committed yourself to the organisation and your work-life balance is heavily weighted towards the former. Your work is your life, at least at the moment.

The Fortunesareus group, has had a bad couple of years worldwide, partly to do with the economic downturn in most areas, but also to do with poor management in some key areas of operations (but not in the UK). In response to these poor results, the US parent had insisted on 5% cost cutting efficiencies in the current year in all subsidiaries: for you in the UK subsidiary, this was a very tough target and you have just about achieved it, but at the cost of a dispirited workforce and a range of economies which could not be sustained in the long term. The need to ensure that the company satisfies all of its regulatory requirements is a major issue and these cuts have left your organisation vulnerable.

At a recent video conference, Dan, the American Group FD, informed you that all subsidiaries must achieve a further 10% efficiency saving in the subsequent year (for which you are currently preparing the budgets), but that all operational and sales targets must still be met. This news is greeted with a degree of incredulity by you and your colleagues but it is made very clear that this is not negotiable.

You know that this is going to be almost impossible to achieve in practice and so, the next day, you call Dan and share these views with him. He tells you in no uncertain terms that your views are unhelpful and that if you are not prepared to implement these cuts then someone else will be found who can. You point out that the cuts will severely impact on the business’s ability to satisfy its legal and regulatory responsibilities:

“We are struggling as it is to satisfy our compliance requirements.”

Dan replies ominously:

“That is your responsibility, not mine.”

By the end of the call it is crystal clear: either cuts will be made or you will be fired.
Once again you think to yourself, can further costs be trimmed without impacting on the company’s compliance needs? You come to the same conclusion that this does not appear possible unless the company is willing to live with the significant risk that it will not comply with the regulatory requirements.

What do you do now?
Scenario 10: Analysis

What are the readily-identifiable ethical issues for your decision?

For you personally

Is there someone else in the organisation that you can discuss this issue with? Others in the organisation must be aware of the need for the company to comply with its regulatory requirements?

Can you elevate this matter for full discussion at a future meeting of the group board?

If, after proper debate, the proposals are still to be enacted, then you will need to consider your position if you still believe that their impact will put the company in a position where it is no longer able to satisfy its regulatory requirements.

Is there a need to consider whistle-blowing?

For the Company and the Group

Has the impact of these proposed cuts on the company’s ability to meet its compliance requirements been thought through properly?

Who are the key parties who can influence, or will be affected by, your decision?

‘You’; your fellow directors; the group FD and his fellow directors; the shareholders; the employees; the financial regulatory body; and customers and suppliers of the company.
What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?

<table>
<thead>
<tr>
<th>Principle</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Integrity</td>
<td>The need to ensure your fellow board members and those of the parent company are aware of the company’s obligation to meet its compliance requirements.</td>
</tr>
<tr>
<td>Objectivity</td>
<td>The need to be able to assess the impact of these proposed cuts without personal bias.</td>
</tr>
<tr>
<td>Professional competence and due care</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Confidentiality</td>
<td>If the company decides to go ahead with this level of cuts is there any need to consider any possible whistle-blowing requirements?</td>
</tr>
<tr>
<td>Professional behaviour</td>
<td>The need to effectively communicate the compliance risks of this proposed cost cutting exercise to your fellow board members and those of the group.</td>
</tr>
</tbody>
</table>

Is there any further information (including legal obligations) or discussion that might be relevant?

What whistle-blowing requirements exist within your organisation and within your regulated sector?

Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?

In the shorter-term possibly, but for the longer-term sustainability of the company it would appear as though these competing strands are aligned.

Based on the information available, is there scope for an imaginative solution?

No.

Are there any other comments?

None.
Scenario 11: We’re all In this together

You enjoy your role as Financial Controller of Little Boxes plc – a public company and a large national developer for whom you have worked for five years now. You have worked your way up through the organisation and are hopeful of a board appointment in the future. You certainly have been accepted as “one of the team” and the board members turn to you for advice on financial and commercial matters on a regular basis, as your boss, the Financial Director, spends a lot of time out the office with the Chief Executive. This has led to the development of close relationships with most of the senior team.

The Chairman of Little Boxes plc, Sir Peter, formerly held high profile roles in the City and has been a very good appointment for Little Boxes. One of his interests is Corporate Governance and he has set very high standards for Little Boxes. You have done much of that work and enjoy a good relationship with Sir Peter. The statement on standards of behaviour in business that you developed under Sir Peter’s guidance is something you are particularly proud of – although it did cause a bit of a stir when it was unveiled, especially the part on entertaining. You have taken a lot of good-natured banter from your colleagues on this subject.

Today you are signing-off a payments run and settle down to do some sample checking. You spot a payment to Plumbrong Ltd and decide to examine the back-up paperwork. This company does a lot of Little Boxes’ work on their new-build houses. They have also recently done work on the extension you had built on your family home. The work on the extension was arranged and managed by your colleague, Bill, the Construction Director of Little Boxes and you have been delighted with the work – the price was a very good one, even if it has somewhat stretched your finances. To safeguard yourself you even had the Internal Audit manager check Plumbrong’s invoice to ensure that the rates you were charged for labour and materials bore comparison with the rates that the company pays. This had also been helpful to you in another way because, as Plumbrong had insisted on billing Little Boxes, all you had seen was an overall charge for “Work done on Extension” on a Little Boxes’ recharge invoice raised by the Construction Director.

As it happens, the invoices making up the payment to Plumbrong are for another piece of “private work” – this time for the Construction Director himself. With the papers is a copy of the recharge by Little Boxes to your colleague together with evidence of his payment. However, you are slightly puzzled as the Plumbrong invoices contain no mention of several items that you know were included from your last visit to his house – such as the Jacuzzi, the high-tech shower fittings and the digital musical system.

Worried on his behalf you ask for the other Plumbrong invoices for this job, only to be told there are none. Shortly thereafter you are also told that a call has been made to Plumbrong who confirm that there is nothing further outstanding.
While you are pondering this, the Construction Director, Bill, arrives in your office. He asks what your query is on his extension as he has heard from his contact at Plumberg that questions have been asked. You explain and tell him that you are concerned and wish to protect him. He looks embarrassed and explains to you that he has known the owner of Plumberg Ltd for many years and that the Jacuzzi, shower attachments and the music system are a gift. He also hastens to reassure you that as he has no part in the tendering procedures (which take place every twelve months), no undue influence is involved.

You gently explain both the ethical issues involved, and the conflict with the company’s statement on standards of behaviour in business.

