# TOPIC 3 PROFESSIONAL ETHICS AND QUALITY CONTROL

Define the term profession and explain the role of being a member of a profession

## DEFINITION OF PROFESSION

Professional accounting bodies in Australia set up the Accounting Professional & Ethical Standards Board (APESB) which established the Code of Ethics for Professional Accountants based on the International Federation of Accountants (IFAC) Code of Ethics for Professional Accountants for the implementation of force of law auditing standard.

Greenwood (1957) 5 attributes to a professional. True difference between a professional and non-professional is not qualitative difference but a quantitative one because non professional also possess these 5 attributes but to a lesser degree.

A professional provides a service to society as a social good to benefit the community.

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| **Systematic body of theory** | Body of knowledge organised into systematic theories or propositions that form the basis of and rationalise complex operations. It include intellectual cultivation and practical experience. |
| **Authority** | Level of authority of body of knowledge (higher than regular people)<br>• Client-professional relationship |
| **Community Sanction** | Demand by community in the form of a series of powers and privileges, reinforced time to time by the community's regulatory power. |
| **Ethical Codes** | Have knowledge other people don't have so professional use it in most appropriate way<br>• Prevent monopoly power abuse<br>• Built in regulatory code – partly formal and partly informal, to compel ethical behaviour on the part of its member. Formal part individual usually swears to abide on admission to the profession<br>• A matter of public interest – ensure the continued confidence of society<br>• Ethical requirement for auditors under s227A of ASIC and s336 of CA2001 |
| **A culture** | Grouping of people with knowledge where higher knowledge in relation of a particular matter<br>• Interaction between formal and informal group<br>⇨ Formal groups are organisations within profession perform service, supplying talent and expand body of knowledge and professional bodies<br>⇨ Informal body all the other affiliations, selective and specific subgroups and units<br>• Professional provides service to society as social good which benefits the community |

International Federation of Accountants (IFAC) defines profession characteristics as :-

(a) Mastery of a particular intellectual skill acquired by training and education
(b) Adherence to a common code of values and conduct
(c) Acceptance of a duty to society as a whole

Brooks and Dunn identify profession as including the maintenance of :-

(1) Competence in the field of expertise and knowledge
(2) Integrity in client dealings
(3) Objectivity in the offering of services
(4) Confidentiality in clients matters
(5) Discipline over member who do not discharge these duties

## DUTIES OF PROFESSIONAL ACCOUNTANT

- Special technical expertise associated with accounting and an understanding of related fields that exceed that of the layperson
- Adhere to general professional duties and values as well as specific standards established by professional body to which they below

- Corporate collapse trigger public enquiries into the affairs of the profession in general
- Brooks and Dunn consider that accounting profession has the duties, rights and values detailed as below :
  - Duties to sustain a fiduciary relationship :
    - Display behaviour that espouses responsible values
    - Pay continual attention to the requirements of clients and other stakeholders
    - Acquire and maintain the required skills and knowledge
    - Maintain a credible reputation for profession and maintain acceptable person reputation
  - Rights allowed :
    - Represent oneself as a professional
    - Be involved in the development of accounting and audit practice
    - Establish entrance standard and examine candidates
    - Require self regulation and discipline of members based on codes of conduct
    - Access to certain or all areas of accounting and auditing activity
  - Values required to carry out duties and maintain rights :
    - Honesty, Integrity, wish to exercise due care, objectivity, confidentiality, competence and a commitment to put needs of public, client and the profession and employer ahead of any self interest

<u>Describe and explain the fundamental principles of Code of Ethics and identify relevant threats and safeguards</u>

Fundamental ethical characteristic : Competence, Objectivity and Integrity

Practice of ethical behaviour requires :

(a) An understanding of ethical issues
(b) A framework within which a responsible decision can be made
(c) An awareness of consequences of such decisions

Why are we concerned about ethics in auditing and assurance?

(a) Objective and critical examination of a subject matter – not being influence
(b) Assessing its credibility – determine after assessment
(c) Provide assurance through issue of an objective opinion – responsibility as users rely on FS

Ethics in Auditing Law Regulation :

1. ASA102 Compliance with ethical requirements when performing audits
2. APES110 Code of ethics for Professional Accountants
3. ASQC1 Quality control for firms that perform audits and reviews of financial information

# CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS

Part A: Introduction & fundamental principles that are applicable to all professional accountants
Part B: Professional accountants in public practice – most important aspects
Part C: Professional accountants in business

Provides a conceptual framework of fundamental principles for professional accountants to enable them to identify evaluate and respond to threats to compliance with such principles.

