



PUBLIC TRUST & ETHICS MOCK MAY 2023

Sample Solution – Fleming & Hutchins LLP

Note to Students:

This is a sample solution for the case study and should not be taken as the only correct answer. There were a number of different methods of completing the case study successfully.

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PTE LLP

FLEMING & HUTCHINS LLP

Introduction

The paper put you in the position of Jamie, a recently promoted manager in the medium-sized professional services firm Fleming & Hutchins LLP ('FH'). You are given information relating to a new client that your firm has accepted, as well as some other conversations that happened throughout the day. You have been asked to identify the public trust and ethical issues and are given four requirements.

NOTE: This guide is structured to look at each issue in turn, after first identifying the issues to be addressed. It works through requirements 2-4 for each issue before moving on and doing the same for the next one. However, students should note that this is not the only approach, and other well laid out structures will gain credit. In particular, students may prefer to look at each requirement in turn.

Requirement 1: Identify the public trust and ethical issues in this scenario.

- 1.1 Acceptance risks of taking on new client
- 1.2 Conflict of interest with MP/confidentiality risk
- 1.3 Lack of Corporate Governance compliance at proposed new client
- 1.4 Knowledge of (alleged) harassment amongst staff
- 1.5 Inappropriate audit and potential audit client entertaining

NOTE: This guide is structured around the above five ethical issues. Students may have grouped group points together slightly differently, perhaps by combining issues or by breaking some down into multiple issues. The student's answer would be considered as a whole, and credit would be available where the main points were considered and appropriately analysed

Issue 1 – Acceptance risks of taking on new client

Evaluate the public trust and ethical issues, considering the impact on the relevant stakeholders.

NOTE: Students would not be expected to draw out every stakeholder noted throughout this answer to score good marks. It would be expected that a variety of stakeholders would be considered across all issues, but not every suggested stakeholder would need to be considered. To score highly, students would be expected to explain the issue, explain why it is an ethical problem and give sufficient consideration to stakeholders.

You have been tasked with completing the client acceptance procedures for the new client, which comes with a range of concerns, particularly as you have been asked to rush this through. This issue can be broken down further to consider the regulatory risks identified as well as professional issues that might arise.

From a regulatory point of view, you have identified that there is a very complex group structure. There is, therefore, a risk that you do not have a full knowledge of your client and may not carry out the necessary acceptance procedures on the correct entities. This is exacerbated by the fact that you are having to rush through the acceptance, meaning you do not have time to gain a full understanding of the client structure.

Given the complex group structure, and the fact that RB is larger than any of FH's other clients, there may be concerns over FH having the resources and technical competence to perform an effective audit.

From a professional point of view, there is a serious reputational risk arising as a result of taking on this client. FH will become associated with a potentially unscrupulous client with poor corporate governance and remuneration (zero-hour contracts) and staffing policies, which will likely impact its own reputation.

In addition, by reviewing the Corporate Governance position and then carrying out the audit there is a potential self-review threat.

There are also several public trust concerns arising in the scenario. First, given that you are being asked to rush the client acceptance, it would appear that FH will not have gone through all the necessary protocols when taking on a new client. For example, you may not have time to discuss the client with the previous auditor, including reasons for their resignation. This is a requirement of the ISAs, and would also be a breach of the ICAS Code of Ethics. These procedures are not only for the benefit of the audit firm, but also help to ensure that the public can trust the work that auditors carry out. Second, we have to consider why RB has lost multiple auditors in recent years. It could be that it doesn't pay its fees or perhaps has aggressive or bullying tendencies. The public expects such companies to be held to account and by failing to do so you may be impacting public trust in the profession.

Stakeholders

- **FH LLP** – the main stakeholder here, as by taking on a problematic client it will become associated with them and likely tarred by association. A reputational hit could hurt its ability to keep or attract new clients and could even lead to going concern issues.
- **Leon and other senior partners** – Leon and some other senior partners have spent time and considerable effort trying to win this client. They are therefore personally responsible for the decision to take them on and, should the firm's reputation be adversely affected, the rest of the firm may try to pass blame to them. Leon will also have his name associated with the acceptance and will, therefore, be directly impacted and held accountable should problems arise.
- **You (Jamie)** – you are the one who has been asked to rush through the acceptance procedures, even though you are aware of several issues (ownership, heightened need to contact previous auditor – a requirement anyway, but particularly important given how quickly they resigned) that require careful consideration. Your name will therefore be associated with the acceptance and you may be held accountable should problems arise with this client.

