



## **47. Code of Ethics for Professional Accountants in India and Indian Knowledge System – A Review**

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### **ABSTRACT**

*An activity ethical or unethical is a matter of relative importance. As an employee of a business concern an accountant maintains books of accountants in compliance with management directives. Management directly helps the auditor in the conduct of audit of financial statements and indirectly helps the shareholders for appointment of the auditor. In either case management plays a significant role. Manager's incentive and auditor's incentive may pose threat to ethical standard of the auditor. Manager's incentives motivate managers to aggressive accounting practices making positive impact on manager's outcomes whereas auditor may allow aggressive reporting with long term need to attract and retain clients etc. The Code of Ethics requirement was introduced to make the auditor aware of DO and DONOT of the profession. In the context of global accounting practice, the International Ethics Standards Board for Accountants (IESBA) formerly the Ethics Committee of International Federation of Accountants (IFAC) has developed the Code of Ethics for professional accountants which require professional accountants to comply with five fundamental principles of professional ethics including integrity, objectivity, confidentiality, professional care, due diligence and independence. In India, principle based rather than rule-based guidelines are generally followed in accounting and auditing practice. The Code applies to all professional accountants whether they are in public or private sector.*

*In India, the chartered accountants are guided by code of ethics as prescribed by the Institute of Chartered Accountants of India (ICAI) which are in convergence with international ethical standards.*

*The basic objective of the study is to review code of ethics of professional accountant in India keeping in tune with Indian knowledge system. Much attention may be drawn upon fundamental ethical principles, analysis of possible threats to the principles and guidelines for mitigating the threats.*

**Key words:** Ethics, Integrity, Objectivity, Professional competence, Confidentiality, Independence

### **1. INTRODUCTION**

Ethics in accounting relate to ethics on the part of management who prepares accounts and on the part of the auditor who verifies accounts. Auditors maintain ethics in professional practice is bone of contention of the issue. Professional accountants have to comply with ethical standards in professional practice. Incentives to avoid ethical standards prevail in practice. The



consequential effects of this practice result in accounting scams coming to the surface all over the world. In corporate accounting creative accounting has become a usual practice. Enron, WorldCom, Satyam, Tyco, Adelphia are some of the illustrious corporate failures due to creative accounting practice and have created accounting crises that have damaged investors' sentiment in the global financial market. There is a nexus between management and the auditor for aggressive financial reporting. The interest of both the management and the auditor are the same to secure their respective positions though that may go against the interest of the investors. There are manager's incentives and auditor's incentives that break the barriers of code of ethics, professional misconduct etc. Manager's incentives motivate managers to aggressive financial reporting making positive impact over manager's outcomes and close interactions with the auditor impact upon audit planning, adjustments etc. Such conditional decisions of the auditor would help him or her achieve audit outcomes, reduce probable risk factors in the conduct of audit of financial statements.

On the contrary, auditors may go in for aggressive financial reporting to protect their interest and in order to avoid various social pressures in making audit decisions (Bazerman et al., 1997). The last resort to settle the crisis happens to be gaining confidence over professional ethics, a source of strength of any profession. However, within the periphery of consumerism keeping in line with ethical standards is an uphill task. In professional accounting Code of Ethics is introduced by the Institute of Chartered Accountants of India keeping in pursuance of international ethical standards in order to cope up with global accounting practice.

## **2. CONCEPTUAL FRAMEWORK**

Ethics in Indian philosophy is deeply rooted to religion representing thoughtful perception of the great Manu, Yajnavalkya etc. There is no denying the fact that the moral stories of our great epics Ramayana and Mahabharata have been valued in the discussion, interpretation of which by different thinkers over several times would have logical understanding of ethical truth behind it and that improvises our ethical persuasion. Ethics have been recognized over 2000 years in Indian philosophy, however little is manifested in Indian work culture in the present time in particular as well as in contemporary business world. The basic problem lies in relative importance. Ethical value changes from time to time, place to place, person to person. A good deal of cerebral exercise has been encouraged for a long period of time on proper judgement of ethical values of human being. Professional ethics of accountants adhere to basic auditing principles of morality, integrity, credibility, objectivity and independence. Because of the judgemental nature of the profession, soundness of auditing principles prevails over rule. 'For example, the honesty principle is easily put in to law in cases of fraud, misstatements, forgery etc. but it is far more difficult to have a law for integrity, loyalty and the pursuit of excellence. The members of the profession are required to maintain a higher standard of conduct than is called for by law' (Auditing 1, ICAI, 2006, P.408). The over-riding motto has been 'pride of service in preference to personal gain'.

'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).

### **3.REVIEW OF LITERATURE**

Professional ethics, code of conduct, continuing professional education, auditor's independence, peer review keeping in tune with Indian knowledge system may resolve the conflict of interest in the Professional ethics in a holistic way. Several articles have been offered in the field of corporate governance but a few deals with ethics and independence of statutory auditors.