Bill looks even more embarrassed and points out that you have also benefited from this largesse. However, he had deliberately not told you so that you would not be compromised because you manage and supervise the annual tender process. In fact, Bill added that several of your colleagues have, over the years, knowingly benefited from a similar arrangement, including the Chairman, Sir Peter.

Bill leaves you to think this over. Personally, this is both a financial and professional embarrassment - you would find it hard to find the cash at the moment, and it may be difficult for others to accept you were ignorant of the position. It also potentially threatens your relationships with your colleagues. With the Chairman, it will be a particularly difficult matter to raise, given his stance on business behaviour. In addition the tendering process appears to have been unaffected to date given your own involvement. You ponder the implications.

What do you do now?
Scenario 11: Analysis

What are the readily-identifiable ethical issues for your decision?

For you personally

Can you retain your integrity by putting in place additional internal controls and ignoring the transactions which have taken place to date?

If you decide that you cannot merely do this, and need to inform the board of what has been happening – what are the likely implications for you? Have other members of the board benefited from such transactions? Is there a need for you to undertake a detailed review to determine the extent of these transactions or can you rely on what the Production Director has told you?

Are there any tax implications for you?

For the Company

Is there a supportive environment for open discussion of practical dilemmas without a recriminatory, or 'blame', culture?

Does the company’s statement on standards of behaviour in business deal with how any breaches will be dealt with?

How can the company ensure that the risk of any future such transactions being entered into is minimised?

Are there any tax implications for the company?

Who are the key parties who can influence, or will be affected by, your decision?

‘You’; the Production Director; the Chairman; the other directors; the shareholders; the directors of Plumbrong Ltd; and potentially HMRC.
What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?

<table>
<thead>
<tr>
<th>Principle</th>
<th>Question</th>
</tr>
</thead>
<tbody>
<tr>
<td>Integrity</td>
<td>How can you retain your integrity in this situation? You have not knowingly received a benefit from a supplier. Several other board members have also allegedly received similar benefits. Although no-one appears to have suffered as a result of these alleged benefits having been received – the tender process has not been distorted – can you merely keep quiet about what the Production Director has told you and install further internal controls to reduce the risk of such transactions being entered into in the future?</td>
</tr>
<tr>
<td>Objectivity</td>
<td>To what extent are you balancing your own (albeit unwitting) involvement and the need for the board to be made aware of these transactions?</td>
</tr>
<tr>
<td>Professional competence and due care</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Confidentiality</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Professional behaviour</td>
<td>Whilst some of these transactions might have taken place prior to the company’s statement on standards of behaviour in business being implemented, certain directors, including yourself, appear to have personally benefited from the close relationship with one of your major suppliers. You were obviously unaware of this issue but now that you are, is there any alternative course of action other than full disclosure to the board of directors?</td>
</tr>
</tbody>
</table>

Is there any further information (including legal obligations) or discussion that might be relevant?

Is this an isolated case or have transactions of a similar type taken place with other suppliers? Does your company provide similar benefits to directors of customers/suppliers?

Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?

It would appear not in this scenario. In this scenario the issue is that directors appear to have been receiving personal benefits from a major supplier.

Based on the information available, is there scope for an imaginative solution?

No.

Are there any other comments?

Has any thought been given to the potential tax consequences of such transactions?
You are the recently appointed interim Financial Director (FD) in a small listed Australian company, Great Bite Engineering. The company produces parts for machines which are used in the mining industry in Western Australia. You have only recently arrived “down under” and were actually looking forward to spending more time on the beach, soaking up the sun working on your tan. You had registered with a local recruitment agency prior to leaving the UK but were most surprised to receive this offer of temporary employment so soon after arriving. Although you had initially thought of turning it down, you had come round to the idea of working the 6 months required and then rewarding yourself by spending the following 6 months taking in more of the sights of the southern hemisphere, which would now include a trip to Queenstown in New Zealand to experience the world’s adventure capital first hand. The thoughts of doing a bungy jump over the Kawarau River would keep you going.

Great Bite Engineering has been struggling of late as the mining sector begins to feel the impact of the worldwide downturn. The previous FD, Dreyfuss, had left his post last month due to ill health. The company’s year-end had just passed and the company urgently needed someone to come in and fill the post on a temporary basis until the directors had the time to search for and appoint someone on a full-time basis.

So here you are in Australia, happy at gaining employment but still wishing that you had allowed yourself more time beforehand to enjoy the local beaches. However, it doesn’t take long to get back into the swing of things. Unfortunately, it would appear that the previous FD was not the most organised person and you are having difficulty tracking down a set of working papers to support the draft year-end accounts. After much searching, you finally track down the supporting papers and begin your review of the breakdown of the figures featured in the draft accounts.

During your review you discover reference to a small number of journals which have minimal supporting back-up. These journals, posted 8 months ago increase the sales figure significantly, 23% of the company’s reported turnover. The journals refer to the Lucan project, of which you have never heard, but you remind yourself that you are new to the company and decide to raise this issue with Robert, the Chief Executive.

Robert welcomes you into his office and then explains that the Lucan project relates to a one-off shipment of specialised parts to a company based overseas. He informs you that only a few people knew about this contract, as apparently a number of countries have placed an embargo on supplying goods of this nature to businesses within this country. That is also why the normal sales process was not followed. Those “in the know” included the former FD. You thank him for enlightening you but then ask why payment has never been received for this order. Robert advises that no payment has so far been received but that payment will be received in due course – the customers may be slow payers but they are very wealthy, and it is not in our interests to chase payment as this might impact on our healthy relationship and future orders. However, he asks you not to mention this to anyone else.
E T H I C A L  D I L E M M A

You leave the room but are somewhat mystified. Sales appear to have been inflated by transactions outwith the company’s normal customer base but for which payment has not yet been received. Have these sales actually taken place and if so has the company sold goods to an entity in another country which may be blacklisted by Australia? Furthermore, will it ever get paid for the goods - if they have indeed been supplied? You are also aware that the Chief Executive has a very generous share options package which he will be able to exercise in a few months time – does this have any impact on the situation?

What do you do now?
Scenario 12: Analysis

What are the readily-identifiable ethical issues for your decision?

For you personally

The ICAS Code of Ethics, which is substantially based on the IFAC Code of Ethics, applies to members regardless of where they are working.

How do you maintain your integrity in this scenario? The Chief Executive has informed you of sales in relation to a project for which there is a lack of supporting documentation and for which payment has not been received. Is he telling you the truth? If he is telling the truth, then how do you get him to face up to the need to chase payment from the customer? You have concerns that, even if the sales were indeed genuine, if the amount due requires to be provided for then it will have a serious negative impact on the results for the year and hence the resulting share price. Furthermore, if the sales were genuine is there any requirement on you to report the sale of goods to a potentially blacklisted country? You need to remind the Chief Executive that the auditors will undoubtedly question these transactions.

