

Unit- 1. Introduction,

What is ethics?

At its simplest, ethics is a system of moral principles. They affect how people make decisions and lead their lives.

Ethics is concerned with what is good for individuals and society and is also described as moral philosophy.

The term is derived from the Greek word *ethos* which can mean custom, habit, character or disposition.

Ethics covers the following dilemmas:

- how to live a good life
- our rights and responsibilities
- the language of right and wrong
- moral decisions - what is good and bad?

Our concepts of ethics have been derived from religions, philosophies and cultures. They infuse debates on topics like abortion, human rights and professional conduct.

Approaches to ethics

Philosophers nowadays tend to divide ethical theories into three areas:

I. Metaethics,

II. Normative ethics and

III. Applied ethics.

- Meta-ethics deals with the nature of moral judgement. It looks at the origins and meaning of ethical principles.
- Normative ethics is concerned with the content of moral judgements and the criteria for what is right or wrong.
- Applied ethics looks at controversial topics like war, animal rights and capital punishment

Ethics vs Morals



Many people use the words Ethics and Morality interchangeably. However, there is a difference between Ethics and Morals.

To put it in simple terms, **Ethics = Morals + Reasoning**.

To have an ethical viewpoint, you should be able to give some reason for it. Yes, Ethics is Moral Philosophy, and Philosophy is all about reasoning

For example, you might feel that it is morally wrong to steal, but if you have an ethical viewpoint on it, it should be based on some sets of arguments and analysis about why it would be wrong to steal.

To be moral is all about adhering to what is described (by society or religion). But to be ethical, you should figure out what is right – by applying some principles and considering all the complexities involved. Clearly, the ethical life is the harder path.

Ethics and Morals – An Analogy with a Car Driver and an Automobile Engineer



Let's take the case of a car driver and an automobile engineer. The car driver knows how to drive a car, but he may not know the engine mechanism or design principles. However an automobile engineer is concerned with how the car works, and the principles involved.

Connecting the above example with ethics and morals, you can see that following morals is just like driving the car without understanding the working principles of the engine. But if you follow ethical principles – you would be using reasoning and analysis (just like the automobile engineer in the above example) to understand the situation/case better. If the engine starts to create trouble, the engineer may be able to use the problem-solving approach as well.

DIFFERENT TYPES OF ETHICS

We need to identify that there are different types of ethics and you may have been already exposed to them.

PERSONAL COMMON PROFESSIONAL

Personal Ethics

- Includes your personal values and moral qualities.
- Influenced by family, friends, culture, religion, education and many other factors.
- Examples: I believe racism is morally wrong. I am in favor of abortion.
- Personal ethics can change and are chosen by an individual.

Common Ethics

- Ethics that the majority of people agree on.
- Many philosophers argue there is no such ethics.
- Do we have the same ethics in the world? Do we have the same ethics in the U.S.? Does everyone in your family share the same ethics?
- Examples: Murdering people for the sake of murder is wrong.
- Notice how this would change in the context of self-defense.
- Common ethics have to be very general to avoid disagreement.

Professional Ethics

- Rules imposed on an employee in a company, or as member of a profession. For instance, journalists, doctors, lawyers, etc.
- Imposed when you are a part of a professional setting or when you are being trained or educated for working for a specific profession.
- Examples: no gossiping, time management, punctuality, confidentiality, transparency.
- Not adhering to these may harm your professional reputation.

Conflict between self-interest & Morality Dilemmas.

Conflict of Interest

A conflict of interest arises when what is in a person's best interest is not in the best interest of another person or organization to which that individual owes loyalty.

For example, an employee may simultaneously help himself but hurt his employer by taking a bribe to purchase inferior goods for his company's use.

A conflict of interest can also exist when a person must answer to two different individuals or groups whose needs are at odds with each other. In this case, serving one individual or group will injure the other.

In business and law, having a "fiduciary responsibility" to someone is known as having a "duty of loyalty." For example, auditors owe a duty of loyalty to investors who rely upon the financial reports that the auditors certify. But auditors are hired and paid directly by the companies whose reports they review. The duty of loyalty an auditor owes to investors can be at odds with the auditor's need to keep the company – its client – happy, as well as with the company's desire to look like a safe investment.

So, those of us who wish to be ethical people must consciously avoid situations where we benefit ourselves by being disloyal to others.

