1. Professional behaviour and compliance with accounting standards

Understand the relationship between **professional ethics** and **conceptual framework/IFRS**

Financial reporting objective/conceptual framework	**Professional issues** Are about the accountant's competence, attitudes and behaviour e.g. can he apply the right technical principles in the right way?	**Ethical issues** Are questions and topics concerned with doing what is acceptable to the client, stakeholders and the public interest. They involve inculcating attitudes that protect and address their interests e.g. making sound decisions about how resources are used, being truthful and fair: "doing the right things the right way; above all do no harm"
Complete: faithfully represents what it purports to represent; no intention to mislead; all relevant information assembled, verified and considered competently to ensure the *commercial substance* of the transaction is adequately reflected in the accounting and reporting treatments adopted by the entity. Keep track of the effect of each transaction on equity, cash flow, capital structure, earnings, etc.	**Judgements** about the nature of transactions (e.g. lease or revenue, PPE or Investment property), **decisions** as to whether to consolidate an entity or not, **assessment of materiality**, etc. require complete information to reflect their nature accurately and to present the items fairly. The issue then is: is the management competent to deal with the relevant industry accounting information systems issues?	Was all **relevant information assembled**; what did the management know and when did they know it? Was any information suppressed? Was there a conflict between **business ethics** and **professional ethics**? Was there adequate disclosure of what is not known? E.g. the outcome of trials, contingent liabilities, IFRS 13 property development projects, etc. Is the management **independent**? Is the management disinterested in the final results or do they have a preferred financial position because it is more likely to reward them more? *Contractual terms* and *regulatory obligations* can induce manipulation of financial position – See **Management of earnings** June 2010 q1b & a
Neutral: without bias	**Significant judgements** may be required in estimating sensitive items such as revenue. Examples:	How should the accountant present the transactions in a fair manner that reflects the commercial substance in an understandable

	- When should revenue be recognized on a long-term contract? How much? What criteria of recognition and measurement should be used? How can the basis of recognition be maintained consistently. - What is the *commercial substance* of a **sale and leaseback transaction**? A sale and leaseback transaction is in effect a loan and revenue should not be recognised and the asset should not be d**erecognised** from the assets of the owner entity.	way? Are there *conflict of interest* arising from the accountants related parties IAS 24? Are there self-interest arising from the accountant's contractual "rights" and "obligations"? E.g. is the accountant paid based on performance? If so there is an incentive to manage earnings to boost rewards based on earnings and earnings derivatives such as share options and share appreciation rights
Free from errors: There are no <u>errors</u> or <u>omissions</u> in the <u>description</u> of the phenomena and in the process applied.	Professional competence requires the accountant to be proficient in producing reliable financial statements	Maintain integrity and act diligently to safeguard the integrity of the financial statements. What **errors** were made and could those errors have been foreseen and prevented? IAS 8 *Accounting policies, changes in accounting estimates and errors* defines an error as i) failure to use information that could have been obtained, or ii) misuse of reliable information that was available.
Relevant: The information has *predictive* and *confirmatory* value. Predictive value is where the information can be input into a process that results in prediction of future outcomes. *Confirmatory value* is where information has feedback value on past decisions.	The *commitment* to customer care as a professional and the requirements of competence sets up a high expectation that the information produced by the accountant in discharging his professional duties would be relevant. For example, the accountant will use the *principles-based*, rather than the *rules-based* approach when dealing with certain transactions in which the economic substance is not obvious.	The Independence of the accountant requires relevant information to be produced at all times. Information that will make a difference as to how the user would evaluate and decide should not be omitted or misstated. Should be prominently displayed where appropriate.

