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ETHICS IN ACCOUNTING

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INTRODUCTION

The appreciation of accounting as a profession is often strongly linked with the upholding of the highest standards of integrity. Ethics and the importance of moral decision-making have assumed the rising importance, owing to pressures put on business leaders by stakeholders, creditors and other individuals affected by the financial performance. Consequently, the competency in value standards has turned out to be a vital element of being a professional accountant. Ethics is simply a word that describes a moral/code system that offers the criteria for assessing right and wrong. An ethical dilemma is, on the other hand, a situation, where a group or even an individual is confronted with a decision that puts test to this moral or code system. According to Ketz (2006), a number of these particular dilemmas are often easy to recognize as well as resolve. For instance, as a student, one may be tempted to want to call his or her professor and ask them for more time about the due cut-off date of an assignment by stating a fictitious sickness, a temptation that put to test one's personal value standards. This is also not new to the accounting profession.

According to Blake & Gowthorpe (2005), just like other individuals operating within the business world, accountants are also confronted with various ethical issues, some of which are often complicated and difficult to solve. Ethics in accounting is often interested in not only how to achieve good, but also how to make ethical choices in relation to the preparation, presentation as well as the disclosure of the financial



information. Ethics has, thus, turned out to be a significant concern area in accounting, a factor argued to be contributed by a sequence of scandals that took place globally, especially during the early 1990s and 2000s, as a result, questioning the integrity of accounting as a profession. These particular scandals have definitely placed doubt on the present-day accounting, and auditing as they have questioned the morality of companies as a whole and accounts in particular. It is claimed that accountants have indeed been the major contributors towards the deteriorating moral standards of many companies. It is within this backdrop, therefore, that this particular report intends to detail on the fraudulent financial reporting as a significant ethics issue in accounting.

PROBLEM STATEMENT

The role played by accountants is irrefutably critical to the society as a whole. These groups of professionals play a part of the financial reporting in addition to being intermediaries within the capital markets. As a result, accountants owe their major obligations to the general public interest. The information these professionals provide is often critical in as far as aiding or assisting investors, managers as well as other interested individuals in coming up with important economic decisions. Accounting, by itself, is a flexible instrument. This is by the requirement as it is the essence of transaction that ought to be replicated within a company's account, rather than its form. In their purest form, the rules of accounting often enable the concerned readers of the firm's financial statements to be able to comprehend the key elements relating to its performance. On the other hand, accounting may be applied as an instrument or tool for manipulating the reader so



that he or she may come off with a fake impression of the firm's performance. Simplistically, if the profit maximization is assumed to be the main goal of a given firm's existence, therefore creative accounting may be applied to merely indicate a rise in terms of revenues as well as a decline in expenditures and liabilities, over and above the realistic income and even expenditure.

In view of this, ethical indecency by these professionals can be very damaging the society, leading to not only mistrust from the general public, but also possible interrupting the operations of the capital market. As highlighted by Dandago & Tanko (2003), recent years has witnessed rising competition amongst companies, a factor that is argued to have compelled or made it significantly difficult for many professions, including accountants to carry out themselves in a manner viewed as professional. A succession of financial reporting scandals from the 1980s brought about this particular issue into the glare of publicity (limelight). According to Dey & Rushe (2009), since the 1980s, there have been a high number of accounting-related scandals highlighted by several media and which are argued to have led to fraud charges, bankruptcy protection applications and even the closure of a number of business organizations, including accounting firms. The scandals, as Dey & Rushe (2009) highlight, were as a result of the false financial analysis, creating accounting and bribery. Many firms had actually a number of problems with falsified accounting practices.

Among the well-known and widely highlighted violations relating to the accounting standards is the case of Enron Company, which is a famous multinational firm that for long had not been giving a realistic view of its business financial statements. Their auditor is argued to have been signing off the validity of the multinational firm's accounts notwithstanding the inaccuracies within its financial statements. When



the given unethical practices were finally uncovered, not only did Enron went out of the business, but they also dissolved the auditor. Enron Company's shareholders lost an amount of money approximated at about \$25 billion, owing to the multinational firm's bankruptcy. On the other hand, even though only a few of the auditing firm's staff were involved in the Enron scandal, the shutting down of the auditing firm resulting in a loss of about 85,000 jobs ("Enron shareholders' move against banks is rebuffed by judge", 2003).