IFAC defines the public interest as the net benefits derived for and procedural rigor employed on behalf of all society in relation to any action, decision and policy.

Code of Ethics adopt the following approach :-

1. Public interest is the overriding responsibility and then used to identify the possible threats and safeguards. Code of conduct are expectation and not bias

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| Integrity | Straightforward and honest in professional and business relationship<br>Not misleading and deceiving |
| Objectivity | Not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others<br>- Treat every client and client equally free from bias |
| Professional Competence and Due Care | Maintain the professional knowledge and skill and act diligently in accordance with applicable technical and professional standards<br>- Law business corporation always change so we have to have the |

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| | responsibility to keep knowledge and mastery updated |
| Confidentiality | Refrain from disclosing or using confidential information<br>- Not publicly available |
| Professional Behaviour | Comply with relevant laws and regulations and avoid any action or omission that may bring discredit to the profession.<br>- Act professional way of standards that affect others<br>- If not comply – loses mebership |

Circumstances may lead to

THREATS to compliance with the principles/independence

Evaluate threats identified

Eliminate or reduce threat with safeguards

2. Threats that occurred

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| Self-Interest | The financial or other interests of a professional accountant or of an immediate or close family member |
| Self-Review | A previous judgment needs to be re-evaluated by the professional accountant responsible for that judgment<br>- Reviewing on work – trust own work |
| Advocacy | A professional account promotes a position or opinion to the point that subsequent objectivity<br>- Cease being objective |
| Familiarity | Close relationship, a professional accountant becomes too sympathetic to the interest of others |
| Intimidation | An accountant may be deterred form acting objectively by threats, actual or perceived. |
| Public practice Behavior | Inappropriate marketing of professional services or acceptance of client |

3. Safeguard may eliminate or reduce threats to an acceptable level. Safeguard can be those created by profession, legislation or regulation and those implemented in workplace. Safeguard includes education,training and experience, continuing professional development requirement, corporate or governance regulations, professional standards and pronouncements, monitoring and external review by legal party.

4. Professional accountants should consider both quantitative and qualitative factor when determine the significance of any potential threat. If safeguard cannot be implemented, decline or discontinue the specific service involved.

5. Nature of the safeguards to be applied varies with circumstances in which threats arise. Professional accountants should exercise professional judgement.

An ethical conflict resolution process should include :-

- Identifying and obtaining all relevant facts and information
- Evaluating the ethical issues involved
- Assessing the relevant fundamental principles applicable to the situation
- Establishing internal procedures
- Reviewing alternative courses of action and their consequences
- Determining best course of action consistent with fundamental principles

PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE

A professional accountant in public practice should not knowingly engage in any business, occupation or activity that impairs or might impair integrity, objectivity or good reputation of the profession which result be incompatible with rendering of professional services.

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| Safeguards Profession, legislation and regulation | ✓ Educational, training, and experience requirements for entry<br>✓ Continuing professional development requirements |

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| | ✓ Corporate or other governance regulation<br>✓ Professional standards and pronouncements<br>✓ Monitoring and disciplinary procedures of professional and other regulatory bodies<br>✓ External review by a legal party of the report and return or other communication of a profession accountants |
| Safeguards Developed by firm | ✓ Firm leadership emphasizes compliance and ethics<br>✓ Quality control and review policies for all client engagement<br>✓ Policies and procedures that ensure all relationships or interests are disclosed<br>✓ Using different partners and teams with separate reporting lines for provision of non assurance services to an assurance client<br>✓ Senior management oversight of safeguarding system<br>✓ Disciplinary mechanism<br>✓ Timely communication of policies and procedures to all partners and professional staff |
| Safeguards Developed by engagement-specific | ✓ Professional review by other professional accountants<br>✓ Consulting third parties such as the audit committee or a regulatory body<br>✓ Partner and senior personnel rotation<br>✓ Discussing ethical issues with those in charge of client governance<br>✓ Disclosure of fees<br>✓ Involving another firm to perform or re-perform part of engagement |
| Safeguards Within the client system | ✓ Appointment of an independent firm to ratify the engagement<br>✓ Competence of employees<br>✓ Internal procedures to ensure objective decision on engagement<br>✓ Proper corporate governance structure with appropriate oversight and communication |

PROFESSIONAL ACCOUNTANTS IN BUSINESS

Those who are salaried employees, partners, directors, owner-managers and volunteer workers, regardless of whether they have a legal form of relationship with employing organisation.