- **Accounting objective** (is our accounting policy relevant? E.g. i) does it reflect the business model and its strategy by exercising appropriate elections e.g. fair value option; ii) does it produce information that helps users make decisions e.g. KPIs such as EPS, earnings multiples, free cash flow, EBITDA; iii) does it produce adequate risk assessment information e.g. **market risk exposure, credit risk exposure**; iv) does it produce prospective information suitable for decision-making e.g. reporting disaggregated information by segment? - **Control objective** (does the control objective reflect the **rigour** required for information to be relevant to its key users e.g. recognition, measurement, presentation and disclosure of holding gains, revenue, cost allocation, lease and other contracts, related parties, etc.?) - **Quality objective** (does the accounting information allow users to understand the quality-related issues of the information? E.g. **fair value measurement** issues and how the standard seeks to address quality issues through e.g. sensitivity analysis (see Barclays bank plc p198 ; *fair value hierarchy; are needless complexities removed, is there adequate disclosure of the limitations of the fair value hierarchy? See Barclays Bank plc Note 17 2014 annual financial statements: p189*)	For example, substance over form delivers more relevant information because it reflects the commercial substance of a transaction rather than its legal form. This principle is evident in recognising the cost of a finance lease (in which substantially all of the risks and rewards of ownership are transferred to the lessee) as capital of the lessee even though the lessor retains ownership of the asset in question.	
Verifiable: - **Accounting objective** (is our accounting policy verifiable? E.g. i) is it based on	The requirements of **objectivity** and **professional scepticism** implicit in the IFRS increase the likelihood that financial	The ethical requirements of independence and objectivity impose the need for verifiability to assure stakeholders of the

ifrs/conceptual framework principles; ii) does it result in amounts that can be independently verified; iii) is it applied consistently.) - **Control objective** (does the control objective reflect the in-built objectivity and relevance conditions of the IFRS e.g. under IFRS13 fair values are subject to the *fair value hierarchy*? The purpose of the fair value hierarchy is to indicate the relative reliability or verifiability of the amounts determined under fair value principles: Level 1 is most objective, being the market price for an identical asset or liability; level 3 is the least objective being entirely subjective, there being no feasible market for the asset or liability; level 2 combines both aspects being a market based price adjusted for factors such as differences in productive capacity) - **Quality objective** (does the accounting information allow users to understand the quality issues arising from the transaction? E.g. fair value measurement issues and how the standard seeks to address quality issues through e.g. *fair value hierarchy*)	statements would be verifiable. Where **significant judgements** have been made to support estimates such as provisions there should be supportable calculations and reasonable and verifiable assumptions. These must be disclosed.	integrity of the financial statements. Verifiability is integral to **transparency**.
Timely: - **Accounting objective** (is our accounting policy up to date? E.g. does it reflect the latest IFRS; if not is there adequate disclosure of this fact in accordance with IAS 1? See Tesco plc 2014 financial statements p75.) - **Control objective** (does the control objective reflect the in-built timing conditions of the IFRS e.g. i) fair values for	There must be an acute awareness of timeliness as all accounting, taxation, publication and related activities have dates and times by which they must be done. For example, the effective dates for implementation of IFRS are published and must be complied with by those entities to which the relevant standard applies. In addition, **most IFRS have in-built timing**	**Disclose delays** e.g. in determining fair values in an acquisition. IFRS 3 *Business combination* allows a **measurement period** of twelve months following the acquisition date. The initial **purchase price allocation** must be done by the end of the first financial reporting period following acquisition. Delays must be disclosed with reasons and their potential effects quantified as far as possible.

assets acquired and liabilities assumed should have been determined within twelve months of the acquisition date; ii) the effects of the acquisition should be reflected in the first reporting period following acquisition?) - **Quality objective** (does the accounting information allow users to understand the timing issues arising from the transaction? E.g. recognition of a gain arising from a liability measured at PV due to the passage of time – **unwinding of the discount**)	**conditions**, restrictions and application requirements. For example, IFRS 3 Business combination: i) requires acquisition date to account for the transaction; ii) restricts the measurement period to twelve months during which accounting for the fair value all assets and liabilities acquired must be completed; iii) apply fair values to acquired components by the end of the first financial reporting period following acquisition.	Comply with timing conditions, restrictions and deadlines. For example, comply with deadlines for VAT, Corporation tax, PAYE, etc. to avoid incurring penalties.
Understandable: presentation, language, layout **See Dec 2010** q1bi,ii & a1bi,ii Use conceptual framework elements (asset, liabilities, income, expenses, equity) to describe the nature of the item clearly and concisely. - **Accounting objective** (is our accounting policy understandable to users?) - **Control objective** (is the control objective understandable?) - **Quality objective** (does the accounting information allow users to understand the transaction and its effects?)	Professional standards of communication require versatility and flexibility. Know the audience; apply the message in plain English; avoid jargon and explain where not avoidable. Enable the user with **reasonable knowledge** of business, financial reporting and is **diligent** about reading a corporate report to gain useful insights about the reporting entity's financial position and results.	As part of discharging its public interest duty the professional accountant must make his message accessible to the diligent non-accountant with the minimum of accounting and financial knowledge. A full set of prescribed financial statements and accompanying reports must be presented as a full package with accounting policies and disclosure notes to explain and describe significant items. The line items and subtotals must be understandable and meaningful. This requires significant judgement in assessing which additional line items, headings and subtotals are relevant to an understanding of a statement such as the entity's statement of changes in equity.
Comparable: **See June 2009** q1c & a1c Three objectives: - **Accounting objective** (is our accounting policy comparable to similar organisations?	An enhancing quality of financial statements that enable users to appraise current financial information by comparison with similar periods, entities and industries.	Professional behaviour would be more respected the more useful information is to its audience. Hence enhancing qualities of predictability, comparability and understandability are highly desirable.