Who are the key parties who can influence, or will be affected by, your decision?

‘You’; the Chief Executive; the other directors; the former FD; shareholders; potential investors; the auditors; customers; suppliers; and employees.

What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?

<table>
<thead>
<tr>
<th>Integrity</th>
<th>How can you maintain your integrity without investigating this matter further?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objectivity</td>
<td>Assumed, as you are new to the company. However, you must satisfy yourself that you are objective.</td>
</tr>
<tr>
<td>Professional competence and due care</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Confidentiality</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Professional behaviour</td>
<td>The need for you to investigate this matter further to arrive at the true position. Did the company make sales to an entity overseas? If so, there is a need to convince your Chief Executive that payment has to be chased or ultimately the debt may need to be provided for. The auditors will undoubtedly question these transactions.</td>
</tr>
</tbody>
</table>
Is there any further information (including legal obligations) or discussion that might be relevant?

Is any further information available about the customer concerned? Is there an embargo on exports to that country? What, if any, other paperwork exists to substantiate the sales made in relation to the Lucan project? Did the former FD have any share options or other financial incentives? Have similar transactions been posted in previous years?

Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?

The ‘Guardian’ role is to report fairly the company’s financial performance and position. Have the Chief Executive and former FD attempted to massage the company’s financial statements for short-term commercial benefit?

Based on the information available, is there scope for an imaginative solution?

No.

Are there any other comments?

None.
Scenario 13:
Unbilled rates – what you gonna do?

You can’t wipe the smile from your face — you have landed on your feet. It now seems like an eternity since you were given the dreadful news that you were being made redundant by your former employer, Teetering Brink Ltd. At that time it seemed as though the world had ended, 5 years of long hours down the pan as you struggled to progress up the career ladder and break through the glass ceiling. You had joined Teetering Brink Ltd immediately after qualifying as a CA and had reached the level of financial controller before losing your job.

However, a business contact had alerted you to the fact that a medium-sized private company in your area, Gettingby Ltd, was looking for a Financial Director (FD) to replace its existing FD, who had sadly passed away. After a whirlwind week following your interview, you now find yourself as the newly appointed FD of the company. Although you have just arrived, the mood amongst the employees appears good and you are glad to have been re-employed so quickly. The economic climate is bleak and you were fortunate to have been in the right place at the right time. Now that you have your feet under the desk, your first task is to prepare the annual statutory accounts for the year to 31 March. Thankfully, the previous FD has left a good set of working papers for the previous year and this makes the task of putting together a reasonable set of draft accounts much less burdensome.

You quickly cast your eye down the numbers and note that, while the company is not exactly flush with cash and has to run a very tight ship when it comes to cash management, it is certainly solvent and has returned a reasonable level of profit given the current economic downturn. Comparing the year end figures with the comparatives reveals a level of profit more or less in line with the previous year although turnover is down slightly. With respect to the balance sheet comparatives, the only item that attracts your attention is the “creditors amounts due within one year” figure. From your limited knowledge of the business, the figures in both years appear rather high and, on further investigation, you note that the respective accruals figures per the notes to the accounts appear much higher than you would expect. On examining the previous year’s working papers file you note that a large accrual was included for business rates although, other than some workings showing a rough arithmetical calculation of the amount concerned, there is no formal paperwork to support this amount which has not been reversed. You then check and discover that no payments for business rates were made in the previous year. You also note that no assessments or demands for business rates appear to have been received for the forthcoming financial year. This raises your curiosity and you decide to ask Joe, the Managing Director (MD), to see whether he can shed any light on this issue.

You are still in the process of establishing your working relationship with Joe. He has been helpful in helping you settle in, but it is obvious he has very clear ideas of what he wants. As MD, he expects to get his own way. Other staff have hinted that he can be very difficult to deal with in debate and that he can be very impatient when his ideas are challenged. There are reports of “fiery” debates around the boardroom table, and that he is prone to using sarcasm as a weapon to blunt opposition. To date you have seen none of this.
You head up to Joe’s office and he is pleased to see you. He asks you how you are doing and how you are settling in. You tell him that you are doing great and have settled in quickly as the people are really friendly. He says that’s great and is keen to emphasise the importance and benefits of a good friendly working environment – and for the MD and FD to be able to work together for the good of the business. He tells you that one of your predecessor’s great attributes was an ability to take a pragmatic view of matters and to adopt a flexible, but fair, approach. He adds:

“As everyone knows, the rules accountants are taught can’t cope with all circumstances you will encounter when it comes to working in a commercial environment.”

He then asks what it is that you require. You tell him what you have discovered regarding the business rates and he laughs:

“Yes, this is a strange one. It relates to when the regional councils were broken up into smaller local councils in the 1990s. For some reason since the reorganisation, Gettingby Ltd has never received a rates notice.”

He adds that:

“The former FD was always prudent though, and each year put through an estimated expense for rates in the accounts. This is necessary because at some time in the future there is the possibility that the company will receive a rates assessment for the period since the reorganisation of the regional councils.”

You feel uneasy. The company has never received a rates demand in 14 years and yet it would not appear as though anyone has ever contacted the local council to inform them. You mention your unease and his demeanour changes. He makes two things quite clear. Firstly, this is the kind of thing he was referring to when he mentioned your predecessor’s flexibility. In this particular instance, while he recognises the issue you are raising, he expects you to put the company’s interests first – every time. Why would you want to draw the attention of the local council to something which is clearly its own mistake? Is that what you see as loyalty to your employer? Secondly, you have seen the books and are well aware of the tightness of the cash position. You must be well aware there is not enough surplus cash to pay anything like 14 years of back rates. Do you want to create a situation where jobs are lost and the company’s future threatened?

Joe leans back in his chair, relaxes and softens his tone. He smiles encouragingly:

“That’s the kind of thing you encounter every day in business as I am sure you know. You seem to me like the kind of person who can cope with the rough and tumble – that’s why I employed you. Off you go and do the calculations for this year – and I don’t mind at all if you put in a bit of extra prudence in the accrual calculation if that will help.”

You go back to your office and ponder the situation. You can see Joe’s point of view - the continued accrual of the cost will ensure the situation is reasonably accurately reflected in the company’s accounts – both the Profit and Loss Account and the Balance Sheet. But where does this leave you – is it sufficient for the company merely to accrue a rates expense each year or is there a duty upon you to do more?

