
AUDIT 2

Code of Ethics for Auditors

Vol.1



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PREFACE

Auditing is a vital element of accounting, and therefore, is covered in all accounting courses, whether in educational institutions or professional institutions. However, this book is written to address explanations on topic of Code of Ethics for Auditors.

The contents of this book arouse as a reference note for students of Diploma Accountancy in Commerce Department for Malaysian Polytechnics syllabus on Audit 2.

In addition, exercise and simple cases were included in this book for individual assessment and lecturer's evaluation. With provided sample answer, hopefully students and lecturer's will get better understanding for the topics.

We surely hope that students and academicians will benefit from this e-book for future references in the auditing field.



ACKNOWLEDGEMENT

This book contains information presented by the authors based on their knowledge and experiences teaching an accounting and auditing courses. In addition, this book also contains information obtained from other parties whose original sources are stated through citations and references.

However, the reader is encouraged to refer to the content of other related book to obtain a detailed understanding of a specific topic.

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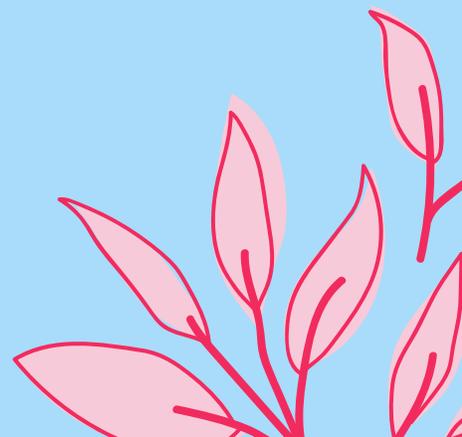
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Letter from the authors



Alhamdulillah, thanks to Allah SWT because with His mercy and compassion we have successfully completed the first volume of book on Code of Ethics for Auditors. The grace of God S.W.T. very big. Should be grateful for whom who received it.

My full appreciation to all students, colleagues and Head of Commerce Department of Polytechnic Tuanku Syed Sirajuddin and Management of Polytechnic Tuanku Syed Sirajuddin which provide all available facilities which include physical aspects such as facilities, tools and moral support. Lots of thanks are also given to friends of lecturers who always give ideas, advices, caution and guidance so that this book can be produced as a guide to the students as well as the relevant lecturers.

Most important of all, special thanks to all my family- spouses, children and families, whom have never endured the support of this life.

Thank you.

Rosasmanizan Ahmad & Nur Iliza Binti Misnan

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AUDIT 2

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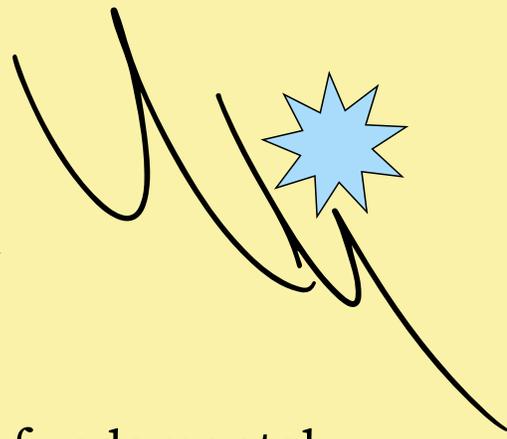
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LEARNING OUTCOMES:



- i. Provide the discussion on the fundamental principles of Ethics and Professional Conduct in accordance with MIA By-Law
- ii. Examine the importance of professional ethics
- iii. Provide the explanation on the concept of independence and its importance
- iv. Provide the situations that can influence independence in appearance and in fact
- v. Service that impaired independence
- vi. Ascertain the important of quality control system

INTRODUCTION

WHAT IS CODE OF ETHICS?

A code of ethics is a comprehensive statement of the values and principles that guide the work of auditors and accountants

As a professional accountant within a public sector organisation, you will have a particularly important role to play in creating, promoting and maintaining an ethical culture within that organisation.