- Control objective (does this transaction compare with the budget?) - Quality objective (does the accounting information allow users to understand and compare the transaction?)		

What is **ethics**? Ethics is a set of principles, rules of conduct that reflect values and norms of behaviour considered to be acceptable to society or a profession, club or other group. The ethical values, ethical standards, ethical norms, etc.

The **role of ethics is to provide assurance** to those who deal with members of a profession e.g. accountants that they (the members of that profession) would do what they purport to do and that they are respectable and represent no danger to the public. To the individual accountant ethics is an incentive to comply to avoid punishment (or sanctions) from the governing body such as the Disciplinary committee of the ACCA.

In return society accords members of a profession respect e.g. the title "Chartered Accountant" is available to the accounting profession, signifying that members of that profession operate under approval by the highest authority body of the land, the monarchy (symbolised by the Royal Charter).

The assurance provided by the ethics code (**IESBA**: *International Ethics Standards Board for Accountants*) is **real** because it signifies that members of the profession are

- Qualified as a result of passing examinations to confirm that they are in possession of the minimum technical knowledge required to perform certain duties normally associated with the profession e.g. audit, assurance, tax advice, etc.
- Subject to the explicit ethical code of conduct that their customers are happy with because it addresses all of the related requirements and if issues arise the ethics code is a useful reference (THE RED LINE THAT MUST NOT BE CROSSED WITHOUT CONSEQUENCES) that can be used in conjunction with specific contracts as a basis for **seeking redress** through the courts, arbitration or by mutual agreement.
- Through *self-regulation* monitored and evaluated for their continuing fitness to perform their duties to private and public individuals.
- Punished for misdemeanours and expelled if the seriousness of the situation warrants it.

Addressing P2 assessment requirements		
	Related ethical requirements	Assessment requirements
Ethical issues	Integrity, professional behaviour, objectivity, confidentiality, Independence	Ability to analyse various business contexts and situations to identify, appraise and resolve ethical dilemmas.
Self-interest	The accountant is expected to act in the best interests of the entity at all times. Material self-interest must be legitimate (based on contractual terms) or otherwise avoided.	To be able to identify self-interest as a potential source of ethical dilemma especially where an employee is vulnerable to victimisation due to his

		ethical stance. For example, if an employee's award of bonus or share options may be suppressed due to an ethical stance or whistleblowing.
Conflict of interest **See June 2009** q1c & a1c	Potential conflict of interest must be avoided or disclosed	To be able to identify and disclose potential conflict of interest in accordance with IAS 24 *Related Party Disclosures*

*a) **Appraise** and* **discuss** the ethical and professional issues in advising on corporate reporting. [3]

The accountant has three roles in corporate reporting:

i) Producer (as employee of the entity to have responsibility for safeguarding the integrity of the financial statements. Analyse how this function is performed, identify ethical standards and issues. **What is the standard approach to the appraisal of ethical and professional issues**? **Ask**: a) what is the objective of the producer? b) what standards should the producer attain, e.g. compliance and ethical standards of integrity, confidentiality, etc.? c) what issues (factors such as professional competence becomes an issue…) arise from the requirement to attain those standards?) d) what guidelines (criteria, principles, authorities, internal or external bodies, etc.) determine the ways in which the issues should be resolved? e) what sanctions exist if the issues are not resolved? Give lots of examples, particularly of areas where management has **accounting policy discretion** to demonstrate how ethical issues may arise and the ways in which they can be resolved. The above grid about the CF and ethics provides **ample demonstration** of how to approach this question. **Therefore, the skills to hone and the means to hone them are**