What do you do now?
Scenario 13: Analysis

What are the readily-identifiable ethical issues for your decision?

For you personally

Can you continue to do as the MD asks and merely accrue an estimate for the rates bill for the year?
If you decide that you cannot merely do this, do you go back to him and advise that the company should contact the local council and inform them of the situation? Is there anyone else within the company that you should speak to regarding this matter?
Are the other directors aware of this issue?

For the Company

Is there a supportive environment for open discussion of practical dilemmas without a recriminatory, or ‘blame’, culture?

Who are the key parties who can influence, or will be affected by, your decision?

‘You’; the Managing Director; the other directors; the company’s employees; the shareholders (if different from the directors); the local council; the general public; and potentially HMRC.

What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?

<table>
<thead>
<tr>
<th>Integrity</th>
<th>Your integrity is undoubtedly being challenged as you are being asked to undertake a course of action which you clearly have doubts about.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objectivity</td>
<td>As you are new to this role it could possibly be assumed that there are no doubts regarding your objectivity. However, does the difficult economic environment and the pressure of possibly disagreeing with your boss, who you hardly know, threaten your ability to be objective?</td>
</tr>
<tr>
<td>Professional competence and due care</td>
<td>Although you are new to your role, your professional competence and due care are assumed. It is your diligence in reviewing the previous set of working papers which has uncovered this issue.</td>
</tr>
<tr>
<td>Confidentiality</td>
<td>You are faced with a situation where your employer obviously believes that their non-payment of rates is confidential information.</td>
</tr>
<tr>
<td>Professional behaviour</td>
<td>Does it serve the public interest for this type of corporate behaviour to be ignored? There would appear to be a potential conflict between the confidentiality due to one’s employer and the potential wider public interest.</td>
</tr>
</tbody>
</table>
**Is there any further information (including legal obligations) or discussion that might be relevant?**

Is there any other reason why the company has not received a bill for business rates?

**Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?**

The FD has a duty to ensure that the rest of the Board are aware of this situation. The business is a private company and consideration would need to be given as to whether the matter should be reported to the shareholders, if these are not the same persons as the directors. Commercially, there is the possibility of a conflict with the company being better off financially if it continues to do nothing in terms of notifying the local council.

**Based on the information available, is there scope for an imaginative solution?**

You could try to use interpersonal skills in a non-confrontational way to offer to find a solution to the underlying problem. Has anyone explained the potential consequences to the MD if this error is discovered by the local council? Would the local council look to name and shame, which could possibly result in negative PR for Gettingby Ltd? Would any interest or penalties be payable by the company? What will happen if at some future date there are plans to sell the company – any due diligence is likely to discover this non-payment of rates – will it have any impact on a potential sale? You could also ask the MD to consider whether Gettingby Ltd has a moral CSR obligation to the local community. The MD, of course, might argue that he is doing more than his fair share by employing a number of people in the local area.

**Are there any other comments?**

None.
Scenario 14: 
Unbilled rates – the auditor’s untold story
(This is a separate scenario, although it is related to scenario 13)

You are the audit engagement partner at Erskine & Severn, a small firm of chartered accountants. You have recently been appointed as auditor to a local company named Gettingby Ltd. The previous auditors, Onemanband & Co, had resigned due to having so few audit clients that it was no longer commercially viable for the firm to retain its registered auditor status. This had provided the opportunity for your firm to take on the client and you and your fellow partners were delighted to be gaining an audit client in what was proving to be a difficult business environment. Times were certainly tough and you were well aware that redundancies were not out of the question if more work was not picked up quickly. You had met Joe, Gettingby Ltd’s Managing Director (MD), at various local events and had a good personal relationship with him. Joe was someone with a very good reputation in the local business community and was involved in a lot of charitable fundraising activities. You believed that this was a good client to win and, with Joe’s considerable business connections this might not be the only audit client that you would pick up in the coming months. Joe had assured you that a good working pack would be prepared by his newly installed financial director (FD) to support the figures in the draft financial statements. Additionally, the client would arrange for the final publication of the accounts.

Six months down the line, you were sitting at your desk reviewing the audit working papers of Gettingby Ltd. As you had imagined, the fieldwork had been done within budget and the files appeared to show that, as Joe had earlier advised, the company had maintained a good set of records and produced appropriate documentation to support the draft figures. Some minor errors had been noted and added to the summary of audit differences, but nothing of any significance, and you were all but finished your review. You looked at your watch, another 20 minutes would see you complete your task – the client was now keen to sign off in seven days time, three weeks earlier than had originally been envisaged. This had just allowed you time to review the files in advance of a meeting with Joe and his FD later that week to discuss any major issues prior to signing.

You continued with the task at hand and opened the creditors section of the file and reviewed the lead schedule. Everything this year appeared in line with that of the previous year. There were no major variations and, to be honest, you had not expected any. There was, however, a note from the audit senior stating that a large accrual had been included for rates – and indeed an accrual of £163,937 was included in the accounts. This appeared to consist of a charge of £15,000 for the year in question and the backlog of the amount which had been accrued in previous years. It was clear that the company had not made a payment of rates for a period of 14 years. It had, however, ensured that the expense had been properly reflected in the accounts. You make a note of this and add it to your list of points to be discussed at the client meeting. You remember that no mention was made of this fact in the consent letter which you had received from the previous firm of auditors. You had not been given access to their working papers for the previous year as the change in audit regulations was not applicable at that time.
ETHICAL DILEMMA

Whilst the accounts appear to be correctly stated, on the premise that rates are due to be paid, you are concerned that it would appear as though the company has never tried to resolve this issue with the local council. You also have concerns about how this item will be treated in the corporation tax computation.

What do you do now?
Scenario 14: Analysis

What are the readily-identifiable ethical issues for your decision?

For you personally

Given your firm’s financial situation (redundancies had been mooted) and the additional work you hope may be generated from your relationship with this client, is there additional pressure on you to placate the client? Is there someone within your firm with whom you can discuss the issue?

For the CA firm

The company has correctly accounted for the situation but is this sufficient? If the company received a bill to pay all of the outstanding rates immediately would it have sufficient cash resources to do so? Does this have an impact on your assessment of going concern?

Although the company has correctly accounted for this matter, how has the rates figure been treated in previous corporation tax returns?

If the local council discovered their discrepancy at a later date, would this impact on your firm’s reputation in the local community?

Who are the key parties who can influence, or will be affected by, your decision?

‘You’; your fellow partners; the Managing Director; the other directors of Gettingby Ltd; the shareholders (if different from the directors); the local council; the general public; and HMRC.

What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?