WHY IT IS IMPORTANT?

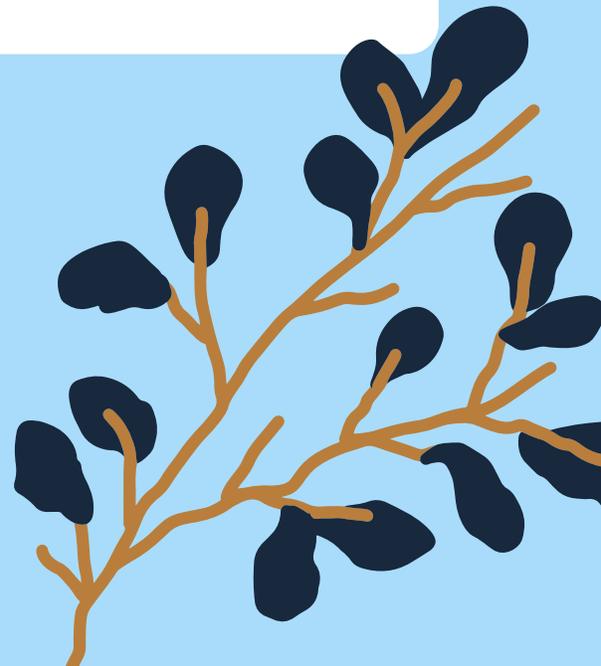
Likewise, ethics is implemented in the organization to ensure the protection of the interest of stakeholders like customers, suppliers, employees, society and government.

The professional accountant is also required to act in the public interest.



WHAT IS VALUE AND PRINCIPLES?

- Value is Values are basic and fundamental beliefs that guide or motivate attitudes or actions
- Principle is a moral rule or standard of good behavior or fair dealing



I. FUNDAMENTAL PRINCIPLES OF ETHICS AND PROFESSIONAL



MALAYSIAN INSTITUTE
OF ACCOUNTANTS

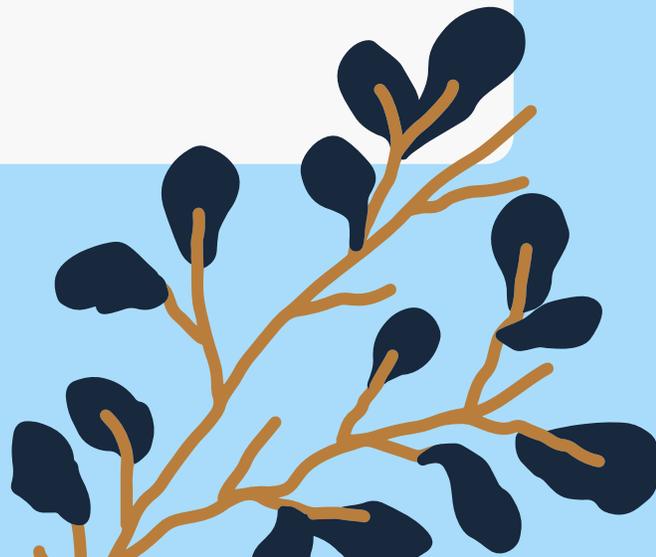
THE FUNDAMENTAL PRINCIPLES (S110)

- 1) Integrity
- 2) Objectivity
- 3) Professional
Competence & Due Care
- 4) Confidentiality
- 5) Professional Behavior



1. INTEGRITY (SUBSECTION 110)

- A professional accountant shall comply with the principle of integrity, which requires an accountant to be straightforward and honest in all professional and business relationships.
- Integrity implies fair dealing and truthfulness.