According to Johnson & Kihlstedt (2005), due to these unethical practices in many companies, accounting has now only demonstrated that it is now easy to adjust to shoddy or substandard practices as well as misleading presentations. Johnson and Kihlstedt (2005) emphasize further that by the mere fact that it has become too accommodative to the suspicious and disparaging procedures, accounting, and its one time dependable watchdog and protector, auditing has no doubt fallen from their original place of not just credibility and accountability that the public together with the business world ought to be expecting from these particular professions.

Borderline, unlawful and unethical practices may still be optimistically in small numbers, however, the issues surrounding accounting are numerous and serious to maintain the lines of faith as strong as they ought to be. Generally, a high number of accounting scandals have centered on the fraudulent financial reporting, usually, the misstatement of financial statements occasioned by the company management. Normally, this is conducted with the intention of deluding or misinforming investors and maintaining the share price of a company. According to Freedman (n.d.), whereas the impacts of this may boost up the firm's stock price within the short term, there are often unpleasant effects within the long run.



HISTORY OF THE ISSUES

Prior to the year 1997, the ethics rules prohibited the accounting as well as auditing companies from carrying out advertising to customers. However, when these rules were repealed, spending among the biggest accounting and auditing companies on advertising increased from approximately \$4 million U.S dollars in the 1980s to over \$100 million U.S dollars in the years following the year 2000. As highlighted by Jackling, Cooper, Leung, & Dellaportas (2007), those, who were opposed to this particular move, argued that by letting such companies to conduct advertisements, the business side actually overlooked the professional side of the accounting profession, as a result, leading to conflicts of interests. This focus is argued to have facilitated the incidences of fraud cases, causing firms to begin offering services, which made them business advisers and consultants, rather than auditors.

As the interest of the accounting companies in low paying audits reduced, a more emphasis on high earning services, including consulting, arose. This disregard for the lack of time on the audits led to little attention to discovering the fraudulent accounting. Soon after the 21st century, there were many cases of poor business practices as well as accounting cover-ups that became public. Enron, as highlighted above, was probably the most popular example, in part because its senior management hyped it as the globe's best business with a new design of running business. As highlighted earlier, the company went from being a prototype or model for future companies to bankruptcy within very few months. Behind the company's puffery though were a number of unethical business decisions that were concealed with accounting frauds. According to Maher, Stickney, & Weil (2007), Enron



Company was not on its own. In fact, the scandal involving Enron had left the media, when another scandal involving WorldCom was revealed. WorldCom was actually the tipping point for several government regulators.

Among the fraudulent accounting examples or cases that were eventually exposed are the companies over-stating their revenue margins as well levels through a simple re-categorization of their sales from software to hardware sales (Jackling et.al, 2007). This practice by these companies would consequently have an effect of recognizing 100 percent of its revenues arising from those sales at the preliminary period of retailing, instead of it being deferred many years as with common practice, as a consequence, inflating not only the reported revenues, but margins as well, within the period. Another more aggressive technique of abusing the principles of accounting on revenues was booking false sales immediately before the end of a given financial year, and later on invalidating that particular sale in the succeeding financial year.

Another fraudulent practice also witnessed among companies was the matching of income along with associated costs. Where a given income result from an expenditure occurs over a given year, it was a common practice to capitalize that the expenditure, showing it in the income and expenditure account over a given period, within which the particular income arises. However, this was not the case. An instance was the WorldCom. The firm reported spending on renting other telecommunication firm's phone lines as additions to the property and equipment, then went on depreciating this particular spend over extensive periods (Chew, 2013).

Enron, a multinational firm, was able to present for many years, rising



revenues, improving profits, increased assets and a good balance sheet to its various investors before finally reporting the bankruptcy in 2001. The company, as highlighted above, had not been showing a realistic view of its financial statements for many years (Chew, 2013). Their auditor is argued to have been signing off the validity of the multinational firm's accounts notwithstanding the inaccuracies within its financial statements. Among its methods of ensuring such a good balance sheet, the status was through its employment of offshore businesses, through which it was able to cheat its debt obligations. These particular responsibilities were in fact never secured into publicly-available accounts; as it employed the use of the available accounting conventions to reject them.