<table>
<thead>
<tr>
<th>Integrity</th>
<th>The need to have a full and frank open discussion on this issue with the MD and the FD of Gettingby Ltd. What happens if they are resolute in continuing as is?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objectivity</td>
<td>As this is a new client, this might naturally be assumed, however the economic conditions and the possible additional work that might come your way are a potential threat to your objectivity.</td>
</tr>
<tr>
<td>Professional competence and due care</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Confidentiality</td>
<td>Assumed, but is there a wider social responsibility to the local council?</td>
</tr>
<tr>
<td>Professional behaviour</td>
<td>Does it serve the public interest for this situation to continue and how does this contrast with the need for confidentiality?</td>
</tr>
</tbody>
</table>
Is there any further information (including legal obligations) or discussion that might be relevant?

You obviously have to discuss the issue with the MD and FD of Gettingby Ltd at the forthcoming meeting to get a handle on all the relevant facts.

Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?

It would appear that there may be a conflict. The commercial interests of the firm are properly best served by not pressurising the company to report this matter to the local council but how does that equate with the auditor’s ‘Guardian’ role?

Based on the information available, is there scope for an imaginative solution?

You could explain the potential consequences to the MD if this error is ever discovered by the local council and encourage him to get the company to voluntarily approach the local council with a view to seeing whether they would accept a delayed settlement of any sums due, preferably spread over a number of years and with little or no associated interest or penalties and with no related publicity. Additionally, you may wish to highlight to the MD that if there are plans to sell the company then any due diligence undertaken on behalf of the prospective purchaser is likely to discover this non-payment of rates which could impact on the sale.

Are there any other comments?

If the client refuses to do anything, does this impact on your ability to continue acting as auditor for this client?
Scenario 15:  
Silence is golden

You are the Financial Director of a large private construction company, Bonnieclyde Ltd. The company undertakes major construction projects such as building new roads, motorways etc. Until last year the company had been very profitable but the economic downturn has started to hit the company hard. The company’s year end was 31 August and the auditors were in during October to do their fieldwork. It is now December and the auditors are coming in tomorrow for their closing meeting to discuss their main findings and any adjustments that will be required to the draft accounts.

You are aware of at least one significant issue which requires to be discussed at the meeting. This relates to the fact that a significant debtor as at 31 August, Dudsareus Ltd, has just recently been put into administration. Additionally, Dudsareus Ltd has been disputing the quality of the work and hence the actual amount due. No payments have been received from that customer post year-end. You are unaware as to whether the auditors are aware of this fact or not. If none of the debt is recovered then the balance sheet position at the year end will move from a net assets position of £2,500,000 to £700,000.

What makes it worse is that the company has carried out further work for this client post year end to the sum of £650,000. The consequences of this do not bear thinking about. You have not yet had time to update your projections to take account of the likely impact of this potential bad debt and of the worsening economic environment which has seen many potential road upgrades postponed. The projections which the auditors had reviewed in October in your opinion now appear to be very optimistic. You believe that they will need to be updated and a copy given to the auditors.

Just as you are thinking this over, Dan, the Chief Executive, comes into your office. He asks whether you have updated the accounts and projections to take account of the new information. You advise that you are just about to do so and that the figures will be available later in the day. He advises you that there is no need and that what the auditors already have is sufficient for their purposes and that projections are a “guesstimate” at the best of times. He also informs you that no adjustments should be made for the debtor which has gone into administration. You inform him that the auditors will demand that the year-end debt is provided for. He advises you to leave the discussions on the recoverability of the debt to him. Additionally, you inform him that the projections will require to be updated as they now look overly optimistic given what has happened in the past few days with your largest debtor now in administration and road contracts which you had budgeted on winning being postponed.
Dan replies that:

“The past year has been very challenging and the bank is putting pressure on me to send them a copy of the audited financial statements at the earliest possible opportunity. If the financial statements do not show the company to be in reasonable health then negotiating our new funding facilities is going to be at best very difficult. Remember, it is not only your job that is on the line – think of all the other 60 or so employees and their families. We will be able to trade through this downturn if we are only given a chance. It is not our fault that we find ourselves in this position - don’t let them pull the rug from our feet.”

What do you do now?
**Scenario 15: Analysis**

What are the readily-identifiable ethical issues for your decision?

*For you personally*

Can you follow Dan’s orders and not update the accounts and projections? Undoubtedly, he is correct in that projections are a best guess of the future, however, they need to be based on the most up to date and best information available. To not take account of current events could be construed as trying to mislead the auditors.

Who are the key parties who can influence, or will be affected by, your decision?

‘You’; the Chief Executive; your other fellow directors; the shareholders (if different from the directors); the employees; the auditors; the bank; and any other creditors.

What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?

<table>
<thead>
<tr>
<th>Integrity</th>
<th>Can you preserve your integrity if the information presented to the auditors is not up to date and does not reflect recent events?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objectivity</td>
<td>The need to set aside the potential consequences of recent events (in a worse case scenario the bank might withdraw/not renew their funding) to prepare financial information which takes account of their implications.</td>
</tr>
<tr>
<td>Professional</td>
<td>Assumed.</td>
</tr>
<tr>
<td>competence</td>
<td></td>
</tr>
<tr>
<td>and due care</td>
<td></td>
</tr>
<tr>
<td>Confidentiality</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Professional</td>
<td>The need to prepare realistic projections based on the most up to date information available. The need also to comply with legal requirements in relation to the provision of information to auditors.</td>
</tr>
<tr>
<td>behaviour</td>
<td></td>
</tr>
</tbody>
</table>

Is there any further information (including legal obligations) or discussion that might be relevant?

What is the likelihood of getting repayment of any of the amount due from Dudsareus Ltd?
Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?

The ‘Guardian’ role would place emphasis on producing the best information possible for decision-making purposes for all parties concerned. In this scenario, the ‘Commercial’ pressure is likely to conflict with this need for transparency.

Based on the information available, is there scope for an imaginative solution?

No.

Are there any other comments?

None.
Scenario 16: Judge and jury
(This is a separate scenario, although it is related to scenario 15)

You are an audit partner in a local office of a large accountancy firm TTZ LLP. One of your biggest clients is Bonnieclyde Ltd, a company which undertakes major construction projects such as building new roads, motorways etc. Until last year the company had been very profitable but the economic downturn has started to hit the company hard. You are preparing for the final audit meeting with the client at which you will discuss your main findings and any adjustments which are required to the accounts. The big issue is clear “Is the company still a going concern?” This issue has caused you many sleepless nights of late – you like the people who run this company and you are well aware of the impact that the closure of this business would have on the local community. You are also well aware that it would most likely have a negative impact on your immediate career prospects.