- **The executive committee** – if it feels forced into signing off on a client acceptance which hasn't been carried out correctly then its own ethics/integrity will be compromised. It will have to make a decision over whether it is worth it.
- **Shareholders of RB** – being a large plc, the shareholders will rely on auditors to hold the company to account and ensure that they can trust in the company in which they hold shares. As a plc, a large number of members of the public could be stakeholders should anything happen to RB.
- **The audit profession/public trust** – should it become public that FH is bypassing necessary protocols, faith in the audit profession may be lost, impacting not only FH but other auditing firms as well. Similarly, if FH does not perform an adequate audit, that will also undermine the public trust in the profession as a whole.

Evaluate possible courses of action/inaction, including the implications of each, with appropriate consideration of relevant ethical theories.

Note: Students are expected to have sufficient knowledge of a variety of ethical theories. Marks are awarded for relating these to the scenario, and there are therefore **no marks** awarded for simply copying and pasting the definitions. To score well, students are recommended to ensure that ethical theories are appropriately linked to the scenario in the evaluation section, the analysis of options section and recommended actions section.

Option 1

Conduct further research into the issues identified. For example, is it true that staff are on zero hours contracts and to what extent? What was the level of director remuneration, and how did it compare to the rest of the industry? Who are the “Wards” appointed to the board this year and what is their experience? It could be that the issues raised are not as serious as suggested in one or two press articles and the threat may not be major. It is important that you remain objective, as making assumptions/decisions without the proper facts could lead to incorrect decisions being made.

Option 2

Discuss the group structure with the client. It is very complex and it's important that you understand exactly who your client is so that you are accepting the correct entities. Ensure this is fully understood before proceeding with the client acceptance. Once you have all the facts, it will be easier to make the correct decision regarding client acceptance. Failing to make the correct decision could result in reputational risk to the firm and possibly impact the public trust in the audit profession.

Option 3

Speak to Leon about the issues. Find out why he was so keen to win the client and ask whether he has considered the potential reputational damage. As above, he may have already considered this and determined with the other senior partners that any reputational risks are ones they are willing to take. We must ensure that we maintain our objectivity and professional behaviour in our acceptance decisions.

Option 4

Speak to Leon and explain that you are uncomfortable rushing through the acceptance given the many issues noted. Explain that you are not prepared to do this, as you are conscious that you need to comply with the relevant auditing standards and money laundering regulations, and in order to carry the process out properly you will require additional time. Although this will be a difficult conversation, it is the right thing to do and would demonstrate virtue ethics, as well as deontological ethics, as you would be seen to be following the necessary acceptance rules. The implication of this is that Leon is likely to be unhappy, but it is the only way to ensure you complete the task properly. As a CA, you must act with integrity at all times, and you are unwilling to risk your CA status by breaching rules.

Option 5

Perform your own assessment on the potential reputational risk. If you are ultimately not happy with the level of risk, explain that you are not prepared to sign off as manager on the client acceptance. This will likely have repercussions for your job. However, this demonstrates virtue ethics, as this would be the right thing to do. As a CA, you cannot sign off on work you know is not completed correctly, despite the potential difficult consequences.

Option 6

Do as Leon initially asked – assume that the firm is happy with the risk given you've been asked to ensure the acceptance goes through, and work to ensure that the client is accepted despite your own concerns. Ensure this is completed by the end of the week in order to keep your partner and the client happy. This would be an example of teleological ethics, as you would be considering the consequences to you of keeping everyone happy and ensuring that a major client is accepted.

Option 7

Report your concerns to the ethics partner, or dedicated risk team if appropriate, so that they can analyse the risk to the firm and make a judgement over whether the client can be accepted.

Recommendation

Raise your concerns with Leon and explain that you are uncomfortable rushing through the acceptance given the many issues noted. Explain that you are not prepared to do this, as you are conscious that you need to comply with the relevant auditing standards and money laundering regulations and in order to carry the process out properly you will require additional time. The implication of this is that Leon is likely to be unhappy, but it is the only way to ensure you complete the task properly and don't risk your CA status. This would also demonstrate virtue ethics.

Issue 2 – Conflict of interest/Client confidentiality risk

Evaluation/Stakeholders

You have noted that FH already acts for RB's main competitor. Acting for a competitor is not in itself necessarily a conflict of interest, however it is possible that the competitor may consider bidding to acquire RB or vice versa. In such a situation, a conflict could arise. In addition, we have been asked to share knowledge across teams by specifically including a member of the MP team on our audit team. The inclusion of Rohan in the RB team will cause a conflict of interest if he continues to work on both clients. We also need to be aware of breaching client confidentiality – as Rohan has worked on the MP account he may (deliberately or inadvertently) breach confidentiality by sharing confidential information. This would be in breach of the ICAS Code of Ethics in relation to both objectivity and confidentiality.