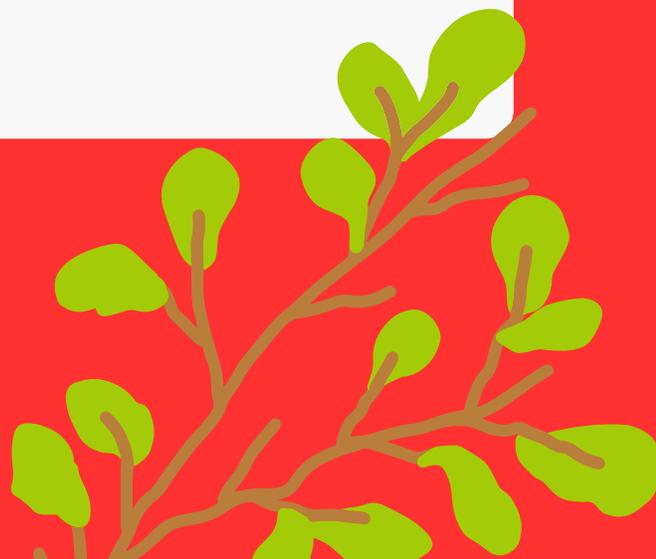


- A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the accountant believes that the information:
 - Contains a materially false or misleading statement;
 - Contains statements or information provided recklessly; or
 - Omits or obscures required information where such omission
 - Obscurity would be misleading



2. OBJECTIVITY (SUBSECTION 112)

- A professional accountant shall comply with the principle of objectivity, which requires an accountant not to compromise professional or business judgment because of bias, conflict of interest or undue influence of others.
- A professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant's professional judgment regarding that activity.



3. PROFESSIONAL COMPETENCE & DUE CARE (SUBSECTION 112)

A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to:

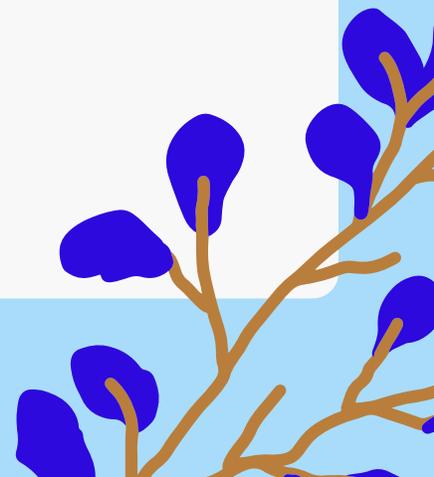
- (i) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organisation receives competent professional service, based on current technical and professional standards and relevant legislation; and
- (ii) Act diligently and in accordance with applicable technical and professional standards

4. CONFIDENTIALITY (SUBSECTION 114)

A professional accountant shall respect the confidentiality of information acquired as a result of professional and business relationships. An accountant shall:

a) Be alert to the possibility of inadvertent disclosure, including in a social environment, and particularly to a close business associate or an immediate or a close family member,

b) to respect the confidentiality of information acquired as a result of professional and business relationships.



d) Not disclose confidential information acquired as a result of professional and business relationships outside the firm or employing organization without proper and specific authority, unless there is a legal or professional duty or right to disclose;

e) Not use confidential information acquired as a result of professional and business relationships for the personal advantage of the accountant or for the advantage of a third party;

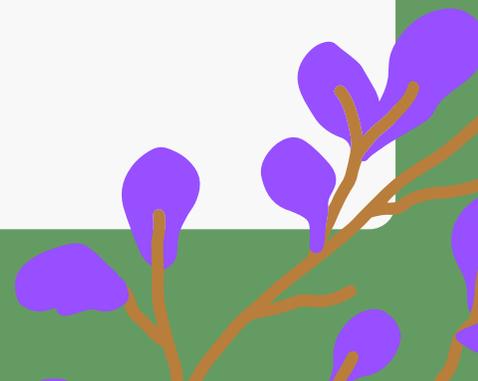
f) Not use or disclose any confidential information, either acquired or received as a result of a professional or business relationship, after that relationship has ended; and

5. PROFESSIONAL BEHAVIOUR (SUBSECTION 115)

Professional behavior – to comply with relevant laws and regulations and avoid any conduct that the professional accountant knows or should know might discredit the profession.