Safeguards in place :

i) Corporate oversight structure, corporate ethics and conduct programs
ii) Recruitment procedures for high calibre staff
iii) Strong internal controls and disciplinary processes
iv) Leadership and transparency
v) Adequate training and education of employees
vi) Procedures and policies to empower staff and encourage communication with senior

Describe and explain the importance of auditor independence and identify instances where this may be threatened

## PROFESSIONAL INDEPENDENCE

RAMSAY Review 2001 – 'independence is fundamental to the reliability of auditors report
CLERP9 (2004) – Additional provisions regarding independence (Part2M.4) –
➔ Conflict of interest and relevant relationships (defined further in pg113)
Without independence the auditor's opinion is suspect. Fact of independence depends on the auditor's integrity, objectivity and strength of character.

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| **Integrity** | Observance of accepted standards of honesty that must form the basis of all professional decision and actions |
| **Objectivity** | Fair and impartial attitude must be maintained with bias not being allowed to influence one's judgment |
| **Strength** | One's ability to withstand pressure and maintain one's integrity and objectivity |

Non audit services providers satisfy the maximum hour test if during the audit period, the number of hours for which they provide non audit services to audited body on behalf of auditor is not more than 10 hours and during 12 months immediately before the beginning of the audit period the number of hours not more than 10 hours.

A person satisfied the independence test if the person :-

a) Does not influence the operations or financial policies of the accounting and audit practice conducted by the auditor

b) Does not participate, or appear to participate in the business or professional activities of the accounting and audit practice conducted by the auditor
c) Does not have any rights against the auditor in relation to the accounting and audit practice conducted by the auditor in relation to termination of the person former employment
d) Has no financial arrangements with the auditor in relation to the accounting and audit practice conducted by the auditor other than wage, salary payment which do not depend on earning of auditor
e) Has no financial arrangement with auditor to receive commission or similar payment

An offence is not committed if person has reasonable ground to believe that there was a quality control in place provided reasonable assurance, and complied with requirements of the law in the event of contravention of s324.

Unrealistically low audit fee set by audit firm to gain new clients – low balling resulting in lower standard performance

**Independence of Mind and In Appearance**

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| Mind | State of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment.<br>- Professional accountant to exercise scepticism and act with integrity and objectivity<br>- Ensure not affected by influences that compromise professional judgment |
| Appearance | Avoiding situation and facts that are so significant that a reasonable person, knowing all relevant facts and having considered the safeguard in place, would reasonably conclude that firm's or professional accountant's integrity and objectivity had been impaired.<br>- Avoid the appearance that integrity, objectivity and professional scepticism has been compromised<br>- Reasonable person test – specific facts and circumstances |

S290 Code of Ethics recommends that the significance of such relationships should be evaluated in the light of what a reasonable and informs third party with all relevant information would reasonably conclude as unacceptable.

Independence requirements for audit and review engagements can be summarised as follows:

(1) Where engagement is provided for audit clients, the audit team, the firm and network firms must be independent of the audit client
(2) Where audit and review engagements are provided for a non-audit assurance client and the report is not restricted to specific users, the assurance team and firm must be independent of the client.
(3) Where the audit and review engagements are provided for a non-audit assurance client and the report is restricted to specific users, the assurance team and firm must be independent of the client and should not have a material direct or indirect financial interest in the client