These fraudulent practices have often been occasioned by different reasons. These particular problems often become public in the end and may end up ruining not just the firm, but the auditors as well for not finding out or revealing the given misstatements early enough. According to Jackling et al. (2007), a number of studies have confirmed that a corporate culture and the values the company holds might negatively change an accountant's behavior in terms of work moral standards.

The particular environment could certainly play a role in the degradation of the moral values that had been initially learned from the university or college. Jackling et al. (2007) highlight that a year 2007 editorial on a journal of Managerial Auditing Journal revealed at least nine factors that have a significant role in moral failures for different accountants based on a study, involving 66 associates of the International Federation of Accountants. The highlighted factors in the order of the significance include self-interest, failure to uphold independence/objectivity, improper professional judgment, lack of moral consciousness, poor



leadership as well as absence of professional support structure.

RECOMMENDED SOLUTIONS

In the present-day corporate world, in which a fraud appears to be significantly rampant, it is significant for accountants to adhere to different moral principles. The accountant's job is essential to the manager's ability to come up with intelligent and informed decisions regarding their company's future. Such decisions have a substantial impact on the society as a whole. If a significantly large company makes poor decisions relating to the flawed accounting information, or if the company misleads the public about its business financial health and it is not tackled by ethical accountants, the impact it can have on the society in general can be very devastating. In particular, and notwithstanding the motivation behind it, the fraudulent financial reporting can bring about dire consequences, often indications of the deeper problems, which can only be deterred through the enhancement in moral standards, improvement in terms of financial management, company's reporting mechanisms, audit quality and the strengthening of corporate governance regimes as a way of increasing public confidence in terms of financial reporting. In view of this, accounting as a profession has without a doubt the responsibility towards these particular areas, the insufficiency of which has basically resulted in business scandals as well as collapses. To handle various criticisms as well as deter fraudulent financial reporting, a number of accounting businesses and even governments have come up with different regulations and remedies for the enhanced ethic standards amongst accounting experts. In view of these, there are several suggested solutions that can help in addressing



the issues relating to fraudulent financial reporting, including the following.

The Implementation of Ethics Teaching in the Accounting Curriculum

According to Ketz (2006), the incorporation of ethics within the education system for accounting students has been backed by a large number of experts within the accounting profession as one of the suggested solutions in as far as dealing with the fraudulent financial reporting is concerned. Recently, for instance, various associations proposed that accounting education ought to not only put emphasis on the necessary skills and knowledge, but instill the ethical standards in addition to the dedication of an expert, as well. Further, Ketz (2006) highlights that the rising number of fraudulent financial reporting cases and extensive fraud cases, relating to the securities trading, justify the requirement for ethics within the accounting curriculum, not forgetting the renewed calls by the society as a whole of the need to integrate ethics in education. Ketz (2006) argues that the urgency of the present ethics problems may actually precipitate the much-required additions to the accounting curriculum.

Providing Accountants with an Education on Ethics Prior to Them Joining the Labor Force

Besides the incorporation of education within the accounting curriculum, Dellaportas (2006) proposes that providing accountants with education on matters of ethics prior to them joining the workforce, for example, through the initial training or even sponsoring their higher



education studies within firms can also help in enhancing the integrity of the profession, and as a result, offering it as a suggested solution in as far as dealing with the fraudulent financial reporting is concerned, as well. Other than this, Ramamoorti, Morrison, Koletar, & Pope (2013) also propose that trainings relating to fraud awareness possibly provided by various internal audit experts or outside advisors, including the explanations on ethics hotlines and leadership regarding how to react when fraud is experienced; control self-evaluations consisting of the process risk holders carrying out risk as well as control mapping, including risk considerations in such given exercises. Dellaportas (2006), thus, argues that several firms as well as accounting organizations should for these reasons expand their assistance to educators by offering them with the education material so as to facilitate the ethics education.

the accounting curriculum.