In the article "Audit Firm Rotation and Audit Quality" Barbara Ariel, Richard G Brody and Kurt Pany have questioned about quality and cost effectiveness of audit firm rotation besides the increased responsibility of the audit committee consequent upon the enactment of Sarbanes Oxley Act 2002. C Terry Grant and Mary Thomas Keim have also taken up efforts in their work entitled "Corporate Governance and the Sarbanes Oxley Act of 2002" in which they have discussed various provisions of the act and its impact on management, board, audit committee and above all independence of statutory auditor. For this purpose, the Public Company Accounting Oversight Board (PCAOB) by the Congress through the Sarbanes Oxley Act of 2002 is a stepping stone towards good corporate governance. The Board exercises power over the external auditors in the process of registering accounting firms with an intent to investigate the quality of accounting practices and pending suits against them. The Board also functions on making rules and setting standards in order for quality control and to safeguard the ethics and independence in the audit process. Professor Ian Percy through the article "Adding Credibility through assurance services" of IFAC in June 1999 tries to add credibility to assurance services over financial information. In the Editorial Comment on the "Performance Gap in the Audit Profession" in The Chartered Accountant vol xx, partII, it was indicated that the present-day accounting and the auditing function need to be upgraded and moulded in such a fashion that the society is able to gather the maximum benefits from the relentless efforts of the committed professional. At this juncture, Namasiku Liandu, Assistant Audit Manager at KPMG, London published his article "Audit Risk in a Brave New World" in The Accounting world, December, 2004.pp.37-43, he has qualified audit risk as occupational hazard. The assurance of high-quality financial reporting for which the assurance of high quality of audit standards have become essential for corporate transparency and market integrity have become highlighted in the article "the process and Assessment of International Standards for Audit" by Starvos B Thomadakis. In another article on "The Public Interest Oversight Board Overseeing standards of audit education and ethics for accounting profession" the author has emphasized on the qualification and behavioral aspects of the auditor in formulating the audit standards. The standards may be principle based and technically efficient to enhance the convergence of audit standards and compliance becomes stronger.

In 1960, American Institute of Certified Public Accountant (AICPA) clearly stated that 'the responsibility of the independent auditor for failure to detect fraud ..... arises only when



such failure clearly results from failure to comply with generally accepted auditing standards. In 1977, the AICPA introduced SAS16 entitled 'The Independent Auditor's Responsibility for the Detection of Errors or Irregularities', so as to clarify authoritative pronouncements on the topic.

In the UK, The Consultative Committee of Accountancy Bodies (CCAB) published their first Auditing Standards in 1980. The explanatory forward to the standards outlines the current UK position. In India, the research effort with regard to finding audit techniques efficient in the detection of fraudulent behaviour has been directed at the 'red flag' approach, i.e., the identification of circumstances in which fraudulent activity is, in fact, taking place. One major study of this nature was that of Albrecht, Cherrington, Payne, Roe and Romney in 1980 and in a number of several other articles under literature review. 'The Enron case clearly demonstrate the value of the traditional work of IFAC and its more recent public interest initiatives' (Johnston, Peter, 2002).

#### **4. OBJECTIVES OF THE STUDY**

The basic objective of the study is to focus upon fundamental ethical principles, analysis of possible threats to the principles and guidelines for mitigating the threats in view of Code of Ethics, Professional Misconduct of chartered accountants in India and Code of Ethics of Professional Accountants by International Federation of Accountants (IFAC).

#### **5. RESEARCH METHODOLOGY**

This is basically a descriptive study based on secondary data. The data source of the study includes books, journals, magazines, newspaper, periodicals, reports etc.

#### **6. DISCUSSION OVER CODE OF ETHICS OF ICAI AND IFAC**

There is need for revision of ICAI Code of Ethics in light of IFAC Code of Ethics for professional accountants and also need for provision in the Code of ethics for professional accountants in India to enhance auditor's independence. The ICAI Code of Ethics emphasize over several rules more stringent than IFAC Code. The Report on the Observance of Standards and Codes (ROSC) team provides for principle based conceptual framework incorporating some rules in the Code of Ethics. The framework is based upon

- **Ethical principles**
- **Threats to the principles**
- **Threats mitigation process**

The IFAC Code of Ethics for professional accountants clearly states that accounting firms and the members of the assurance team must be independent of management and must assess threats to independence for public interest more importantly than complying with set of specific rules. Audit quality to a greater extent depends on auditor's independence. In fact, there are some factors like, 'self-interest, self-review, advocacy, familiarity and intimidation, threats' (ROSC, P.25) having impacted upon independence of auditors.



According to the Institute of Chartered Accountants in England and Wales (ICAEW), principle-based rather than rule-based guidelines may be introduced in the code of ethics and that can hold substance over form (ROSC, P.25).

The framework may include some more issues:

➤ **Limited liability partnership of audit firm**

Audit firms having limited liability partnership with a minimum professional liability insurance cover based on quantum of revenues may enhance independence of auditor.