Threats are detailed in Section 290.102 to 290.231 of the Code of Ethics

| | Threats | Safeguards |
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| Financial Interest | Self Interest threat<br>➔Nature, position, materiality of financial interest<br>➔$5000 S324CH allowed | 1. Involve an additional professional accountant who did not take part in the engagement to review work done by member of audit team<br>2. Excluding member from any substantive decision making concerning audit engagement |
| Loans and guarantees | Create threat to independence when loan made is material under both firm,network firm and audit client | 1. Additional professional accountant from outside the firm or network firm to review work performed<br>2. Loan made to partner, reduced by the repayment of the loan or termination of the guarantee |
| Business, family and personal relationships | Self interest and intimidation threats | 1. If insignificant, only possible course of action is to terminate business relationship or reduce magnitude of relationship<br>2. Firm refused to perform audit engagement<br>3. Removing the individual from the team<br>4. Structure responsibilities so that the professional does not deal with matters within the responsibility of close family member |
| Employment Relationship | Self interest, familiarity & intimidation based on:-<br>- Position of person | S206 Sarbanes Oxley Act prohibits an accounting firm from providing audit services for a company issuing financial statements if the CEO or CFO was employed in audit practice during the 1 year |

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<td><ul><li>Extent of involvement</li><li>Length of time</li><li>Previous position person had</li></ul></td>
<td>before audit.<ol><li>Refused to perform engagement if it is significant</li><li>Independence not compromised unless position was not taken in contemplation of combination, benefits or payments due to the former partner from audit firm settled in full, does not continue to participate or appear to participate in firm business and professional activities, and position held with audit client is discussed with those charged with governance</li></ol>Audit client is a public interest entity that is either a listed company or an entity defined by regulation or legislation as a public interest entity, audit has to comply with the independence requirement applicable to listed entities.</td>
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<td>Staff assignments, recent service and serving as an officer or director of an audit client<br><br>Should not serve as officer, director, liquidator, controller, scheme manager, official manager and administrator</td>
<td>Self review, self interest and familiarity threats depend on :<ul><li>Position</li><li>Length of time</li><li>Role individual play</li></ul></td>
<td><ol><li>Conducting additional review of the work performed by the seconded staff not giving responsibility for any function or activity that has performed during the period of loan assignment</li><li>Additional professional accountant to review the work performed by individual or discussing issue with those charged with governance of audit client – audit committee</li><li>Audit firm refused to perform or withdraw if partner or employee of audit firm become a secretary of the client firm</li></ol>Performing routine administrative services to support a company secretarial function or providing advice in relation to company secretarial administration not a threat</td>
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<td>Long association with an audit client including partner rotation</td>
<td>Familiarity threat depend on:-<ul><li>Length of time</li><li>Role of individual on assurance team</li><li>Structure of the firm</li><li>Nature of assurance engagement</li></ul></td>
<td><ol><li>Rotating senior personnel</li><li>Additional professional accountant who is not a member of assurance team to review work done by senior personnel</li><li>Independent internal quality reviews</li></ol>For public interest entities or listed entities, individual shall not be the key audit partner for more than 7 years and cannot be member for 2 years. Cannot participate in audit, quality assurance process, or consult with audit team or the client regarding technical or industry specific issues, transaction or event unless unforeseen circumstances arise<br><br>Firm with only few people with necessary knowledge of the audit client, grant an exemption from partner rotation provided specified safeguard are applied</td>
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<td rowspan="2">Provision of non assurance services to audit client</td>
<td>The greater knowledge of the assurance client's business, better assurance team will understand clients procedures and policies, its control and risk<br><br>Depend on nature, involvement and materiality of matter</td>
<td><ol><li>Policies and procedures to prohibit professional staff from making management decisions for the audit client</li><li>Discussing independence issues related to provision of non audit service with those charged with governance – audit committee</li><li>Identifying responsibilities for provision of non audit services by the firm</li><li>Involving an additional professional accountant to advise on the potential impact of the non audit engagement on the independence of member of audit team and firm</li><li>Involving an additional professional accountant to provide assurance on a discrete matter of the assurance engagement outside of the audit engagement</li><li>Obtaining client acknowledgement of responsibility for the results of work performed by firm</li><li>Make arrangements so that personnel providing non audit services do not participate in audit engagement</li></ol></td>
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<td colspan="2">Services provided :-<table><tr><td>Management responsibilities</td><td>Requires exercise of judgment. It includes setting policies and strategic direction, directing responsibilities, implementing and maintaining internal control</td></tr></table></td>
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| | | - Audit so significant no safeguard can reduce such threats |
| | Preparation of accounting records and financial statements for audit client | Technical assistance such as input regarding accounting principles, FS disclosure, appropriateness of controls, helping client resolve reconciliation problems, analysing information closure and proposing journal entries do not threaten independency.<br><br>Firm shall not provide accounting or bookkeeping services including payroll or preparation of FS! In emergency cases, audit member can assist in preparation provided this personnel providing the accounting service shall not be in audit team |
| | Valuation services | Self review threat – Significant → Firm withdraw or refuse to perform engagement |
| | Taxation services | Compliance, planning, provision of formal tax opinion does not create threats but audit firm shall not prepare tax calculations of current and Deferred tax liabilities for purpose of preparing accounting entries<br>- Use professional who are not member for audit team to perform service<br>- Tax professional who is not involved in providing tax service to advise the audit team in respect of FS statement or obtaining service of external tax professional or obtaining tax clearance from tax authorities<br>If self review threat significance, do not provide the service. |
| | Internal audit services | Self review threat<br>- Ensure clear separation between the management and control of the internal audit<br>Shall not perform internal audit services if public interest entity |
| | IT system services audit clients | Self review threat but no threat if no management functions are performed. Where audit client is a public interest entity(PLE), audit firm shall not provide IT services |
| | Other services | Support services and legal services create self review threat<br>Evaluate threat based on nature andmateriality<br>- Use professional who are not part of audit advised<br>- Recruitment service and client PLE do not provide<br>- Corporate finance services – significance evaluated based on nature and materiality |
| Fees | Possibility of losing the client so self interest threat exist. | 1. Independent member of the audit team shall perform an engagement quality control review prior to the issuance of the second year financial statement<br>2. A professional regulatory body perform an engagement quality control to the engagement quality review performance during second year audit after audit opinion has been issued and before issuance of audit opinion of the 3rd financial statement<br>Fees exceeding 15% shall have pre issuance review.<br>Overdue fees shall be considered whether its loan<br>Shall not enter engagement If contingent fee present |
| Compensation & | Evaluation policies | Shall not be evaluated on or compensated based on partner success in selling non-assurance service to client |
| Hospitality and | Gift | Should accept gift unless clearly insignificant |
| Actual or threatened litigation | | Self interest and intimidation risk created.<br>- Relationship be treated with candour and full disclosure<br>- Evaluate based on materiality of litigation<br>- Remove member of the team<br>- Having independent professional reviewing the work performed<br>- If safeguard don't work, withdraw |