When undertaking marketing or promotional activities, a professional accountant shall not bring the profession into disrepute and shall not make:

- a) Exaggerated claims for the services offered by, or the qualifications or experience of, the accountant; or
- b) Disparaging references or unsubstantiated comparisons to the work of others



II. IMPORTANCE OF PROFESSIONAL ETHICS



Responsibility: Deep understanding of professional, ethical and legal responsibilities is the necessities of works in this profession

Doing work truly: Resorting of professional accountant to general ethical principles

Impartiality in judgment: The professional accountant should have a judgment without benefits contradict and others influence and don't prejudice.

Autonomy: The ability of professional accountant to keep impartiality and the independent auditor shouldn't have direct benefits or important indirect benefits in the unit.

Professional qualification: The professional accountant should have adequate information of techniques in professional work and should have required skills and experiences.

Confidentiality: The information of employer should be confidential. The auditor is not obliged to disclose the employer confidential information without his permission and the disclosure is only in legal courts



THE STORY OF ENRON CASE

ENRON, ETHICS AND TODAY'S CORPORATE VALUES



The Story of Enron Case

- Enron, once a sleepy natural gas pipeline company, grew to become the nation's seventh largest publicly-held corporation. But its shoddy business practices, aided by bankers and advisors feeding from the gravy train, brought down the company in December 2001.
- First, current laws and SEC regulations allow firms like Arthur Andersen to provide consulting services to a company and then turn around and provide the audited report about the financial results of these consulting activities. This is an obvious conflict of interest that is built into our legal structure.
- Second, a private company like Enron currently hires and pays its own auditors. This again is a conflict of interest built into our legal system because the auditor has an incentive not to issue an unfavourable report on the company that is paying him or her.
- Third, most large companies like Enron are allowed to manage their own employee pension funds. Again, this is a conflict of interest built into our legal system because the company has an incentive to use these funds in ways that advantage the company even when they may disadvantage employees.

- The company's failure in 2001 represents the biggest business bankruptcy ever while also spotlighting corporate America's moral failings. It's a stark reminder of the implications of being seduced by charismatic leaders, or more specifically, those who sought excess at the expense of their communities and their employees.
- In the end, those misplaced morals killed the company while it injured all of those who had gone along for the ride. Surely, if there are profits to be made, some type of scheme that attempts to skirt the law or even cross boundaries will occur. It's been that way throughout history. But with each passing scandal, new rules and codes emerge that surpass those of the past. And while [Enron won't be the last case](#) of corporate malfeasance, its tumultuous tale did initiate a new age in business ethics.

HOW CAN YOU RELATE CODE OF ETHICS WITH ENRON CASE?

“Ethics and integrity are at the core of sustainable long term success,”
Richard Rudden, managing partner at Target
Rock Advisors in New York State

“Without them, no strategy can work and, as Enron has demonstrated, enterprises will fail. That’s despite having some of the ‘smartest’ guys in the room.”



III. PROVIDE THE EXPLANATION ON THE concept of independence and its importance

Independence of the external auditor means independence from parties that have an interest in the results published in financial statements of an entity (True and fair view) Its relate with trust.

IMPORTANCE?

- Enhance the credibility of F/S by providing written reasonable assurance from an independence sources - accordance to accounting standards.
- Adopting and applying the ethical requirements of the concepts embodied in the key words – integrity, independence and objectivity, confidentiality and competence.

HOW AUDITOR PROTECT THEIR INDEPENDENCE?

- Avoid all relationships with manager and staff in the audited entity and
- Other party parties that may influence, compromise or threaten the ability of auditors to act and
- Be seen to be acting independently.



IV. PROVIDE THE SITUATIONS THAT CAN INFLUENCE INDEPENDENCE IN APPEARANCE AND IN FACT

The avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised.