Stakeholders

- **MP** – It could impact our firm's independence on its work, it may be allocated an unfamiliar team, or it may have its sensitive information that we know from working with it used against it if we use it to assist our new client.
- **Rohan** (the manager) – If he is brought in to work on both clients, he will be in a difficult situation given he has inside information on both clients which could help one at the expense of another.
- **FH as a firm** – will be subject to regulatory and client action due to inadequate ethical walls/confidentiality arrangements if either client's confidentiality is breached.
- **You (Jamie)** – it has been made clear to you that you must have this client accepted by the end of the week. However, now that you know about these actual and potential conflicts of interest, you need to decide whether or not to continue with the client acceptance. Depending on your decision, you may be in breach of the ICAS Code of Ethics, which would have an impact for your status as a CA.

Evaluation of options

Option 1

Explain to Leon that you are concerned about adding Rohan to the team for RB, as this is a serious independence threat and could also compromise client confidentiality. Discuss the need to have ethical walls between the two teams.

Option 2

Do as Leon asks and add Rohan to the team, as he will provide useful knowledge. This is an example of teleological ethics, where the benefit of Rohan's knowledge would be deemed to be more beneficial than any potential future conflict.

Option 3

Raise your concerns with the ethics partner/another partner. This is likely to cause difficulty with your relationship with Leon, but if you have already tried to raise your concerns with him, this may be your only other option.

Recommendation

First, speak to Leon and explain your concerns about the independence and confidentiality issues. If he is unwilling to listen, or put safeguards in place, then you should speak to the ethics/compliance partner within the firm. As a CA you must act with integrity at all times and ensure objectivity is not compromised.

Issue 3 – Breach of Corporate Governance Code Requirements

Evaluation/Stakeholders

You have noted that RB has breached the Corporate Governance Code in a number of ways. You note that Dan Ward has served as both the chairman and chief executive. While this is a breach of best practice, there is scope for companies to 'comply or explain'. In this case, RB has provided no explanation as to the reason for Dan holding both roles. Further, there are a number of exec/NEDs who appear to be related to Dan, which casts doubts on the independence and likely challenge of the NEDs. Finally, the company has failed the requirement for the audit and nominations committee to meet 'sufficiently regularly'. The fact that all committees have only met once in the year is likely to mean that the new appointments in November were made by Dan, with no input/challenge from other directors. This links back to him holding both roles of chairman and chief executive and, therefore, having excess power within the company.

Stakeholders

- **RB** – the company will suffer reputational damage if it is public knowledge that it has failed to comply with the Corporate Governance Code.
- **Shareholders** – if the reputation of the company is damaged due to non-compliance, investors will lose confidence in the governance of the company and the share price will fall as a result. This will impact both existing and potential new investors.
- **Public trust** – as a listed plc, there is a greater deal of public interest in the company and, therefore, any breaches will have a greater impact on the public trust in the business and the audit profession if the previous year audit report is unmodified.
- **Dan** – if Dan is viewed as holding too much power within RB, and he is deemed to be making inappropriate decisions (such as the appointment of family members to the board), his own personal and professional reputation will be damaged.
- **FH** – if FH provides a review of corporate governance prior to audit acceptance, then its objectivity as auditors may be breached, as it should not then take on the audit work. In addition, if FH accept the audit engagement, and the breaches of corporate governance becomes widely known, it will have a negative impact on the reputation of FH, and its other clients may also suffer by association. This could also be deemed to show a lack of integrity and professional behaviour by FH.

Evaluation of options

Option 1

Do nothing – chose to overlook the various breaches of the Corporate Governance Code. The implication would be that RB could face reputational damage if it is seen to be not complying with best practice of the Corporate Governance Code. It may also raise questions over its overall compliance with other laws and regulations if it is viewed as flouting these guidelines. There would also be a knock-on effect for our firm, if we are seen to be acting for a client who is not complying with the Code. This could cause reputational damage to our firm, and also impact on public trust both in our firm and potentially in the wider audit profession. As it is a new client, this could impact on the acceptance decision/acceptance risks discussed as part of Issue 1 above.