Skills to hone	Means to hone	Criteria of successful outcomes
Generic accounting discussion skills. How accounting discussion works.	Read notes in IAS 19; isolate the elements; study application to case study. Extend practice to develop confidence.	Fluency in structured discussions that covers all the elements of particular problems and issues.
Applied understanding of ethical texts: *absorb and re-shape*.	Study the nature of **applied understanding (see CIMA assessment guide)**; make sure you are clear about the reasons for reshaping knowledge and how it can be done. Practise reading and re-shaping knowledge regularly, using the **worksheets** as a scaffold, but after a while practise without the scaffold of the worksheet.	Clearly structured and developed notes that highlight issues and the applicable standards. Demonstrates clear understanding of what type of text it is and how it works: *expository*, *analytical* or *argumentative*. **Expository writing** is writing to *inform* and *illuminate* (and can be used to *advise*) by explaining and evaluating alternatives. This kind

		of writing can be used to *delineate* good from bad practice. Useful for achieving clarity and avoiding confusion. **Analytical writing** is also writing to illuminate by analysing data focusing on *relationships* e.g. between practice and ethics. **Argumentative writing** is where a claim is made and the writer provides arguments to prove the claim. This kind of writing can be used to *counter deviations* from practice that have the potential for abuse. An example of where argumentative writing is required is where the directors intend (or decide) to classify a loan as operating cash flow rather than financing cash flow to maximize their operating cash flow based rewards or to mask a loan to a director. Structure of argumentative writing: state the premise that prove the conclusion; provide persuasive reasoning by applying the premise to the facts of the case interrogatively; conclude.
Deductive reasoning	For a general explanation refer to **The accounting question** in P2 terms and techniques. For an application worked example refer to Critical Thinking case studies (an ethics deductive reasoning exemplar) For further practice refer to the September 2015 Exam guidance	Provide well-grounded answers that accurately respond to discursive questions.
Ethical and professional core principles	See above discussion relating the conceptual framework to ethical principles. Also refer to Critical thinking in P2 terms and techniques.	Respond to the syllabus expectation A.2.b
Application of ethical and professional principles with reasoning to the various themes: dilemma, denial, affirmation, critique of intention or decision,	Refer to the annotated answers to past questions. Refer to September 2015 exam guide.	Answer discursive ethical questions about IFRS applications effectively.

ii) Attester (as auditor of the entity: to assess the integrity of the financial statements and express an opinion as to the validity of the view presented of the financial position and performance for the reporting period.)

iii) Adviser (as independent consultant advising on **producing qualitative** (e.g. welfare of staff, risk assessment, human rights, employment rights, etc.) and **quantitative information** to understand the central tasks in corporate reporting and the qualitative requirements. To advise on how IFRS, CSR, risk reporting, governance, management commentary, strategic reports can be produced such that the corporate reports will present useful and consistent information alongside the financial statements that give a true and fair view of the financial position at the reporting date and of the financial performance for the period under review. This includes advising on when departure is appropriate in order to more effectively reflect the substance of the transaction). What issues arise?

Appraise professional and ethical issues

This means you should think about what ethics means, how they apply to each of the above roles and whether they are effective in assuring the stakeholders of the integrity of the financial statements and the view they present.

What is it about corporate reporting that requires the application of ethics?

Stakeholders rely on the financial statements to evaluate performance and make investment decisions. The integrity of the financial statements is therefore a highly valued input by the accountant. Therefore the accountant has a public interest duty to ensure financial statements are credible. This is his obligation to society for the privilege of operating under Royal Charter, being able to regulate itself and award recognisable qualifications.

Accountants audit the financial statements produced by accountants. Even an audit cannot verify all the transactions; hence a high degree of reliance has to be placed on the accountant as produce of the financial statements. The ethical commitment of the accountant is therefore highly desired for the financial statements to have credibility.

Analyse corporate reporting practices to identify ethical issues. See table above.

Is ethics enough to achieve the objectives of corporate reporting? No. Despite ethics codes, corporate governance and other regulations corporate scandals still persist and people will always try to manipulate the financial statements e.g. “management of earnings”. Recently there was the case of Tesco plc accelerating revenue recognition to manage earnings and support share price performance. Tesco’s management chose to breach Generally Accepted Accounting Principles (GAAP) which professional accountants are required to comply with. This highlights the need for continuous external policing by a combination of external agencies to safeguard the integrity of financial statements and protect stakeholder interests.