The company’s year-end was 31 August and your firm carried out most of its work during October. At that time everything looked fine, however, recently you noticed that one of the company’s major customers, Dudsareus Ltd had been placed in administration. Although you are not sure of the amount of work carried out post year-end you do know that further work was carried out for this client. You are also aware that at the company’s year-end Dudsareus Ltd owed Bonnieclyde Ltd £1,800,000. You were aware that Dudsareus Ltd were disputing the amount due but such a stalling tactic was commonplace in the industry – you had fully expected the vast majority of the sum due to be paid. This is all now in doubt.

At the meeting with the client, you are surprised to find that the Financial Director is not able to attend the meeting due to ill health. After the usual small talk you ask whether the client has made any provision in relation to the amount due from Dudsareus Ltd and also whether it has updated its projections to take account of this. Dan, the company’s Chief Executive, advises you that he does not believe this to be necessary. He informs you that the administrator has advised him that Dudsareus Ltd will be able to meet all of its current outstanding debts. You advise Dan that you sincerely hope that this will indeed be the case but that you will need to check with the administrator directly. Dan asks why this is necessary as he is happy to give you a letter to that effect. You advise Dan that you have to do your job.

Dan stands up and starts shouting:

“You have been our auditor for years, at the first sign of trouble you appear willing to help the bank shut our doors, the effect of which will be a disaster for the local community and also for your firm. Many of your neighbours work for this company, what will they think, what will their children think? This will impact on your own children at school. All we are asking for is time – to let us trade out of this situation. As far as I am concerned, the accounts will not be altered. You can do as you wish – however, remember what I have...”
told you – local communities need businesses like ours. I will let them know who caused the closure of this business, if that is what it comes to!”

What do you do now?
Scenario 16: Analysis

What are the readily-identifiable ethical issues for your decision?

For You Personally

Is the Chief Executive serious about his proposed intentions which could affect your family?
The need to be truthful and honest with your client. You have a responsibility to issue an opinion on the truth and fairness of the financial statements on behalf of your firm and auditing standards require you to gather sufficient evidence to allow you to do this.
If the full debt due from Dudsareus Ltd has to be written off, what is the current financial position of the company?

Who are the key parties who can influence, or will be affected by, your decision?

‘You’; your fellow partners; the Chief Executive and other directors of Bonnieclyde Ltd; the shareholders (if different from the directors); the employees; the bank; any other creditors; and possibly customers.

What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?

<table>
<thead>
<tr>
<th>Integrity</th>
<th>The need to be truthful and honest with your client. You have a responsibility to issue an opinion on the truth and fairness of the financial statements and auditing standards require you to gather sufficient evidence to allow you to do this.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objectivity</td>
<td>It is imperative that you retain your objectivity in order that you can remain in the role of auditor.</td>
</tr>
<tr>
<td>Professional competence and due care</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Confidentiality</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Professional behaviour</td>
<td>The need to follow all relevant standards. This will require you to obtain sufficient audit evidence on which to base your audit opinion. If the client attempts to prevent you from obtaining the necessary evidence then the repercussions should be explained to the client.</td>
</tr>
</tbody>
</table>

Is there any further information (including legal obligations) or discussion that might be relevant?

The likely level of debt recovery that the administrator expects. Additionally, what other contracts is the company currently working on and how profitable are they? Likewise, what other contracts is the company contracted to commence work on and how profitable are they forecast to be?
Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?

There may be commercial pressures to help the client to maintain its funding package with the bank, however, the ‘Guardian’ role requires that the auditor has to report on whether the financial statements show a true and fair view of the company's financial performance and position.

Based on the information available, is there scope for an imaginative solution?

No.

Are there any other comments?

None.
Scenario 17: True, but fair?

You are a recently appointed audit partner in a large independent firm of accountants. You are delighted that you are now a partner and can’t wait to sign off your first set of accounts. Your firm recently won an audit tender for a medium-sized family owned company, Milnetic Ltd, and the firm’s managing partner has allocated the client to you. The managing partner is reasonably close to the family which owns Milnetic and you believe that this is at least part of the reason why the company decided to appoint your firm.

As is normal, you go through all the firm’s new client procedures which include writing to the previous auditors and also obtaining sets of statutory accounts for the previous 3 years. When you receive the written reply from the previous auditors, you note that they have nothing to report other than any matters addressed in their audit report. This seems strange, so you quickly review the company’s set of financial statements for the previous year and note that the company’s audit report was qualified on the basis of non-compliance with an accounting standard. The audit report highlights that the company operates an occupational defined benefit pension scheme and advises that the directors, on cost grounds, decided not to have an FRS 17 valuation performed by an actuary. The audit opinion adds that the auditor is unable to quantify the impact of this non-compliance with FRS 17. You wish that you had access to the working papers of the predecessor auditors but the relevant audit regulation was not applicable at this time.

You are considering the impact of this issue when Max, the Managing Partner, comes into your office. He provides you with an oral briefing on Milnetic Ltd and then asks you whether you have any queries. You inform Max what you have found. Max replies:

“I do not see any problems; if the client does not believe that it is worth paying for this information then who are we to tell them otherwise: it is a family business after all. If we have to, we can adopt the same approach as the previous auditors and qualify the audit report on the same grounds.”

That is when you inform him that you have doubts as to whether the audit qualification issued was appropriate in the circumstances. The previous auditors issued an “except for - disagreement with accounting treatment – due to non compliance with an accounting standard” and you believe that a “limitation of scope” opinion may have been more appropriate. You are not sure but you surmise that this may be because of the requirement that if a client places a limitation of scope on the work of the auditors which will require the auditor to issue a disclaimer of opinion, in advance of the auditors accepting that appointment, then unless the restriction is removed, the auditor should not continue in office for that particular client. Max replies that you should go ahead and reassess the position once the audit fieldwork has been completed by your team. However, he adds:

“Bear in mind that although the Managing Director (MD), is an acquaintance it has
taken me a number of years to get him to use our firm as auditors – I do not want to do anything that would upset him unnecessarily and jeopardise our business relationship."

You are now reviewing the audit files of Milnetic Engineering Ltd for the year in question. The company has a turnover of around £18 million and is showing a profit of £2,900,000 for the year after taking account of the proposed audit adjustments. However, you notice that the directors have once again refused to obtain an FRS 17 valuation and therefore no pension scheme surplus or deficit is reflected in the accounts. You realise that the lack of an FRS 17 valuation will mean that you will have to qualify your first audit opinion. Whilst this concerns you, what really worries you is the type of qualification that will be required i.e. a limitation of scope. If the extent of this limitation leads you to issue a disclaimer of opinion, then your firm would not be able to act for this client going forward unless the client changes its stance on obtaining FRS 17 actuarial valuations. Max will be furious if you adopt this approach.