Option 2

Speak to Leon, as the partner on the assignment, and raise your concerns about corporate governance and the proposal to prepare a report prior to accepting appointment as auditors. This should help to ensure that you are not complicit in signing off a report that incorrectly states that the client's corporate governance is in line with the Code, and should also reduce the self-interest threat noted in Issue 1. As above, Leon may not be happy with you putting obstacles in the way of the new client, however you are a CA and should demonstrate professional behaviour at all times.

Option 3

Speak to the ethics partner, or another partner that you trust, regarding the issues with non-compliance. This could have implications for your relationship with Leon, if he feels you have gone above his head when you didn't agree with his decisions. However, in order to protect your own CA status, and the reputation of the firm, you should follow virtue ethics and do the right thing by reporting this.

Option 4

Speak to Leon and suggest that you or he contacts the client and asks them to amend the current year draft corporate governance statement. If they refuse, consider the implications for your acceptance.

Option 5

Contact ICAS and ask for guidance, explaining that you have raised concerns internally which have not been taken seriously.

Recommendation

Firstly, speak to Leon and explain your concerns. Explain that you are not comfortable providing the review in advance of taking on the audit, and that in either case, the issues around non-compliance should be investigated and considered carefully if you are to accept the audit. If he is unwilling to listen, then raise your concerns with the ethics partner. Only if you have exhausted these options, with no success, should you consider reporting externally.

Issue 4 – Alleged staff harassment

Evaluation/Stakeholders

You have been asked to include Johanna and Andy on the same engagement team, however you are aware of personal issues between the two and have had the issue of harassment raised with you. You therefore have two issues to resolve in this case. First, you need to consider how to deal with the immediate question of staffing for this engagement and how you will resolve that. Second, you then have the wider problem of knowing about harassment within the firm. Although you have been asked not to reveal this information, you also need to consider that harassment cannot be allowed to go unchecked and, therefore, you need to consider how you will tackle this underlying problem within the firm.

Stakeholders

- **Johanna** – a direct stakeholder, as she is the one being harassed and put in an uncomfortable position working with Andy.
- **Andy** – any decision you take on how to proceed will directly affect Andy, be it through disciplinary action or having his behaviour tolerated and allowing him to carry on behaving this way.
- **You** – you are the only one with this information but have been asked to keep it quiet. You therefore have a personal dilemma over whether it is more important to maintain the confidentiality or attempt to resolve the situation. As noted above, you have a double dilemma in terms of resolving the initial staffing situation as well as the underlying harassment problem.
- **The engagement team** – there could be an uncomfortable atmosphere within the team if both are involved and Andy continues to act inappropriately. Other team members will likely notice, and either be uncomfortable or consider this type of behaviour to be condoned. This could also result in many other staff members being stakeholders, as the acceptance of this type of behaviour could impact the behaviour of others and the overall culture within the office.
- **FH LLP** – when cases of harassment become public, this often has a negative impact on the relevant company's reputation, which could end up being the case in this situation.

Evaluation of options

Options regarding the immediate staffing issue

Option 1

Refuse to put Johanna and Andy on the same team together in order to avoid the awkward situation. Attempt to find an alternative staff member, perhaps by arranging a staff swap with another client team. This will also help to ensure that you maintain the confidentiality principle and don't break Johanna's confidence in you.

Option 2

Speak to Johanna and ask how she feels about working closely with Andy. It may be that she has no problem with this. Only if you determine she is not happy with the arrangement would you then look for a solution. This may not be the best solution if you expect Johanna will say she's ok with it just to put on a brave face, or because she thinks it's what you want to hear. The implications are likely to be a strained working relationship, which could possibly have an adverse effect on the quality of work carried out.

Option 3

Put the two of them on the team but monitor the situation. If you are all working in an audit room together, take it upon yourself to hold Andy to account for any inappropriate comments he makes in front of the group. This way you'll be acting on facts, and not betraying Johanna's confidence. There is a danger that if your behaviour is different to what it normally would be, Andy could realise that Johanna has spoken to you and this could cause a strained working environment as noted above.

Option 4

Speak to HR about the situation. Explain that Johanna doesn't want to make a formal complaint, but you feel an obligation to do something about the situation. This would breach the confidentiality that Johanna had placed in you but would be an example of teleological ethics, as you would be considering the outcome of preventing harassment.

Options regarding the underlying harassment:

Option 1

Speak to Andy and say that you have heard reports about his behaviour. Tell him that this is not appropriate and that he will need to modify his behaviour. This could damage your working relationship with Andy, if the claims turn out to be untrue, so you would need to be very careful how you approached this conversation. It would also affect the working relationship between Andy and Johanna, as he would be aware that she had spoken to you.