Why do ethical breaches happen despite corporate governance and ethics codes?

Because financial statements are used to attract investors and evaluate management performance the pressure to perform is enormous and can lead to red lines being crossed. Managerial contractual obligations and rewards may be tied to share price performance which is in turn responsive to published financial statements. There is also a conflict between *business ethics* and personal or *professional ethics*. The business needs to survive in order to be ethical and at times ethics may jeopardise business survival especially where competitors operate with lower degree of ethical commitment and can get away with it – at least in the short term. Should Google put ethics (a concern for human rights and freedom) before business in China?

What do you think can be done about it?
By far the most important incentive to manipulate financial statements is short term managerial reward. Therefore limiting short-term rewards e.g. bonuses and increasing longer-term rewards e.g. share options with a long vesting period is the most practical way to limit ethical breaches.

Prison terms should also be considered for the most excessive breaches such as theft.

Increased professional policing will be necessary to ensure breaches are detected and addressed promptly.

Professional training firms, practices and examinations must inculcate ethics as inherent and essential professional behaviour. Coupling of ethics with professional duties must be strengthened to ensure full and unwavering commitment to ethics in practice.

Management must embed culture in the organisation so that it is pervasive throughout.

Discuss professional and ethical issues
Consider the objectives of corporate reporting and determine whether professional and ethical behaviour serves those purposes well. To what extent do you think professional and ethical standards and behaviours are adequate?

"Some financial officers may take a narrow view of what compliance and ethics is all about, perhaps thinking ethics and compliance is only about following rules or – worse yet – some place they only hear from when something is wrong.

Overcoming those misperceptions requires development of a relationship before there's a problem to discuss. That involves reaching out to colleagues who are responsible for financial operations, auditing, risk management and communications. Let them know you consider yourself part of their team, and they a part of yours.

The CECO's (Chief ethics and compliance) goal is to be a trusted partner with these colleagues. To that end, you should connect on a regular basis and let these colleagues know you are always available as a sounding board and an expert on the company's ethical commitments."

b) **Assess** the relevance and importance of ethical and professional issues in complying with **accounting standards**. [3]

ORIENTATION NOTES

To assess is to judge or decide the amount, quality, value or importance of something. Applying this definition to the expected learning outcomes implies that the student should be able to evaluate the role and importance of ethics in applying IFRS to business transactions, conditions and other events?

This **critical approach** to the study of ethics at the professional level appropriately requires:

i) an understanding of the **business context** in which professional and ethical issues arise (ethical reasoning in context);

ii) appreciation of the relevance and importance of ethical and professional issues attendant upon the application of IFRS to a variety of **business contexts** and **situations (apply the right principles in the right way);**

iii) **ability to assess threats to professional** behaviour and to be able to respond appropriately within current ethical and professional guidance and frameworks (risk assessment and management of perceived threats to professionalism including using resources and resigning);

iv) ability to assess whether **institutional arrangements and conventions** introduced to mitigate potential misuse of IFRS by managers are effective in providing assurance to investors.

Judgement requires clear objectives, deep knowledge of subject matter, awareness of pitfalls, alternatives and processes for resolving issues in ways that may not be conclusive, and that trade-offs may be necessary due to the potential tension between business needs and ethical imperatives. **Attitudes** that are <u>conducive to making sound professional judgement consistently</u> include: i) circumspection; ii) divergent thinking; iii) critical reflection; iv) awareness of limits; v) ability to relate parts to the whole and vi) commitment to ethical standards.

The above **expected learning outcome** amply reflects the complexities inherent in seeking to apply principle-based IFRS in a business context. Case-based learning would be most effective in encouraging the development of real-world applications of professional principles and ethical values. As the student is required to appraise the relevance and importance of ethical and professional issues in IFRS applications <u>it is essential that the study and exam practice materials include ample examples that demonstrate the relevance and relative importance of ethical and professional issues in the context of applying IFRS</u>. This should be accompanied by suitable exercises that engender critical reflection and independent appraisal of IFRS applications while addressing ethical and professional issues in a balanced and realistic manner. For example not to jump to conclusion that just because an unusual accounting practice or policy has been adopted therefore unethical behaviour is evident; or a change in accounting policy is evidence of management of earnings. A professional approach requires the student to infer only what can be supported by clear evidence. In an ethics question it is perfectly acceptable to conclude that “there is not enough evidence to infer that the entity’s practices are unethical”.