Conflicts of interest and ethical threats

All employees should act ethically both at work and in their private life.

Members of professional bodies, such as qualified accountants, often have codes of ethics to guide them when ethical dilemmas arise. A discussion of what is meant by "professional" and different codes of ethics can be found [here](#).

This page looks at specific conflicts of interest and ethical threats.

Conflicts of interest and ethical threats

Conflicts of interest and their resolution are explained in the conceptual framework to the code of ethics.

A framework is needed because it is impossible to define every situation where threats to fundamental principles may occur or the mitigating action required.

Different assignments may also create different threats and mitigating actions - again it is not possible to detail all the assignments an accountant undertakes.

The framework helps to identify threats - using the fundamental principles as guidance.

This approach is preferable to following a set of rules - which may not be applicable. (see later in this chapter).

Once a material threat has been identified, mitigating activities will be performed to ensure that compliance with fundamental principles is not compromised.

Where conflicts arise in the application of fundamental principles, the code of ethics provides guidance on how to resolve the conflict.

Conflicts of interest

There are potential threats which may lead to conflicts of interest and lack of independence. These are:

self-interest

self-review

advocacy

familiarity

intimidation.

A threat to independence is any matter, real or perceived, that implies the accountant is not providing an independent view or report in a specific situation.

An accountant needs to be independent so others can place reliance on his/her work.

Lack of independence implies bias, meaning less reliance would be placed.

Threat to independence	Possible effect on ethical behaviour
Financial interests – an accountant holds shares in a client company.	Conflict between wanting a dividend from the shareholding and reporting the financial results of the company correctly. May want to hide liabilities or overstate assets to improve dividends. (Self-interest threat)
Financial interests – an auditor holds shares in a client company.	Conflict between wanting a dividend from the shareholding and providing an honest audit report on the entity. May want to hide errors found in the financial statements to avoid qualifying the audit report and potentially decreasing the dividend payment. (Self-interest threat)
Close family member has an interest in the assurance client.	Self-interest threat. May decide not to qualify the audit report to ensure that the financial interests of the family member are not compromised. May also be an intimidation threat – if an employee, the assurance client may threaten to sack the family member if a qualified audit report is produced.

Threat to independence	Possible effect on ethical behaviour
The assurance partner plays golf on a regular basis with the chairman of the board of the assurance client.	Self-interest threat. There may be a conflict between potential qualification of the company financial statements and losing the friendship/golf with the chairman.
Fee due from a client is old and the assurance firm is concerned about payment of that fee.	Intimidation threat. The client may threaten to default on the payment unless more work is carried out by the assurance firm. The assurance firm may also be seen to be supporting the client financially, implying that any report will be biased because the firm wants the 'loan' to be repaid.
A company offers an assurance partner an expensive car at a considerable discount.	Potential conflict because the partner may want the car, but also recognises the ethical threat of appearing to be bribed by the client. The partner may accept the car and not report this. (Self-interest threat)

Threat to independence	Possible effect on ethical behaviour
A close family member is a director of a client company.	Potential conflict because an assurance partner would not want to qualify the audit report and create bad feeling between the partner and the director. The audit report may therefore not be qualified when it should be. (Familiarity threat)
An assurance partner serves as an officer on the board of an assurance client.	Self-interest and self-review threats. The partner would have a conflict between producing information for audit and then reporting on that information. The partner may either miss errors or even decide to ignore errors identified to avoid having to admit to mistakes being made.

Conceptual framework

A conceptual framework can be explained as follows:

It provides an initial set of assumptions values and definitions which are agreed upon and shared by all those subject to the framework.

It is stated in relatively general terms so it is easy to understand and communicate.

It recognises that ethical issues may have no 'correct' answer and therefore provides the generalised guidelines and principles to apply to any situation.

Safeguards

Safeguards seek to reduce or eliminate threats. They fall into three categories created by the:

Profession

These include:

education and training including CPD requirements

setting of corporate governance regulations and professional standards

monitoring of professional work including disciplinary proceeding

Work environment

Business Ethics

There are many examples which include:

- internal control systems
- review procedures
- disciplinary procedures
- organisational codes of ethics
- separate review and reporting for key engagements.

Individual

These include:

- complying with professional standards
- maintaining records of contentious issues
- mentoring
- contacting professional bodies with queries.