# TOPIC 4 THE AUDITOR'S LEGAL LIABILITY

Discuss the contemporary legal environment in which auditor operate.
Responsibility of the auditor under common law may be via contracts with clients or in certain circumstances, with third parties to whom a legal duty of care is owed. Also of interest is the extent of liability terms of:

i) Determination of damages awarded by the courts where negligence is proven
ii) Defences that may be offered by auditors in full or part mitigation of their responsibility.

Why sue the auditors ? (a)(b)(c) Insurance hypothesis

a) They are to be blame for corporate collapses and expectation gap
    - Unrealistic expectation of audit as guarantee
    - Auditor's fault – It did not cause collapse but partly to contribute to it
b) Deep pocket theory
    - Sues the ones who can afford it – sue the people who perceive to have the cash
c) Professional Indemnity insurance
    - Insurance policy where insurance company will pay up to certain amount if get sued so it doesn't cost them
    - Creates a perception that auditors have deep pocket and contributes to the extent of claims filed against them
    - The more the accountant get sued, the more insurance company have to pay, the harder to get the insurance and premium increases as well
    - Insurance claim varies depending on firm's claim, experience and risk profile
    - Coverage gap between potential liability and available insurance cover exposes auditor to risk of significant personal liability
d) Internationalisation of the profession
    - Caught up directly in lawsuits originating overseas.
    - Controlled entities and branches of multinational companies with overseas creditors and ownership interest

Change in Legal Liability - Limited Liability

a) Professional Standards Legislation (PSL)
    - Limit of liability by the use of caps based on the amount of the fee for the service provided – Minimum cap of 500,000
    - Professional indemnity insurance is required
    - To curb large damages payout
    - Replaced joint and several liability with a national model of proportionate liability
b) Joint and Several Liability
    - Liability of Partnerships
        - Auditors and accountant are partnership ➔ unlimited liability
        - Partner sued against individual wealth
    - Proportionate Liability (Sued partner in the firm based on their fault)
        - Allocation of liability on proportion of blame – allow court to look at as a group and apportion liability/blame between them
        - The plaintiff loss will be divided among the defendant according to their proportion of responsibility

1. Cambridge Credit Corporation Ltd and Anor v Hutcheson & Ors initial award of 145mil
    - Momentum for the accounting profession to seek legal reforms that are likely to curb unwarranted litigation
2. AWA v. Daniels t/a Deloitte, Haskins & Sells & Orcs
    - 'The defendant may indeed seek contribution from other persons responsible for major damages. Why should the whole of the burden of a possibly insolvent wrongdoer fall entirely on a well-insured or deep-pocketed defendant.'