Levels of understanding

Ensure levels of understanding attained are reflective of intellectual **level 3** (IL) – encourage students to prove this against predetermined rubrics.

Coping with untaught applications

The assumed context in which professional activities take place

The assumed activities to be undertaken by the learner to attain the intended learning outcomes

Types of questions
Examples of past questions that are relevant to these learning objectives are:

Assessing relative importance of ethical and professional issues
Why do students run out of things to write about? The tank is empty; garbage in garbage out.

What is good accounting? How can it be recognised by its effects?
Appreciate the importance of industry-practice
Demonstrate awareness of the interrelatedness of financial statements and how this can be used to investigate and reconcile items that may warrant further investigation to allay suspicion of questionable practice.
Aligning teaching and learning the desired attributes of the good accountant – *constructive alignment*.
Simulation: *encourage students to use what ethics and IFRS knowledge they have to make accounting decisions.*
What is **aggressive accounting**?
What is **unusual accounting** e.g. companies operating a differentiation strategy wishing to take innovate and take advantage of market conditions
What is **conservative accounting**?
Common accounting standards are not the same as common accounting practices.
Manager's business and financing decisions have different valuation implications. Discuss and give some examples.
Explain the relevance of business strategy to financial reporting and the accounting policies used.

Examples of trade-offs: i) estimates may provide relevant information but at the expense of reliability. What is the ethical and professional issue there?
Examples of ethical imperatives:

IL	Sub outcome	Awareness of **business context** and of the ethical and professional issues that are germane to it. In other words, you identify the business context and ask what issues are important and connected with it?
3	Professional Extremely skilled and knowledgeable at dealing with complex business context issues; versatile; rounded; insightful, creative; evidences critical thinking about business context.	Demonstrates sound understanding of the entity's business strategy and how specific ethical and professional issues relate to the requirements of strategy. For example, the financial requirements of expansion could potentially induce fraudulent financial reporting to present positions favourable to securing a bank loan. **Case Example**: ACCA June 2014 q1c **Answer example (extract)** The central ethical issue is whether the Finance Director is under pressure from other directors to misrepresent the substance of the transaction in order to present a preferred financial position that is advantageous in terms of securing a loan. How should the Financial Controller deal with the resulting ethical pressure given his disagreement with the

		Finance Director over the classification of the lease?
2	Skill level Competent at handling difficult but not complex business context driven issues; applies knowledge and analyses effects of applications to business context. Not confident about exercising professional judgement in relation to business context.	Demonstrates understanding of the relationship between business strategy and ethical and professional issues.
1	Knowledge level Displays verbatim knowledge of the issues. No attempt to analyse, apply and interpret the relevance and importance of the **business context** to the ethical and professional issues that are faced.	Evidences understanding but connection to ethical and professional issues are not completely and soundly made.
0	Sub-Knowledge level No knowledge of ethical issues and their relationship to business context.	There is no evidence of understanding or awareness of business context and its implications for ethical and professional issues.

Can judge the relevance and importance of ethical and professional issues in applying IFRS in a wide range of business contexts and situations and can apply appropriate institutional safeguards to mitigate the effects of potential accounting misuse.

Skills to be honed
Knowledge to be gained
Attitudes to be learned (*e.g. the culture sets the tone at the top*):
Attitudes assessment criteria:
i) Proactive
ii) Committed;
iii) Enthusiastic but not committed e.g. fickle, controllable
iv) Casual;
v) Indifferent;
vi) Hostile

Types of attitudes
- i) Accuracy
- ii) Caution

Analyse how IFRS are applied and the issues that arise in that process
Examples: Read in conjunction with the table above that explains how the Conceptual Framework relates to professional and ethical duties.

What issues arise in relation to **recognition** e.g. accrual, revenue, lease, recognition and classification? Accruals could be delayed to avoid reducing profits; it is a matter of management judgement and could be excluded from the books entirely, evading detection, there being no impact on cash flow. Finance leases could be misclassified as operating leases which increase charges to the profit or loss and minimises taxable profits thereby reducing the tax burden on the entity. See June 2014 q1c & Answer. Also consider Sekoyen's suggested answer and critique of the examiner's answer.