Improving Internal Controls

Improving internal controls forms another considerable suggested solution to fraudulent financial reporting as a significant ethics problem in accounting. As Draz (2011) highlights, smart collaborations and continuous improvement within a firm is capable of significantly keeping fraud cases in check. Draz (2011) argues that there are several solutions to successful fraud prevention; however, one of the most significant tools within the organization toolbox is strong internal controls. Strong and effective internal controls evaluated by proficient and independent auditors are often argued to be barriers to fraud. Internal controls, thus, help business organizations to function more efficiently. Internal controls are generally processes effected by a company's management and other company personnel, aimed at providing or offering reasonable assurances as regards the attainment of objectives in



various categories, including the effectiveness and efficiency in terms of operations, reliability/dependability of the financial reporting, as well as the observance of applicable laws and regulations.

According to Draz (2011), some of the ways of improving internal controls within the organization include enhancing the communication process within the organization, the segregation of roles and through the audit interaction. A regular communication or interactions between various departments of an organization are paramount to the process of reducing this ethical dilemma. As Draz (2011) highlights, communication protocols have to be well set up and agreed upon within the whole organization. Other than this, critical incident event distribution notification procedures and even processes ought to be put in place to make sure that everybody within the organization is aware of any incident, while also understanding what their specific roles are when any incident occurs. On the other hand, segregation of duties ensures that the opportunity to conduct fraud is reduced. This, according to James (n.d.), can be explained by the fact that the act tends to separate the accounting duties such as authorization, recordkeeping and the review of functions within the accounting process.

Draz (2011), on the other hand, claims that internal controls ought not to be viewed as stagnant as they are often dynamic and evolving as the business, technology and even the business environment transforms in reaction to competition, legislation, industry practices, regulation and prevailing economic conditions. Nonetheless, whereas no firm, even those with the most effective internal controls, is immune to frauds, improving and strengthening of the policies, processes and procedures on the internal control entirely makes organizations less attractive to not only the internal, but also the external criminals, who may be seeking to take advantage of the internal control weaknesses.



Nurturing an Integrity and Ethics Culture within the Organization/Establishing a Strong Control Environment

The connection existing between fraud and the tone at an organization's top management has received significant global attention in the past few years. Tone-at-the-top (also referred to as strong control environment), the ethical environment created within the workplace by an organization's top leadership, often has a direct impact on the employees of any given organization. According to the Association of Certified Fraud Examiners (n.d.), whatever the tone an organization's management sets up, it will definitely impact the organization's workers. If a tone set up by the top leadership upholding ethics, the employees or workers will most likely be inclined to maintaining the same values. The strong tone is often developed by the organization not only establishing, but also complying with various written policies. The policies, as highlighted by James (n.d.), ought to be specific and integrate in terms of various consequences, especially when the procedures are not obeyed.

On the other hand, if the top management of the company appears not to be concerned with the values and focuses mainly on the bottom-line, the employees of such an organization are most likely to be prone to committing frauds as they will consider that the ethical conduct of the company is not actually a focus or even a priority in the organization. Employees often pay significant attention to the actions of their leaders/bosses, while following their guidance. In view of this, Rammoorti et.al (2013) highlight that nurturing the integrity and ethics culture within an organization also acts as an important recommended solution in as far as deterring the ethical issue of fraudulent financial reporting within the accounting profession is concerned. Supported by



the organization's or company's code of conduct, constant ethic audits, enforcement of observed violations of various codes, maintaining an ethics hotline/a whistleblower hotline and explicitly rewarding good behavior will definitely play a significant role in as far as discouraging this moral dilemma is concerned.

Initiating Annual Examinations of the Financial Statements by an Independent Party

As highlighted by James (n.d.), it is the management of an organization that is often the party that performs a fraud. The management of an organization may bear the pressure to attain its financial goals or even be given the incentives should certain goals be met. In view of this, in order to assist the management of an organization from involving itself in exceedingly aggressive modifications to its financial statements, the company ought to employ an independent party to examine its financial statements on a yearly basis. Engaging such independent individuals to carry out the company's financial statement review usually deters the employees from deliberately presenting false financial statements. Initiating annual examinations of the financial statements by an independent party can, thus, serve as an essential recommended solution to fraudulent financial reporting issues within an organization.

Enhanced Criminal Penalties on Fraud Offenders

Criminal penalties for the violations of the accounting ethics can also serve as an important solution to ethical accounting issues relating to fraudulent financial reporting by company accountants. Such penalties may provide a good way of dealing with individuals involved in manipulating the company's financial records and destroying



information. Besides, there are currently various legislations allowing for strict penalties on such individuals, who commit such frauds, while also protecting any whistleblowers.