➤ **Inclination to audit client:** Audit firms would not compromise with professional independence at the cost of audit fees and reappointment. Professional independence is need of the hour in order to maintain not only transparency of the profession but also to ensure true and fair reporting of financial information. Statutory auditor is appointed to protect the interest of shareholders and the society at large. Inclination to audit clients under no circumstances ensures independence of auditor. Code of ethics guide the auditor in this direction.

➤ **Professional relationship with audit clients:** Audit firms should maintain professional relationship with clients where no personal or business relationship do exist under any circumstances. Professional attitude prohibits audit firm from maintaining other relationships with the clients and its partners and that should be disclosed in audit report.

➤ **Cooling off period:** Audit partners may opt to join the client company provided a cooling off period be assumed by audit partners before engaging the client company at any position.

➤ **Professional training and education programme:** The ICAI conducts professional training and education programme keeping in line with IFAC pronouncement on continuing professional education and development and it is an ongoing process.

Following courses are introduced by ICAI with regard to professional training and education programme.

a) **Inclusion of elective course on International Accounting and Auditing Standards**

Theoretical as well as practical application of International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) in course structure in the curriculum designing process should be initiated in the undergraduate business/accounting programme so that the profession can cope up with changing business environment in global perspective.

b) **Business Ethics**

Business Ethics as a separate subject should be incorporated in undergraduate business/accounting programme. Professional examinations should be conducted to examine practical aspects of professional ethics in contemporary business practice. It is to be noted that Indian knowledge system provide scope for enriching Indian ethics that would directly or indirectly contribute to business ethics not only in India but the world over. Indian ethics is proved to be broader than western ethics in holistic point of view.

c) **Reviewing professional examination process of ICAI**





Professional examination in the present scenario attempts to examine student's aptitude regarding application aspects of accounting and auditing standards and let them understand difference of application between Indian and International Standards. The ICAI should conduct an independent review of the current assessment methodology.

**d) Licensing authorized trainers**

The accounting firms should be authorized to train the apprentice auditors regarding practical aspect of all the applicable standards and Codes. The accounting or audit firm should also be engaged to audit at least one major business enterprise in the region. The ICAI be empowered to arrange screening prior to licensing the trainers and update the list on the basis of periodic assessment of potential trainers. The ICAI should also determine the capacity of the clients of authorized trainers to act as a major business enterprise.

**7. CONCLUSION**

Over the period of time, it is observed that principle-based auditing and accounting standards are more effective than rule-based standards as principles covers wide spectrum of diverse issues. A few principles may potentially address so many rules. Rules breaking and new rules formation is a continuous process under different circumstances but principles do not change so frequently under any circumstances. Indian business ethics is based on some basic principles that have wide application. In India principle based rather than rule-based standards are generally followed and code of ethics of professional accountants is based on principle-based guidelines incorporating principles of integrity, objectivity, professional competence and due care, confidentiality, and professional behaviour. Presently professional ethics is being discounted in practice by professional accountants in India and abroad also due to greed of professional accountants over management incentives that leads to accounting crisis. The ICAI Code of Ethics requires holistic view of fundamental ethical principles to address possible threats to the principles and guidelines for resolving the threats. Last but not least, it goes no saying that sacrificing those incentives may have positive impact upon transparency of audit profession and profoundness of professional ethics and above all protection of all stake holders of corporate financial position in the society. Finally, the regulatory bodies like ICAI, SEBI in India should come forward by the side of the auditor for their protection from undue external pressure just for the sake of protection of society at large, otherwise, professional ethics would become a utopian scheme.

**8. SUGGESTIONS FOR FURTHER RESEARCH**

Professional ethics is broad in scope and several issues come within its purview. Hence, improvement and extension of the present study cannot be ruled out. There is need for continuing more exploratory and empirical research on different aspects of professional ethics. On the basis of present study, some thrust areas for conducting future research in the area of professional ethics in light of the Indian Knowledge System can be noted down,

**a) In-depth study of professional ethics in light of Indian ethics**



An in-depth and extensive study by a group of researchers may be conducted for improvement of code of ethics of professional accountants in light of Indian ethics.

**b) Comparative study**

Future research based on comparative study between code of ethics of professional accountants in India and code of ethics of professional accountants in developed countries like USA to determine whether the US experience is similar to that in India may be pursued.

**c) Study on users' perception of professional ethics requirement**

A detailed study can be made on the users' perception of professional ethics on audit profession.

**d) Study on standard setting and enforcement in India**

An extensive study can be conducted on the role of code of ethics to audit quality improvement.

**e) Ethical aspects of audit firms**

Ethical aspect of different audit firms can be studied in the context of corporate scams.

**f) Study on audit efficient regulatory measures**

A detailed study may be conducted over code of ethics compliance mechanism and the role of related agencies in this regard.

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