What issues arise in relation to **measurement** of stocks (IAS 2 *Inventory*), accounts receivable (IFRS 9 Financial instruments), etc. Recognition of bad debts could be delayed to avoid reducing profits and because it goes by default (do nothing) and there is no cash flow impact it could go undetected unless the auditors are diligent in appraising risks attributable to i) poor credit assessment and control; ii) environmental deterioration as in an economic downturn that causes people to default on their debts.

What issues arise in relation to **presentation** (e.g. IAS 7 *Statement of Cash flows* where *direct* or *indirect* options can be used? Where incentives exist management could select the option that presents cash flow in the most favourable position as in June 2009 q1c & a1c and December 2010 q1b & a1b.

What issues arise in relation to **disclosure** (e.g. IAS 24 *Related Party*); IAS 38 *Intangible assets* suppression of information about R&D to justify capitalisation of development expenditure that should otherwise be expensed thereby boosting profits to earn a bonus and or satisfy market and stakeholder expectations?

2. Ethical requirements of corporate reporting and the consequences of unethical behaviour

a) Appraise the **potential ethical implications** of **professional and managerial decisions** in the preparation of corporate reports. [3]

Corporate reports are the responsibility of the management; professional accountants advise the management and take delegated responsibility for their production. "**Appraise"** suggests you should consider how important ethical implications are likely to be for the professional accountant and management in safeguarding the integrity of the financial records and in producing corporate reports. Are they (management) likely to view ethics in the same way given the accountant is personally required to comply with the ethics code of his profession whereas management are only concerned with business ethics and the two don't necessarily overlap in all relevant areas. How should the accountant go about reconciling business ethics with professional ethics in practice and how should he persuade management to buy into his profession's higher code of ethics?

What are the implications of ethics code compliance?

Differences of opinion may arise over the recognition and presentation of specific transactions. In such situations both managers and accountants have an overriding responsibility and duty to represent all transactions so as to show a true and fair view. The accountant **must** refer to the ethics code and be guided by its principles in resolving any conflicts and **must** never breach them. For example, just because legal compliance has been achieved does not mean that ethical compliance has also been achieved. The spirit, not the letter of the GAAP should be adhered to. In this regard concepts such as *substance over form* must be used as a guide to the determination of the accounting treatment, presentation and disclosures to be adopted. For example, sale and leaseback, leases, etc.

The accountant is not allowed to resolve an ethical dilemma by saying he was only following orders. He is required to take a stand and seek assistance from the ACCA for specific guidance and from the relevant internal sources such as the Chief Ethics and Compliance officer, the Audit Committee, etc. Such assistance can ensure that he identifies and addresses grey areas and so avoid ethical risks.

Transparency is crucial to assuring integrity, objectivity and propriety in all decisions. This means that all plans must be clearly communicated and criteria for decision making must be clearly explained and accountability demonstrated through appropriate reporting within the governance chain.

All potential *conflict of interest* and *related parties* must be disclosed.

Confidentiality must be maintained at all times. The accountant or manager must not use the entity's information to gain personal advantage for themselves or third parties.

The accountant may find it is difficult to be a member of the team and yet have to be true to his professional ethics. He may be criticised for lacking "*team spirit*" and not having the company's interests at heart. But the accountant must be able to counter that criticism by saying that he has a responsibility to stakeholders and to the public that overrides his allegiance to the internal management because in complying with the ethics of his profession he is protecting the company's shareholders from abuse of their resources and from being misled about the true financial position. Fulfilling that need at the same time protects the company and its management from accusations of ethical breaches which can only benefit everyone concerned.

Whistleblowing may be appropriate where ethical breaches are evident. The accountant should be protected against adverse managerial reactions in the event of whistleblowing being initiated by him.

Maintaining integrity can help protect against financial reporting fraud and major ethical challenges

"Jose Rodriquez, a partner at KPMG, told the January 2012 ERC Fellows meeting that revenue recognition, to cite one example, offers opportunity for questionable decision making because of grey areas about when a company records revenue on its books. A decision to accelerate or delay recognition by one quarter can affect public perception and open the door to longer-term risk because what you borrow in one quarter must be returned in another. However, there may be a continuing temptation to keep fudging the numbers, which can turn a small lapse into a major ethical challenge."

Maintaining objectivity can reduce potential for financial reporting fraud

"The ethics officer can do that."Mulvaney, an auditor at PwC before assuming ethics and compliance responsibilities, said helping to focus colleagues on maintaining their objectivity protects the company by helping employees recognize the right decisions."