What do you do now?
Scenario 17: Analysis

What are the readily-identifiable ethical issues for your decision?

For you personally

Even at this late stage would it be possible for you and Max to convince the MD and his fellow directors of the need for Milnetic Ltd to get an FRS 17 valuation performed by an actuary? Have you explained to the MD that your firm will possibly not be able to act as auditors if the ongoing limitation of scope is not removed?

Depending on the nature of the pension scheme – (i.e. is it being wound up, closed to new entrants and/or future accruals, number of members, status, etc) is there any other way that sufficient audit evidence could be obtained to allow a proper assessment of the non-compliance with FRS 17 (e.g. with reference to the actuary’s triennial funding valuation performed on behalf of the trustees)?

If neither of these options is possible, can you convince Max that the only way forward is to issue either a qualified opinion (except for limitation) or a disclaimer of opinion if the possible effect of the limitation on scope is so material and pervasive that you are unable to express an opinion on the financial statements.

For the audit firm

Is there a formal process for review by another audit partner where the firm is set to issue a qualified audit opinion?

Would your fellow partners be willing to risk the reputation of the firm by issuing an audit opinion which does not appear to properly reflect the nature of the matter requiring the qualification?

Who are the key parties who can influence, or will be affected by, your decision?

‘You’; your fellow partners; the directors of Milnetic Ltd; the shareholders of Milnetic Ltd; customers; suppliers; and employees of Milnetic.
What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?

<table>
<thead>
<tr>
<th>Integrity</th>
<th>You need to be open and honest in your views to the client and to your Managing Partner. Your integrity will be questioned if you follow a course of action that you have doubts about. You need to be able to satisfy yourself that you are issuing an appropriate audit opinion.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Objectivity</td>
<td>You need to ensure that your decision is not swayed by any pressure that may be put on you by the client or your managing partner.</td>
</tr>
<tr>
<td>Professional competence and due care</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Confidentiality</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Professional behaviour</td>
<td>The need to show professional courage and ensure that the most appropriate audit opinion is issued in the circumstances.</td>
</tr>
</tbody>
</table>

Is there any further information (including legal obligations) or discussion that might be relevant?

More information with regards to the defined benefit pension scheme would be helpful. Is the scheme closed? How many members are there? What information is available from the triennial funding valuations?

Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?

The commercial pressure may well be to keep the client (although this may be diluted because there is a real financial risk to both you personally and the other partners in your firm if the pension fund is in deficit and the auditors were seen to be negligent in their approach). Any such commercial pressure that does exist may conflict with the ‘Guardian’ role which will be to ensure that the auditor is fully transparent in his audit opinion in relation to Milnetic’s financial statements.

Based on the information available, is there scope for an imaginative solution?

The first option is to try and persuade Milnetic Ltd of the need to obtain an FRS 17 valuation from an actuary. The benefits of having a clean audit opinion should be conveyed to the directors to help them arrive at a more informed judgement as to whether the company should or should not obtain a valuation.

Depending on the position of the pension scheme, it may be possible to obtain sufficient other information to allow an assessment of the state of the scheme in the audit opinion, which although not removing the need for a qualified audit report would possibly remove the need for a disclaimer of opinion.

Are there any other comments?

None.
Scenario 18: 
Deal or no deal?

You are a salaried corporate finance partner in a mid-tier accountancy firm, Hip Hop Ska & Co. The current economic climate is such that the number of deals taking place has fallen significantly and both current work and prospects in the pipeline are low – the M & A market has all but disappeared – you have never known it to be so inactive. As a result of the economic conditions your firm is currently undertaking a cost review exercise and it is rumoured that the headcount – both staff and salaried partners – will be reduced significantly. The mood in the office is apprehensive, as salaried partners and staff worry about their positions. Americana, the Managing Partner, has issued an edict encouraging partners and staff to work longer hours and chase all potential business opportunities.

You have been working as an adviser to a significant non-audit, owner-managed business client of the firm, Nice and Easy Ltd. The company is large in size and, although like most businesses they are finding trading conditions difficult, they are managing to keep their head above the turbulent water. However, a number of years ago the company branched into another area in which it set up a subsidiary company, Rhythm Blues & Punk Ltd. The subsidiary has performed steadily but the directors now feel that in order for this subsidiary to grow further it needs additional capital. The directors have decided that providing additional capital at this point in time does not feature in their current strategic plans and have therefore decided to dispose of Rhythm Blues & Punk Ltd. Whilst the directors appreciate that economic conditions are difficult and uncertain, they are very keen that the subsidiary is not sold at a “fire sale” price. If push comes to shove they would rather retain Rhythm Blues and Punk Ltd than sell it for significantly less that it is worth. The subsidiary has now been on the market for several weeks attracting a fair degree of interest from potential purchasers. In the last fortnight however, a frontrunner, Alternative Country Ltd, emerged and following appropriate due diligence, the deal is now nearing completion.

Your fees have been agreed in advance on a contingent fee basis, meaning that the fee for the transaction will be based on a percentage of the consideration achieved and you will receive no fee if the deal does not proceed. In your mind this deal must be completed – you cannot afford to write off the amount of time you have now spent working on this transaction – successful completion and the associated fees attained will provide you with some time to get further prospective transactions in the pipeline and therefore safeguard your position at the firm at least in the short-term – that may be enough for you to ride out the current economic storm.

On the day the deal is due to be completed, you are summoned by your Managing Partner. He informs you that he has been very impressed by the manner in which you have led this assignment – all that is needed now, is for both parties, the buyer and seller to sign on the dotted line. Ominously, however, Americana adds that this deal is now vital to the survival of the firm’s corporate finance department – the firm has already seen a couple of mooted M & A transactions fall by the wayside in recent days – the firm just could not afford another one – it would not just be your job that would be on the line.

You then leave for the meeting with your client with the words of your Managing Partner ringing in
your ears “a deal must be done!” On arrival at the meeting which you had hoped would be a straightforward crossing of the “i’s” and dotting of the “t’s” you are aghast to find out that at the 11th hour, the prospective buyer, Alternative Country Ltd, has substantially lowered their offer for your client’s business, citing the downturn in the economy – they are a bit late, you think to yourself – and you wonder whether this has been a carefully orchestrated ploy to try and force your client’s hand – the other prospective bidders have long since left the table. You appreciate that if your client still wants to go ahead with this transaction then they will have to lower their expectations, however, your experience and skill as a corporate finance adviser tells you that Alternative Country Ltd’s revised offer undervalues the target company. Your first course of action is to try and get the purchaser to raise their offer back to their original intended amount – however, unfortunately you are unsuccessful at negotiating an increase in the price on behalf of your client. The purchasers are adamant – this is a take it or leave it final offer.