INDEPENDENCE IN APPEARANCE

- The auditor must maintain a professional distance from employees and stakeholders of that company. This means you are not allowed to make friends with people relating to that company or be at risk of taking on the appearance of bias

IV. PROVIDE THE SITUATIONS THAT CAN INFLUENCE INDEPENDENCE IN APPEARANCE AND IN FACT

INDEPENDENCE IN MIND

Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity, and exercise objectivity and professional skepticism.

V.SERVICE THAT MAY IMPAIRED INDEPENDENCE

Threats	Particulars
Self-interest	the threat that a financial or other interest will inappropriately influence your judgement or behaviour;
Self-review	the threat that you will not appropriately evaluate the results of a previous judgement made; or an activity performed by you, or by another individual within your firm or employing organisation, on which you will rely when forming a judgement as part of performing a current activity;
Advocacy	the threat that you will promote a client's or employing organisation's position to the point that your objectivity is compromised;
Familiarity	the threat that, due to a long or close relationship with a client or employing organisation, you will be too sympathetic to their interests, or too accepting of their work; and
Intimidation	the threat that you will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over you.

TO MAINTAINED THE INDEPENDENCE WHAT AUDITOR SHOULD DO?

They auditor should applied the professional accountants to:

- **Identify threats (5 types of threats)**
- **Evaluate the significance of the threats identified**



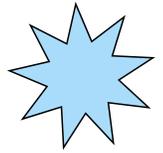
INTRODUCTION



- The fundamental of auditors' appointment was based on trust and it appears that public trust legitimates the auditors' position on the market.
- The auditor, as the recipient of that confidence from the general public, has an obligation of moral and ethical behaviour in order to meet the expectations bestowed on his work.

ISA 220 deals with the specific responsibilities of the auditor regarding quality control procedures for an audit of financial statements.

OBJECTIVES OF QUALITY CONTROL SYSTEM

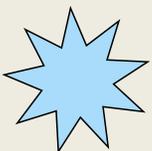
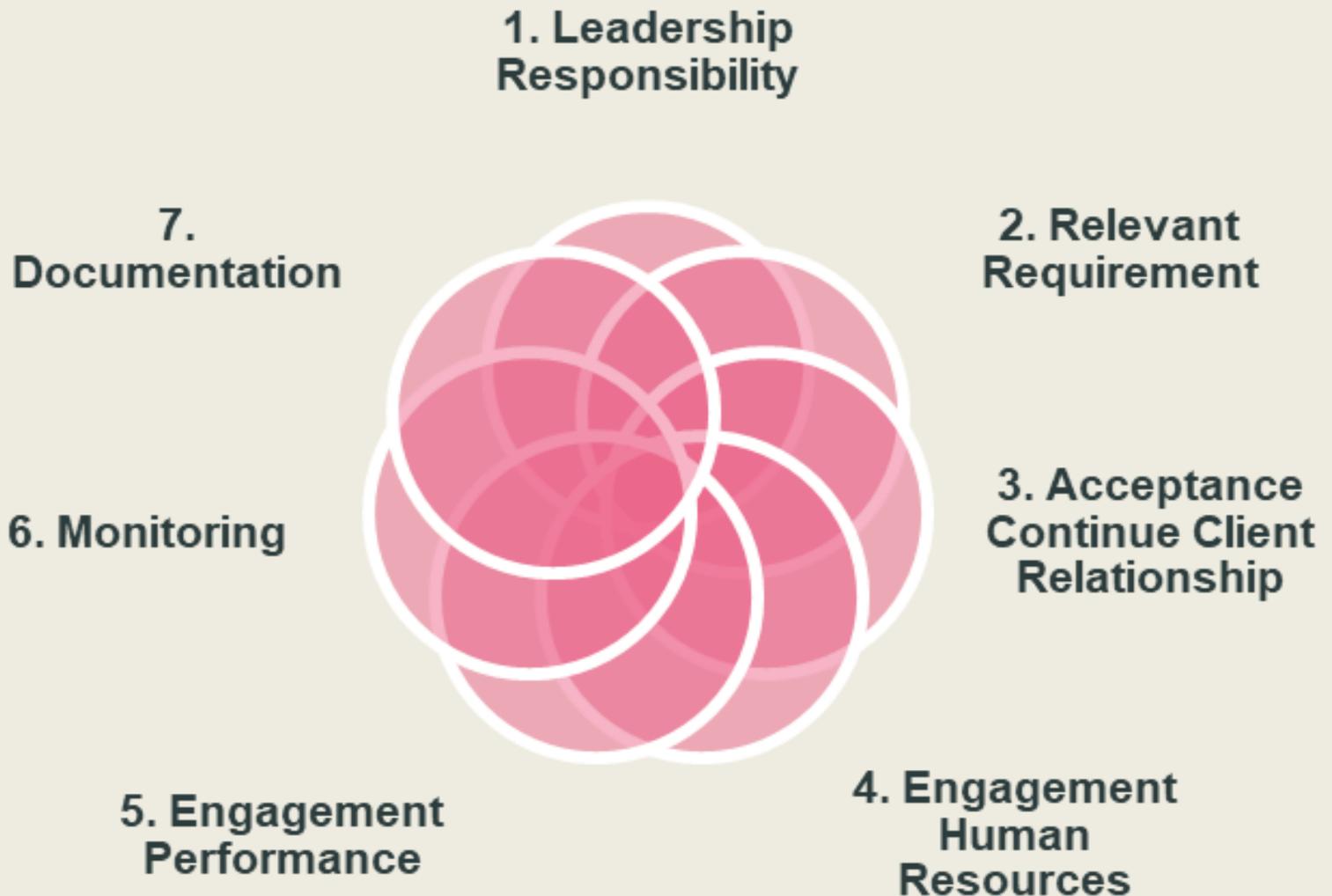


The objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that:

- a) The audit complies with professional standards and applicable legal and regulatory requirements; and
- b) The auditor's report issued is appropriate in the circumstances.



VI. ISA 220 - ELEMENTS OF QUALITY CONTROL SYSTEM



1. Leadership Responsibility

- The firm should establish policies and procedures designated to promote an internal culture based on recognition that quality & high standards is essentials in performing engagements.
- They may be communicated by training, meetings, formal or informal dialogue, mission statements, newsletter or briefing memoranda.

2. Relevant Ethical Requirement

Throughout the audit engagement, the engagement partner shall remain alert, through observation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements by members of the engagement team.



3. Acceptance Continue Client Relationship

- Has considered the integrity of the client and does not have information that would lead to conclude that the client lacks integrity
- its competent to perform the engagement and has the capabilities, time, resources to do so and, can comply with ethical requirements.

4. Engagement Human Resources

- The sufficient and appropriate resources of the members of the engagement team
- The sufficient personnel with capabilities, competence and commitment are describe as follows:
 - Professional education
 - Working experience
 - Continuing professional development and training and
 - Coaching by more experienced employees

5. Engagement Performance

This evaluation shall involve:

- (a) Discussion of significant matters with the engagement partner;
- (b) Review of the financial statements and the proposed auditor's report;
- (c) Review of selected audit documentation relating to the significant judgments the engagement team made and the conclusions it reached; and

6. Monitoring

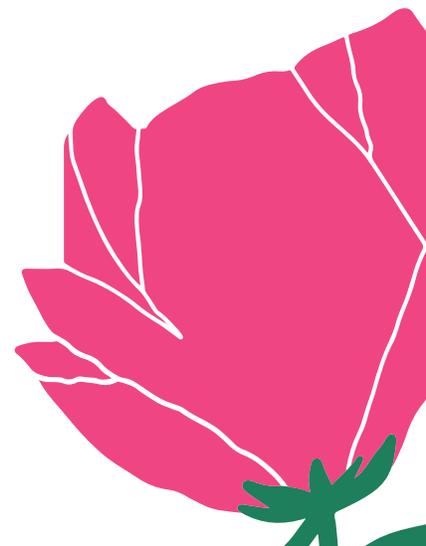
Obtaining an understanding of the information from the firm's monitoring and remediation process, as communicated by the firm including, as applicable, the information from the monitoring and remediation process of the network and across the network firms.