Reducing managerial performance pressure can help reduce financial reporting fraud as in Tesco plc.

"Michael Young, an attorney who specializes in securities and financial litigation at Wilkie, Farr, Gallagher, suggested that financial fraud isn't typically the result of core dishonesty or an intention to commit fraud. "Fraud starts with pressure to perform. Folks rationalize to meet goals, and they step over the line bit by bit."

"Pay Attention to Third Parties and Outside Events
In addition to the normal business pressures of satisfying customers and earning a profit, employees may also feel pressure created by outside expectations or events. Following outside events, including analyst expectations and government actions such as tax law changes or new financial reporting rules, can help you anticipate temptations that could lead to misconduct or ethical breakdowns.

For example, company leaders might be tempted to fudge sales numbers for an important new product that is falling short of expectations or to manipulate the timing of revenue or profits for tax purposes. Investor perceptions of the company and analysts' targets for the company's stock price also can serve as early warnings of possible pressure points.

Make sure that your reading list includes stock market and investment reports, as well as news about government policy and regulation. Your value to other senior managers will increase if you can spot financial and other business risks before they become problems."

b) Assess the **consequences** of not upholding **ethical principles** in the preparation of **corporate reports**. [3]

Consequences for the entity

Assess the Culture and the Pressure Points

"…you need to understand enough to recognize issues that can raise the risk of financial misstatements. For example, concerns about a company's share price create pressure to meet expectations about earnings. At times, that pressure can tempt financial officers to manipulate numbers in ways to meet or appear to meet targets. Because accounting requires judgment, there are usually ample opportunities to make things look rosier, at least in the short run. You have to know enough to recognize language that may not tell the full story even though it is literally truthful."

Tesco's accounting scandal

Business risks can be accentuated by ethical breaches

"Most public companies assemble a substantial amount of information about their financial reports for presentation to important stakeholders. PowerPoint presentations, press releases, and statements by key officers are typically posted on corporate web sites and distributed to the news media, shareholders and a host of investment firms and market analysts. In assembling these materials companies choose what information to highlight, how to portray the numbers, and what to say about future business prospects. It's human nature to want to put the data in the best light and predict a bright future for the business. But that instinct may be at odds with objective analysis, a conflict that may raise ethical questions as well as business risk. Painting too rosy a picture could lead to shareholders litigation or other legal challenges down the road."

Where spin goes unchecked underlying ethical breaches can cause significant ethical risks

"…you can play an honest broker by asking questions that are intended to encourage objectivity and mitigate the possible ethical risks from potentially misleading "spin" in public documents. It's worth remembering that, sometimes, spin can be overly and deliberately pessimistic.

For example, some companies like to set low expectations for profits and sales to avoid disappointing shareholders and analysts. But low-ball estimates may have as many ethical implications as overly optimistic statements if they mislead investors or affect the value of company officers' own stock or options in some fashion. Share prices can surge dramatically when earnings reports beat expectations, presenting an opportunity for stock trading profits by an insider who wrongly takes advantage of the information. Thus, ethics officers must be alert if public statements about business prospects seem out of line with objective reality in any direction."

Consequences for the accountant

The accountant who is found to have breached the ethics code will be subject to sanctions by the ethics committee.

WHAT MENTAL QUALITIES ARE EXPECTED OF YOU?

The examiner expects you to demonstrate critical thinking about ethical and professional issues and the ability to construct an analytical and evaluative response to ethical dilemmas. You must always base your points on the details of the case and your comments must relate to the ethical principles and say whether they are being or likely to be breached or not. Remember that ethics questions are never straightforward: therefore don't be too quick to judge. You need to be circumspect. You are not allowed to sit on the fence – you must take up a position and justify it on ethical and professional grounds. Therefore learn and practise the right way as suggested above and in the P2 Question Strategy.

Earn quick and full marks and don't be one of the students referred to below:

"Question 1c required candidates to discuss the views of a director regarding the fact that there was no point in an accountant studying ethics and that there was no ethical issue in the false disclosure of accounting profits. Candidates answered this part of the question very well. However, it is also this part of the question that often candidates leave out and do not answer. Ethics is a critical part of the syllabus and as such every candidate should be capable of answering this question." Examiner's Report June 2013