High level of cases in Australia corporate collapse was due to the lack of availability of insurance in Australia.

Lack of appropriate insurance concerns are threefold:-

1) Professionals may be operating without appropriate insurance cover and divorcing themselves from asset through discretionary trust and leaving client unable to access appropriate damages in case of negligence
2) Contraction of supply of professional services is likely to lead to reduced competition
3) Withdrawal of professional services, especially in areas critical to the public interest will adversely affect the wellbeing of the community.

The impact of the CLERP9 Act :-

1. ASIC must be satisfied that they have adequate and appropriate professional indemnity insurance before registering with CLERP9
2. Insurance should be enough to cover any claims reasonably expected to arise from suh audits of companies and registered scheme, fit for purpose and on usual commercial terms, and reasonably available in the market place
3. Insured amount will depend on the largest audit engagement fee that directors of the audit company reasonably believed will be charged

<u>Describe and explain the liability of the auditor under contract and negligence</u>

**Liability to Shareholders and Auditees**
Corporations Act stipulates that auditors, in cases of irregularities, are required to report to ASIC if they have reasonable grounds to suspect any contravention of the law.

- ⇨ Major problem : if he or she is mistaken, may be liable for a defamation action by the party identified by auditor as perpetrating fraud
- ⇨ Found themselves in court on the criminal charge of fraud after issuing unqualified reports on financial statements subsequently found to be misleading

An auditor is liable to compensate a plaintiff if:

(a) A duty of care is owed to the plaintiff
(b) The audit is negligently performed or the opinion is negligently given
(c) The plaintiff has suffered a loss as a result of the auditor's negligence (casual r'ship)
(d) Loss is quantifiable

Liability Under Contract

- Contract between client and auditor
  - Owed to the client – privity of contract
  - Responsibility by the client and auditor
  - The only people can sued is the client and auditor and can only sued only based on term of contract is not fulfilled
- Three Elements (Terms you can sued for a breach)
  - Offer
  - Acceptance
  - Consideration
- Breach of Contract
  - Engagement letter – shows the agreement between the parties, their expectation and roles which are signed by the parties
  - Parties can sued each other in the event of any breach in the terms of the letter