7. Documentation

The auditor shall include in the audit documentation:

- (a) Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.
- (b) Conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.
- (c) Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.
- (d) The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement.



Self Try Question

Q1. Discuss the term as below:

- i. Integrity
- ii. Objectivity
- iii. Professional Competence and due care

Q2. Describe the elements of Internal Control



Case Study

Performance information Outline of the case You are the deputy director of finance and information for a public hospital trust, with overall responsibility for the preparation of non-financial performance information. The newly appointed finance director is putting considerable pressure on you concerning the collation and reporting of this year's performance information for presentation to the board of trustees and your regulator. The director has made it clear that she expects the reported performance information to result in the hospital retaining its high rating by the regulator. Some favourable performance information has not been adequately verified, but the director is willing for it to be reported, because it will enhance the perceived performance of the trust. You are aware that some departments have had difficulties meeting targets during the last year, due to funding constraints and staff shortages.

From your scrutiny of the information systems, you are concerned that the relevant information may be incorrect, and that the correct performance information would draw attention to some severe performance shortfalls within the hospital. You are aware of some instances where departments have been double counting activity in order to increase the funding income of the hospital. This was highlighted in a recent internal audit report, which will shortly be submitted to the audit committee. The director is putting considerable pressure on you to conceal this issue, in the short term, while she reviews the position and puts in place a plan for remedial action.

Questions As a professional accountant in the public sector:

- (a) Which fundamental principles feature more prominently for safeguarding?
- (b) What would be your key considerations in your approach to resolving the dilemma presented?
- (c) What course of action would you take to resolve the dilemma?

Answers

Q1. Discuss the term as below:

- i. Integrity - A professional accountant shall comply with the principle of integrity, which requires an accountant to be straightforward and honest in all professional and business relationships.
- ii. Objectivity - A professional accountant shall comply with the principle of objectivity, which requires an accountant not to compromise professional or business judgment because of bias, conflict of interest or undue influence of others.
- iii. Professional Competence and due care – Act diligently and in accordance with applicable technical and professional standards.



Q2. Describe the elements of Internal Control

i. Leadership Responsibility

The firm should establish policies and procedures designated to promote an internal culture based on recognition that quality & high standards is essentials in performing engagements.

ii. Relevant Requirement

The engagement partner shall remain alert, through observation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements by members of the engagement team.

iii. Acceptance Continue Client Relationship

Competent to perform the engagement and has the capabilities, time, resources to do so and, can comply with ethical requirements



iv. Engagement Human Resources

The sufficient and appropriate resources of the members of the engagement team.

v. Engagement Performance

This evaluation shall involve: discussion of significant matters with the engagement partner.

vi. Monitoring

Obtaining an understanding of the information from the firm's monitoring and remediation process, as communicated by the firm including, as applicable, the information from the monitoring and remediation process of the network and across the network firms.

vii. Documentation

The auditor should include in documentation the nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement.

Answers

(a) Key fundamental principles;

Integrity: You must use your best endeavors to ensure that the performance information finally reported gives a straightforward and honest picture of the performance of the hospital trust. You should not knowingly be associated with information that contains false and misleading statements.

Objectivity: How can you maintain your professional objectivity in the face of undue pressure from the finance director? If the hospital's performance rating affects your own position, how can you avoid self-interest influencing your ethical judgement?

Professional competence and due care: You are required to perform your work diligently, thoroughly and on a timely basis. This will require balancing the need to verify much of the performance information with the need to report within a reasonable time.

Threats to compliance; there is an intimidation threat to your compliance with the fundamental principles, since you are being deterred from acting objectively because of pressure to exercise undue influence over you

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