Developing a Swift, Decisive Action towards Responding to Fraud Incidents

This provides another recommended solution in as far as deterring the ethical issue of fraudulent financial reporting is concerned. As argued by Rammoorti et al. (2013), the development of a swift, decisive action enables employees of a company and others conscious of the company's serious commitment in terms of tackling issues related to fraud head-on. According to Draz (2011), for instance, there is a continuous requirement by organizations to raise the employees' awareness as regards their roles in safeguarding the company's resources against unethical practices such as the fraudulent financial reporting. The overall role of this is normally to point responsibilities with regards to the fraud prevention, for instance, the procedures to be followed in case a fraud is suspected. In general, the decisive action towards responding to fraud incidents imply that all the staff of the organization are required to always act honestly in order to safeguard the resources of the company, for which they are actually responsible. On the other hand, the management ought not to tolerate any kind of fraud and, consequently, ensure that there is a company policy that will thoroughly probe the fraud suspects and where necessary refer them to the police as early as possible.

Ensuring High Quality Accounting Standards

Ensuring the high quality accounting standards is definitely another



crucial recommended solution towards deterring fraudulent financial reporting. As highlighted by Maher et al. (2007), companies ought to act in accordance with the initial and ongoing disclosure obligations, the goal being to stop misleading or even unfinished financial reports and provide up to date investment decisions. The high quality accounting standards play a significant role in as far as delivering relevant, valuable information to various investors. In reality, the quality is often reflected by the effectiveness of the financial information in decision-making. The high quality standards of accounting often produce financial statements that detail events within the period, when they occur and not prior to or after. There are, therefore, no additional reserves or even deferment of loss recognition, and the actual unpredictability is not concealed by the mere fact of trying to create a false picture of a steady and consistent growth. The quality is, thus, the transparency of company's financial reporting that reflects the underlying business. Developing the high quality standards is, however, a long-term process. On the other hand, given the right commitment, it brings about the increased investor's confidence, a factor that is argued to improve a company's liquidity, minimize capital costs as well as facilitate fairer market prices.

as long as the evaluation is built with the related data and observation of according activities taken in order to meet a required objective (Ulrich 2011). This does not have anything to do with criticism as the evaluation does not mean description of the drawbacks only.



CONCLUSION

These days, ethics in accounting among many businesses is a high contentious issue, especially due to the sensational business scandals that occurred in many nations, as a consequence, resulting in considerable damages not only to the economy, but to the society, as well. As highlighted, there is also no doubt that such scandals have questioned the morality of companies as a whole and accountants specifically. From the report, it is evidently clear that financial reporting frauds have significantly increased within many companies over the recent years, a significant problem that has without a doubt invited the increased attention lately. As highlighted within the report, there have been a high number of cases by companies of what seems to be fraudulent financial reporting that has gone undetected by auditors. Ethics and professional conduct undoubtedly play a significant role within the accounting profession, making sure that there is the public trust in as far as financial reporting as well as business practices with an organization or business is concerned. Definitely, this confirms that the nature of the job done by the accountants and even auditors calls for a higher ethics standard level, since shareholders, prospective shareholders and other individuals, who use the given organization/company's financial statement, depend heavily on annual financial statements of such organizations to enable them to come up with informed decisions regarding the investment.

In fact, these groups of individuals rely on various viewpoints of the company's auditors and accountants, who normally prepare and verify the financial statements respectively, to give out a realistic and fair outlook of the given company. In view of this, ethics knowledge is capable of helping both the accountants and auditors to deal with the



ethical dilemmas, allowing them to make correct choices that, even though might not help the firm, will definitely help the interested public, who normally depends on the accountant and auditor's reporting. The report generally provides an analysis on the fraudulent financial reporting as a significant ethics issue in accounting, highlighting its history and finally providing various recommended solutions to the issues. Among various recommendations highlighted in the report, there are the need to implement the ethics education within the accounting curriculum, providing accountants with an education on ethics before they join the labor force, the enhancement of internal controls, the initiation of yearly examinations of financial statements by independent parties, enhancing criminal penalties on fraud offenders, developing swift, decisive actions aimed at responding to fraud incidents, ensuring high-quality accounting standards, and nurturing an integrity and ethics culture within the organization.

