

## "SETTING THE AGENDA FOR ETHICS"

RESPONSE BY  
THE UNITED KINGDOM SHAREHOLDERS' ASSOCIATION

TO

THE ETHICS STANDARDS BOARD'S  
CONSULTATION PAPER (MAY 2002)

### 1. INTRODUCTION

The Consultation Paper has a great deal to do with the quandaries faced by those who claim professional status and find themselves, when employed by a corporate body, owing a duty both to their professional bodies (who often regulate them) and to their employers. The Paper treats, of course, of accountants, but the quandaries are similar for all professionals, being more acute when they are employed by a corporate body rather than a professional firm.

We have deliberately written in terms of 'professionals' and 'duties', rather than ethical standards, because we feel these words help to clear some of the fog which surrounds the issues being dealt with. Ethical standards seem to us more rooted in the higher plane of morality applying to individuals in all walks of life. Hence we find helpful the words of an engineer who suggested that "professional status is an implied contract: to serve society over and beyond all specific duty to client or employer in consideration of the privileges and protection society extends to the profession."

We have been as brief as possible, not only for ease of reading, but also because having very limited resources we have found ourselves struggling somewhat to respond to the many important consultation papers which have surfaced recently. It may be relevant to note that the Cadbury Report issued in 1992 was the first paper which we responded to. There have been many since.

In answering your questions, we have repeated each question in your Paper in order to ease the labours of those who read our response without having the benefit of your Consultation Paper in front of them.

### 2. ANSWERS TO QUESTIONS

**Q1 What factors should be considered when determining the public interest with regard to the ethical standards of accountants?**

Truthfulness and trust.

**Q2 Should the ethical standards of accountants be based solely on a system of rules or on a system of principles supported by guidance and rules?**

Just one or two principles.

**Q3 What are the principal ethical issues encountered by accountants in industry, commerce and the public sector? Is additional guidance needed in these areas?**

If accountants are employed by a company (or public sector body) then they are often not able to act in a truly professional capacity since they owe a duty to their employer who will have a large say in setting the ethical standards which presumably will be touched on in their contract of employment. On the other hand if they are employed by a professional firm (assumedly independent), their duty to their profession should hold sway without the same conflicts of interest which can arise in the former case.

**Q4 Should the ethical responsibilities of accountants working within the financial reporting process differ from those of accountants working outside that process? If so, how?**

Not perhaps a useful distinction?

**Q5 Is there a loss of public confidence in the independence of auditors in the United Kingdom and the Republic of Ireland? If so, how serious is it?**

Yes - and serious.

**Q6 What are the other ethical issues encountered by accountants in public practice? Is additional guidance needed in these areas?**

We don't know.

**Q7 Can company auditors ever be truly independent while they are effectively appointed - and reappointed - by the directors on the advice of management?**

No. The present practice flies in the face of the original intention of the Companies' Acts which required the appointment of auditors by shareholders to look after their interests.

**Q8 What other models for appointing company auditors should be explored? For example, is there a case for establishing an independent body to appoint auditors to listed companies?**

Yes in principle. However, since the costs of auditing are borne by shareholders the difference in costs between any new system and the present one should be carefully assessed.

**Q9 Should audit committees be strengthened in order to play a more active role in achieving auditor independence? If so, how?**

Probably yes, but costs again are important to consider.

**Q10 Should guidance be developed for those charged with governance - and, in particular, for audit committees - on their consideration of auditor independence? If so, by whom? (This would fall outside the ESB's remit)**

We don't understand the question. Surely those "charged with governance" are the members of the Board. They have probably had their fill of guidance over the last decade.

**Q 11 Should the independence requirements differentiate between different types and sizes of entity? If so, what distinctions should be made?**

No

**Q12 Should all advisory services provided by accountants in public practice be subject to the same ethical requirements as audit?**

Yes

**Q13 What are the key areas that should be addressed by guidance supporting principle-based requirements for auditor independence?**

No comment, other than that the discussion which precedes this question does seem to suggest the setting up of a new, very complicated regulatory regime.

**Q14 Can an accounting firm provide non-audit services to an audit client without impinging on auditor independence?**

No

**Q15 Which non-audit services do you consider present the greatest threat to auditor independence?**

They all present a potential threat.

**Q16 Should there be a bar or significant restriction on the provision of non-audit services to audit clients? If so, what would be the impact on the quality and cost of the audit?**

Yes, there should be a bar. We don't see why there should be any negative impacts on quality and cost where a competitive market obtains.

**Q17 Should an engagement partner be permitted to market the firm's non-audit services to an audit client?**

No. If the sole purpose of the audit is to provide an independently validated set of accounts to shareholders, then there should be no occasion for the "audit engagement partner marketing the firm's non-audit services to an audit client". We suggest that the need to pose the question indicates the close business relationship which now exists between auditor and client company.

**Q18 Is there a threat to independence if the audit engagement partner's performance is assessed and rewarded in the accounting firm on the basis of success in 'selling' non-audit services to audit clients?**

Assuming accountants are subject to all the normal behavioural patterns - ie they respond to incentives, then clearly there must be a threat.

**Q19 Should there be tighter restrictions on employment of former accounting firm personnel with audit clients? If so, what should they be?**

Yes. Dealing with the matter in the contract between client and auditor seems the most straightforward way.

**Q20 Should there be a requirement for periodic rotation of senior members of the audit team?**

The question would not arise if the audit firm were to be appointed by an independent body.

**Q21 Should there be a requirement for periodic rotation of the accounting firm acting as auditor in order to introduce a fresh approach to the audit after a certain number of years? If so, how often should this occur and what would be the impact on the quality and cost of an audit? If not, should there be a requirement for periodic tendering for the audit appointment?**

Yes.

**Q22 What guidance should be given on what constitutes financial dependence? In particular, what percentage of a firm's total fee income is it acceptable to receive from an audit client?**

See answer to Q20.