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Professional Ethics of Chartered Accountants in India – A Review

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1. Introduction:

Professional accountants of today are in great trouble to comply with ethical standards in practice.In the context of global accounting practice accounting scandals or creative accounting practice become a phenomenon. Enron, WorldCom, Satyam, Tyco, Adelphia are some of the illustrious corporate houses fall pray to accounting scam. The accounting crises have damaged investors' sentiment in capital market. It is deep rooted to the nexus between management and the auditor towards aggressive accounting practice. There are some sorts of incentives (manager's incentives and auditor's incentives) that break the barriers of code of ethics. Manager's incentives motivate managers to aggressive interpretation of financial statements making positive impact of manager's outcomes, stock price changes, pay / bonuses and reducing effect on manager's turnover and close interaction with the auditor / client for evidence collection, transaction advice / structuring, negotiation, switching auditor etc. Such interactions and mutual understanding between the manager and the auditor impact on audit planning, adjustments, opinion choice and retaining clients. On the other hand, auditor may allow aggressive reporting with long term need to attract and retain clients as well as their potential interest to secure future engagement with the same clients. Audit and non audit fees can affect auditor compensation either directly (via, fee linked bonus and partnership shares) or indirectly (via, preferential advancement and retention) and disagreement with the client may jeopardize client relationship and result in loss of fees.

At this juncture, professional ethics is gaining more importance to resolve the issue. Professional ethics is the backbone of a profession; it is the mental make up of the professional accountants to stick to ethical standards at any cost so that true and fair financial reporting can not be an illusion. However, in India the Institute of Chartered Accountants of India

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introduces Code of Ethics, Professional Misconduct etc for the chartered accountants. With the changing business environment mental attitude of public across the globe has changed. So, to cope with the situation ethical standards of professional accountants of India need revision keeping in line with international ethical standards. The objective of the study is therefore to review Code of Ethics, Professional Misconduct of chartered accountants of India in light of International Federation of Accountants (IFAC) Code of Ethics for Professional Accountants where more attention is drawn upon fundamental ethical principles, analysis of possible threats to the principles and guidance for mitigating the threats.

2. Conceptual Framework

Ethics is an unbounded rationality that is easy to perceive but difficult to measure. In reality, ethics sometimes becomes illusion. It is an issue where much can be discussed but little can be achieved. However, for the sake of the profession, some guidelines have been framed by the Institute in a specific way for its members for adherence to in practice and that are to some extent enforceable by law. In this respect, professional ethics refers to DO and DONOT of the profession. Professional ethics in broader sense; guide auditors to stick at basic principles of integrity, objectivity and independence for the interest of users of financial information and of society at large. Because of judgemental nature of activities of the profession, soundness of principles prevails over rule. The code of ethics bears high moral value as it claims that the members discharge their duties and responsibilities paying due regard to the interest of the general public. The professional misconduct is set measures of discipline and conventions voluntarily established by the members and that may have a force of law. Any breach of code of conduct would result in the member being deregistered from practicing the profession.

The IFAC's International Ethics Standards Board for Accountants (IESBA) (IESBA website, March2009) formerly the Ethics Committee has developed the Code of Ethics for Professional Accountants which require professional accountants to comply with five fundamental principles of professional ethics comprising integrity, objectivity, confidentiality, professional competence, due care, and professional behaviour. The Code applies to all professional accountants, whether they are in public practice, industry, commerce, the public sector or education. The IESBA also develops interpretations of the Code of Ethics for Professional Accountants to address questions that have broad implications. A member body of IFAC or a firm is required to follow the standards as stated in the Code.

In India, the chartered accountants are regulated by the code of ethics, professional misconduct in accordance with ICAI Act 1949.The First and Second Schedules of the Act prescribe a list of circumstances where a chartered accountant is deemed to be guilty of professional misconduct. For example, professional misconduct guides the auditors to adhere to auditing standards in the conduct of audit of financial statements. Clause9 of Part1of Second Schedule of the Chartered Accountants Act 1949 requires auditors to comply with auditing standards in practice. Otherwise, they would be held guilty of professional misconduct. The Council of ICAI is empowered to enquire in to the conducts of chartered accountants in other circumstances also. For application of professional misconduct of all chartered accountants is referred to in Part III of First Schedule of the Chartered Accountants Act 1949.PartI of the First Schedule is applied for professional misconduct in relation to chartered accountants in practice. Part II of the First Schedule applies to chartered accountants in employment. The Second Schedule deals with misconduct which requires action by the High Courts.

Professional ethics also encompasses independence of the professional accountants which has now become a debatable issue across the globe. Independence of the auditor signifies independence in fact and independence in appearance. 'An auditor professionally strives for independence in facts which represents the mental attitude of the auditor. That is the auditor favours neither the client nor those who read the financial statements. However, the accounting profession must also be concerned with whether other parties believe that the auditor is independent. In this case the auditor must avoid relationship that suggests that independence has been lost' (Bailey, 1994, p.2.05). A merger of the two aspects of independence provides that the auditor concerned with such values as integrity, objectivity and credibility, has to comply with different rules, regulations, acts, auditing standards etc while doing attestation service (Basu, Dr.B.K., 2004, P.8.6).