Option 2

Report Johanna's problem to HR so that they can investigate and potentially discipline Andy. You could keep Johanna's name out of it, however this may make it harder to investigate and Johanna may have preferred for the issue not to have been raised at all. However, if you have a strong belief that there is a problem, then you should report it to HR. This would be an example of virtue ethics if you believe that reporting a problem is the right thing to do.

Option 3

Do nothing, so as not to breach the confidentiality requested by Johanna. If the allegations are true, this means that the situation will not be resolved, Andy's inappropriate behaviour will continue and there will be no formal disciplinary proceedings. Johanna could become more uncomfortable working and may end up taking time off or leaving.

Option 4

Speak further to Johanna, advising that she would be better to report the harassment, as such behaviour should not be tolerated. Help her to understand how she could do this and help to come up with practical solutions such as ensuring she and Andy are kept apart while any investigation is going on.

Recommendation

First, speak to Johanna. Encourage her to go to HR and offer to go with her. Explain that the partner is scheduling her for a job which would require working with Andy. While you are aware of the situation and can do your best to keep them apart, without a formal reason she is likely to find herself working with him on this or future assignments. Tell her that you don't want to breach her confidence, but that if she is refusing to work with Andy you will need to provide a reason why and may need to approach HR.

Issue 5 – Audit client entertaining***Evaluation/Stakeholders***

You have been asked to organise an event for prominent audit clients, however the "business" portion of this is very small, with the majority of the day being dedicated to enjoyable activities. Providing hospitality and/or gifts to audit clients is a significant threat to independence and needs to be carefully considered to ensure that no threat exists. Actual and perceived independence threats are equally as important. It would appear as though this type of event would clearly breach the Ethical Standard and impact objectivity. Furthermore, Leon is intending to use the event to try to win future audit work, which is highly unethical and would again likely lead to independence threats.

Stakeholders

- **FH/audit profession** – if the public learn of this event they may interpret it as inappropriate client entertaining, bringing both FH and the audit profession in general into disrepute. It may also cause an actual familiarity threat to independence, hence compromising the quality of FH's audits.
- **Leon**
 - a. as the partner involved in hosting this event, he will be directly affected by any reputational impact. It will also likely be audits that he is in charge of which would face an actual independence threat. If the quality of his audits is called into question, he will be the one ultimately responsible.
 - b. in addition, the way he is going about attempting to win new audit work is unethical. Audit firms should not attempt to sway a new client by providing hospitality.
- **Judy Bates** – if she is seen to accept this hospitality, it could impact her and her company's reputation, if she is seen to be willing to accept hospitality in return for the promise of work. This could also be viewed as bribery.
- **Shareholders/the public** – shareholders of the companies which are invited to this event will be impacted themselves if the auditor is not independent of the company, potentially leading to a poor quality audit.

Evaluation of options

Option 1

Cancel the whole event (or refuse to organise). This would not be an ideal option, given it would upset people within your firm and their clients.

Option 2

Speak to Leon about your concerns. Explain that for the hospitality to be considered incidental and therefore not a threat to independence, the business part of the event must be much larger. You could suggest ways to make this so – for example, speakers or topics to be covered, as an alternative to the BBQ. This is likely to affect your relationship with Leon, as you are challenging his instructions, but as a CA you must act with integrity. You would be demonstrating deontological ethics, as you would be ensuring the rules of the Ethical Standard are followed.

Option 3

Discuss with Leon the presence of the potential client and what his intentions are in this area. If you believe there to be a risk of inappropriate behaviour to win a client, you may choose to express this fear to Leon or the ethics partner.

Option 4

Discuss the event with the firm's ethics partner. Allow him/her to carry out an investigation to determine whether actual or perceived independence threats arise as a result.

Option 5

Do nothing/organise the event as requested. This is clearly not a viable option, as you are aware of the risks of doing so. It may be considered an example of teleological ethics, as you would be considering the consequences of ensuring your working relationship with Leon remained on a good level, and that you continued to keep clients happy. However, if it transpired that you helped the firm breach independence rules, you could jeopardise your CA status and your own reputation.

Recommendation

Firstly, speak to Leon and raise your concerns. Suggest that the event should focus more on the industry update, with relevant speakers/sessions and only have a small element of hospitality. This would still allow networking, without the risk of compromising objectivity. Leon is likely to be unhappy with this, however if he insists you go ahead with the event as he has planned, you should speak to the ethics partner.