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<tr><td rowspan="2">Liability Under Negligence</td><td colspan="2">Any conduct that is careless or unintentional in nature and entails a breach of any contractual duty or duty of care in tort owed to another person or persons.<br>- Negligence – don't have to have a contract<br>Determine negligence exist by the plaintiff showing three elements of negligence:</td></tr>
<tr><td>Duty of care owed by the defendant to the plaintiff</td><td>1. When is a duty owed?<br>2. Donoghue v Stevenson (lady drinking a snail)<br>⇨ "A person who are so closely or directly affected by my actions that I might reasonably have them in my contemplation"<br>⇨ Idea of Neighbour – owe duty of care so closely and related use in contemplation.<br>⇨ Conscious that action affect people around them<br>3. Owed by Auditor – To client and shareholder (who audit report prepared for?)</td></tr>
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<td>Duty of care breached by the defendant</td>
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1. What is the duty owed?<br>
⇨ What do we expect of the person(auditor)? Standard of care expected.<br>
⇨ Did the auditor do what is reasonably expected of them.<br>
⇨ Kingston Cotton Mill Co – watchdog not bloodhound<br>
Skill, care and caution of a reasonable competent, careful and cautious auditor at reasonable degree<br>
⇨ London and General Bank – He is not an insurer; he does not guarantee the books<br>
Argued against unrealistic expectation<br>
⇨ Pacific Acceptance Corporation Ltd v Forsyth<br>
Court looked at what a ‘reasonable auditor’ would do. Set of expectation that an auditor would meet in order to show that they have taken due care (7)<br>
2. Do the actions lead to a breach ?<br>
⇨ Match actions against standard expected<br>
⇨ Fact : What did the author do?<br>
⇨ Comparison : What is expected? Did the action meet the expectation? If yes, no breach otherwise it is breached.
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<td>Quantifiable loss or damage sustained due to breach</td>
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Auditor fault that the loss happen<br>
⇨ Causal connection<br>
➔Link between the actions of the person and damage sustained<br>
➔Failure to show link will mean that legal action will fail
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Client sue the auditor in the tort of negligence to obtain damages sufficient to restore the client to its original position. Depend on the court judgment<br>
- Auditor must exercise judgment in applying standards to the specific circumstances where compliance with accounting standards would not give true and fair view and where additional information and explanation must be added<br>
- ASIC raised areas of future focus for audit firm and inspection including<br>
✓ Audit evidence, professional scepticism and use of other auditors and experts<br>
✓ Quality of judgement and decisions made by the auditor<br>
✓ Deficiencies in auditor conduct appear to have contributed to insufficient transparency in the financial position and performance of an entity leading to collapse
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<td>Due care</td>
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Relevance of professional standards namely :-<br>
- Auditing standards in determining adequate performance of audit work<br>
- Accounting standards in determining the basis for expressing an opinion on fairness of presentation<br>
Kingston Cotton Mill Co. and London and General Bank Case<br>
⇨ Auditor does not guarantee that financial statement are fairly presented any more than a solicitor guarantees to win a case.<br>
⇨ Auditor does not guarantee to bring to bear the highest degree of skill in performance of his or her duries<br>
⇨ Watchdogs not bloodhounds – deny legal responsibility for detection of fraud<br>
Pacific Acceptance Corporation Ltd v Forsyth<br>
⇨ Willingness of the audit staff to allow themselves to be persuaded by perpetrator of the fraud to accept his representation on matters where corroborative evidence was available<br>
HIH Royal Commission report emphasizes on fiduciary relationship where the elements :<br>
(a) The fiduciary undertaken to act in the interest of another<br>
(b) Undertaking gives to the fiduciary the power to affect interest of other party<br>
(c) The person to whom the fiduciary duty is owed is vulnerable to the fiduciary abuse of his or her position<br>
Purpose of fiduciary obligations:<br>
(a) Maintenance of high standards of honesty and propriety by those who are under a duty to act in the of others<br>
(b) The confiscation of gains arising from the abuse of a relationship of trust<br>
(c) Protection of one person’s reasonable expectation that other will act in his or her interest and not in pursuance of a contrary self interest or conflicting duty
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<td>Privity of contract</td>
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1. Contractual relationship that exists between two or more contracting party.<br>
A & B signed the contract with promise and consideration, no obligation can be imposed on C.<br>
2. Scope of doctrine
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| | ❖ Applies only to contractual rights and obligations, if the contract involved gives rise to non contractual right and obligations then it is possible for these to be enforced against or in favour of those who are not parties to the contract.<br>So if A & B contracted and also include protecting C then C may have a claim against B if failure to discharge duty<br>❖ Under contract, directors or more commonly, the liquidator or receiver may sue the auditor in respect of losses incurred by the company arising from auditor negligence and monies recover would pay creditor and then shareholders |
| Causal Relationship | Exist between the breach of duty by the defendant and the loss or harm suffered by the plaintiff.<br>⇨ Relationship must have been reasonably foreseeable and it must be proven that the loss suffered is attributable to negligent conduct of audit in negligent case<br>Segenhoe Ltd v Akins & Ors and Galoo Ltd v Bright Graham Murray |
| Contributory Negligence | Failure of the plaintiff to meet certain required standards of care.<br>⇨ Court tends to examine all relevant circumstances to judge the likely proportion of liability attributable to respective parties<br>AWA Ltd v Daniels t/a Deloitte Haskins & Sells & Ors |
| Damages | Where auditors fail in their duty to act with reasonable care and skill, whether under contract or in tort, a plaintiff is entitled recover any economic loss arising out of such breach of duty. Two issues :-<br>1. What is purpose of statements that may give rise to reliance reasonably being placed on them?<br>2. To what extent may responsibility for any loss be assigned on the one hand to the auditor's negligence and on the other to other causes and other parties?<br>Victory from Continental Casualty Co. v PricewaterhouseCoopers – Investor could not show any direct damages resulting from auditors alleged fraudulent inducement that occur when investment was made. |