3. Revision of ICAI Code of Ethics in Light of IFAC Code of Ethics

With the increasing competition among Indian audit firms in global capital market, the ICAI Code of Ethics needs immediate revision in light of IFAC Code of Ethics for Professional Accountants. In this regard Naresh Chandra Committee had made several commendable recommendations that are most suitable for legislation. The ICAI Code of Ethics covers several rules which may appear to be stricter than those defined by the IFAC

Code. In this respect the Report on the Observance of Standards and Codes (ROSC) team suggests that there should be a principle based conceptual framework along with some of the rules to be incorporated in the Code of Ethics. The framework should comprise, inter alia,

- **Fundamental ethical principles**
- **Analysis of possible threats to the principles**
- **Guidance for mitigating the threats**

The IFAC Code of Ethics for Professional Accountants lays down that accounting firms and members of the assurance team must necessarily be independent of management. They should identify and evaluate threats to independence for public interest rather than merely comply with a set of specific rules. In fact, there are some factors like, 'self interest, self review, advocacy, familiarity and intimidation, threats' (ROSC, P.25) which may potentially affect independence.

According to the Institute of Chartered Accountants in England and Wales (ICAEW), the most effective way of maintaining independence in reality, is to introduce principle based guidance than rule based guidance that can be complied with to the letter and that can hold substance over form (ROSC, P.25).

There may be some more issues as follows that may be incorporated in the framework.

- **Remove restriction on number of partners permitted in an audit firm:** Audit firms need to be converted to limited liability partnership with a minimum professional liability insurance cover on the basis of quantum of revenues of an audit firm.

- **Undue dependence on audit client:** Audit firms would determine maximum fee from one client out of total firm fees to such a level that would not compromise audit firm's independence. Currently, the maximum audit fee from one client is permissible at 40% of total fees.

- **Prohibit personal /business relationship with audit clients:** The audit firms , its partners and their relatives are prohibited from maintaining relationship with audit clients where current regulations requires only disclosure of such relationship in audit report.

- **Prescribe a 'cooling off period':** There is scope for audit partners to join the client company. However, it is recommended there should be a three year 'cooling off' period prior to joining the client company at any position.

- **Improving professional education and training arrangements:** The ICAI has already introduced continuing professional education programmes. However, it needs to be brought in line with IFAC issued pronouncement on Continuing Professional Education and development. The ICAI has introduced following rigorous courses for professional education,

a) **Introducing elective course on International Accounting and Auditing Standards**

There should be detailed discussion as well as practical application of International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) as part of the undergraduate business/accounting programme.

b) **Business Ethics**

A separate subject on 'Business Ethics' in undergraduate business/accounting programme should be introduced and through professional examination candidates' knowledge about practical aspects of professional ethics should be tested.

c) **Improving professional examination of ICAI**

The ICAI needs to undertake a detailed and independent review of the current assessment methodology. It could proceed by framing objective type questions, introducing case studies to test students' practical training and aptitude regarding application of standards and examining ability to make difference between Indian and International Standards.

d) **Making arrangement for licensing authorized training providers**

The accounting firms should have significant role to play as authorized training provider. The firm should provide audit service to at least one major business enterprise in the region and the firm should be most competent to make the trainee auditors well equipped with the practical aspect of all the applicable standards and Codes. The ICAI should screen audit firms prior to licensing them to accept any trainees. It should maintain a list of authorized practical training providers and update the list on the basis of periodic assessment of the capabilities of the existing and potential training providers. Moreover, the ICAI regional body will determine the capacity of the client of authorized training providers to meet the previously established threshold of a major business enterprise.

4. Conclusion

There is a long standing debate over principle versus rule based standards. Principle based standards are less voluminous than rule based standards. Professional ethics lay emphasis on principle based standards. Auditing principles incorporates integrity, objectivity, professional competence, due care, confidentiality, and professional behaviour. These values carry weights that shape the auditors to dignify professional ethics in practice. However, in practice these auditing principles are being discounted that results in accounting crisis. The intensity of manager's incentives and auditor's incentives aggravate this crisis. These incentives in either or both of the cases may, sometimes, appear stronger to ignore requirement of professional ethics for the auditor and over time divert auditors from keeping in line with professional ethics. The ICAI Code of Ethics should be comprehensive enough that can help in identifying fundamental ethical principles, analyzing possible threats to the principles and providing guidance for mitigating the threats. It is worthy to mention that Indian accounting and auditing standards are based on principles where ethics hold vital role to play. Last but not least, the regulatory bodies like ICAI, Securities and Exchange Board of India (SEBI) etc should come forward to safeguard those auditors following professional ethics in practice; otherwise professional ethics will become a utopian scheme.

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