Ethical threats and safeguards

An ethical threat is a situation where a person or corporation is tempted not to follow their code of ethics.

An ethical safeguard provides guidance or a course of action which attempts to remove the ethical threat.

Ethical threats apply to accountants - whether in practice or business.

The safeguards to those threats vary depending on the specific threat.

The professional accountant must always be aware that fundamental principles may be compromised and therefore look for methods of mitigating each threat as it is identified.

Examples of ethical threats and safeguards

Ethical threat	Safeguard
Conflict between requirements of the employer and the fundamental principles. For example, acting contrary to laws or regulations or against professional or technical standards. (Intimidation threat)	• Obtaining advice from the employer, professional organisation or professional advisor. • The employer providing a formal dispute resolution process. • Legal advice.
Preparation and reporting on information Accountants need to prepare/report on information fairly, objectively and honestly. However, the accountant may be pressurised to provide misleading information. (Intimidation threat)	• Consultation with superiors in the employing company. • Consultation with those charged with governance. • Consultation with the relevant professional body.

Ethical threat	Safeguard
Having sufficient expertise Accountants need to be honest in stating their level of expertise – and not mislead employers by implying they have more expertise than they actually possess. Threats that may result in lack of expertise include time pressure to carry out duties, being provided with inadequate information or having insufficient experience.	• Obtaining additional advice/training. • Negotiating more time for duties. • Obtaining assistance from someone with relevant expertise.
Financial interests Situations where an accountant or close family member has financial interests in the employing company. Examples include the accountant being paid a bonus based on the financial statement results which he is preparing, or holding share options in the company. (Self-interest threat)	• Remuneration being determined by other members of management. • Disclosure of relevant interests to those charged with governance. • Consultation with superiors or relevant professional body.

Ethical threat	Safeguard
Inducements – receiving offers Refers to incentives being offered to encourage unethical behaviour. Inducements may include gifts, hospitality, preferential treatment or inappropriate appeals to loyalty. Objectivity and/or confidentiality may be threatened by such inducements. (Self-interest threat)	• Do not accept the inducement! • Inform relevant third parties such as senior management and professional association (normally after taking legal advice).
Inducements – giving offers Refers to accountants being pressurised to provide inducements to junior members of staff to influence a decision or obtain confidential information. (Intimidation threat)	• Do not offer the inducement! If necessary, follow the conflict resolution process outlined in the next section.

Ethical threat	Safeguard
Confidential information Accountants should keep information about their employing company confidential unless there is a right or obligation to disclose, or they have received authorisation from the client. However, the accountant may be under pressure to disclose this information as a result of compliance with legal processes such as anti-money laundering/terrorism – in this situation there is a conflict between confidentiality and the need for disclosure.	• Disclose information in compliance with relevant statutory requirements, e.g. money laundering regulations.
Whistleblowing Situations where the accountant needs to consider disclosing information, where ethical rules have been broken by the client.	Follow the disclosure provisions of the employer, e.g. report to those responsible for governance. Otherwise disclosure should be based on assessment of: legal obligations, whether members of the public will be adversely affected, gravity of the matter, likelihood of repetition, reliability of the information, reasons why employer does not want to disclose.

Ethical dilemmas and conflict resolution

Rules- and principles-based approaches

Most professional institutes use a principles-based approach to resolving ethical dilemmas.

Use of a rules-based approach is normally inappropriate as rules cannot cover every eventuality.

Rules- and principles-based approaches

Rules-based approach	Principles-based approach
(1) Establish ethical rules that members must follow.	(1) Establish fundamental ethical principles that members must follow.
(2) Ensure members are aware of the rules.	(2) Ensure members are aware of the principles.
(3) Ensure members comply with those rules.	(3) Require members to identify and address threats to compliance with the principles and make an appropriate response to mitigate each threat.

Rules-based approach

Benefits:

Easy to check compliance as based on fact.

Easy to amend rule set as required.

Disadvantages:

The list of rules may not be complete.

There is no room for individual decision making.

Principles-based approach

Benefits:

Recognises that every threat cannot simply be 'listed'.

Allows for subjective judgement, so the member can apply the principles in accordance with their specific situation and nature of the threat.

Disadvantages:

In some situations it may be difficult to confirm that the compliance action was appropriate as two people may make different and valid decisions based on the same threat and circumstances.