You update your client, at which point the directors ask you whether the prospective purchaser’s offer represents a fair value for the subsidiary in the current economic climate, noting that they will go with your recommendation.

What do you do now?
Scenario 18: Analysis

What are the readily-identifiable ethical issues for your decision?

For you and your firm personally:

The purchaser has made a revised reduced offer for your client’s subsidiary business. You do not believe this to be a reasonable offer for the business but have you given sufficient consideration to the state of the economy when arriving at your valuation?

There would appear to be considerable pressure on you and your firm for this deal to go through. Can you properly manage this pressure without it impacting on your professional judgment?

Who are the key parties who can influence, or will be affected by, your decision?

You; potentially your family; your fellow partners and staff; your client; and the prospective purchaser.

What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?

<table>
<thead>
<tr>
<th>Integrity</th>
<th>The need to be open and honest with your client. Is the prospective purchaser’s offer reasonable in the current economic climate?</th>
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</thead>
<tbody>
<tr>
<td>Objectivity</td>
<td>How do you ignore the commercial pressures which you have been put under?</td>
</tr>
<tr>
<td>Professional competence and due care</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Confidentiality</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Professional behaviour</td>
<td>The need to disregard anything other than the task at hand which is advising your client on the proposed sale of their subsidiary company. Given the economic conditions, is the prospective purchaser’s offer reasonable?</td>
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Is there any further information (including legal obligations) or discussion that might be relevant?

No.
Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?

The commercial pressure which you are under to force through the deal conflicts with the ‘Guardian’ role, which in this case requires you to act in the best interests of your client regardless of whether this may not appear to be in your or your firm’s short-term best interests.

Based on the information available, is there scope for an imaginative solution?

An approach could potentially be made to the other previously interested parties to see whether they would still be willing to discuss a potential purchase.

Are there any other comments?

The case study highlights the dangers from both a firm and client perspective of agreeing to undertake an engagement on a contingent fee basis.
Scenario 19: Everyone’s a winner

You are a recently qualified CA, working in the insolvency department of a medium-sized accountancy firm. You are currently working on the sale of a piece of land that belonged to a company that has gone into liquidation. The sale of the land stipulates that bids have to be submitted via email by midday that day. A few bids have been received but not as many as were anticipated. You are sitting drinking a cup of hot chocolate eagerly awaiting the “High Noon” deadline in order that you can collect any further bids and get out for your lunch. The local pub serves a very good pie and beans but is also very crowded on a Friday lunchtime. You are impatient to get there as soon as you can.

At 11.30am you receive a call from a prospective buyer who wishes to remain anonymous. The caller informs you that he is very interested in the land but does not want to have to pay over the odds to ensure that he gets it. Therefore, he makes the following proposition to you:

He is willing to pay a premium of 15% above the highest bid received by 11.55am provided he is informed beforehand of the highest bid received.

The caller advises that this way everyone wins as he explains succinctly as follows:

“Your firm and ultimately the bank win because a higher fee is received for the asset in question, I win because I do not have to make an unnecessarily high blind bid and you will also be rewarded by me for your hard work.”

He adds that this illustrates that “transparency is the best policy”.

The caller reiterates that this is the most effective outcome for all parties concerned and that your boss will be delighted that a last minute offer has at least ensured a reasonable return for the asset in question. The bank will also be very pleased as this sale will increase its level of return on the debt outstanding.

You advise the caller that this is not the way that you or your firm do business and that if he wants to attempt to purchase the land then he should follow the required procedure of the sale and email his bid prior to the midday deadline.

The caller advises that he respects your integrity but advises that this type of activity is commonplace in the industry and insinuates without naming names that other more senior personnel within your firm have taken advantage of his very generous financial terms in the past. Furthermore, the bank is unlikely to be happy if it was to find out that your firm had rejected a higher bid than what was eventually obtained for the asset. This could have a serious impact on any future work being awarded to your firm and your own career would suffer as a result.
The caller then advises that he will phone you back in five minutes for a decision as to whether you will accept his proposition. You do not get a chance to reply, as the caller then hangs up.

What do you do now?
Scenario 19: Analysis

What are the readily-identifiable ethical issues for your decision?

For you personally

The first issue is do you immediately raise this with someone senior before the caller phones back? Secondly, when the caller does phone back do you transfer the call to someone more senior, do you get someone more senior to listen in to the conversation or do you merely deal with the caller yourself?

The third issue is do you raise sensitively and professionally, the caller's accusation relating to senior staff internally within your firm. Consideration should be given to discussing the matter with your firm's ethics partner, if there is one, or if not, with a trusted partner within the firm?

Who are the key parties who can influence, or will be affected by, your decision?

'You'; the caller; the partners and staff in your firm; the bank; other creditors; and other prospective buyers.

What fundamental ethical principles for accountants are most applicable and is there an apparent conflict between them?

<table>
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<tr>
<th>Integrity</th>
<th>Can you retain your integrity if you distort the tender process? How do you deal with the caller's allegations about more senior personnel within your firm?</th>
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<tbody>
<tr>
<td>Objectivity</td>
<td>The need to consider the interests of all of the other parties involved in the tender process.</td>
</tr>
<tr>
<td>Professional competence and due care</td>
<td>Assumed.</td>
</tr>
<tr>
<td>Confidentiality</td>
<td>How could one justify divulging confidential information to the caller in the interests of maximising the selling price of the land?</td>
</tr>
<tr>
<td>Professional behaviour</td>
<td>You have to handle the client's allegations sensitively and professionally. You have no knowledge as to the accuracy of the allegations made by the caller.</td>
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Is there any further information (including legal obligations) or discussion that might be relevant?

All relevant information appears available.
Is there a conflict between the ‘Guardian’ and ‘Commercial’ strands of an accountant’s responsibilities?

From the given information, the firm and the bank would appear to be better off commercially if the information is divulged, although this is not certain as a late bid from an unnamed prospective buyer may yet be received prior to the deadline. The ‘Guardian’ aspect in this scenario is to ensure that a fair tender process is held which appears to be in conflict with the short-term commercial pressure.

Based on the information available, is there scope for an imaginative solution?

No.

Are there any other comments?

None.
Shades of Grey
Ethical Dilemmas