

**ETHICAL STANDARDS AND ACCOUNTING PRACTICES:  
STILL AN AREA FOR CONCERN**

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**ABSTRACT**

Ethical standards are a major area of concern for organizations when preparing and communicating financial statements. Reflective of this, management, directors and employees must exhibit and maintain ethical standards which should include honesty, integrity, fairness and responsibility. Companies are satisfied with meeting certain types of ethical standards, but the overall philosophy of business still remains, i.e. individuals within an organization must exceed expectations and maximize the returns to its shareholders. Sometimes employees may sacrifice the integrity of a company and compromise duties that exist between the company and society.

**INTRODUCTION**

During the past decade there have been numerous accounting scandals that have caused corporate collapses which have shaken the financial arena and created huge losses for investors, the present financial crisis of the latter part of 2008 revealed the greatest challenge yet. The majority of these collapses were caused directly by the unethical behavior of CEOs, directors, officers, and employees who misrepresented the financial condition of the corporation by providing misleading financial information. Notable scandals include but are not limited to the following.

1. Bank of Credit and Commerce International (BCCI), a major international bank with 30,000 employees and operations in 78 countries. It was the seventh largest private bank until 1991 when it was closed.

*Allegations:* More than \$13 billion funds are unaccounted.

2. Adelphia Communications Corporation was the fifth largest cable company in the United States before filing for bankruptcy in 2002 as a result of internal corruption.

*Allegations:* CEO, convicted of fraud and conspiracy for looting the company of more than \$100 million, hiding more than \$2 billion in debt the family incurred, and lying to the public about Adelphia's operations and financial condition.

3. Enron Corporation, one of the world's leading electricity, natural gas, pulp and paper and communications companies which employed 22,000 people. America's Most Innovative Company lost its fame in 2001 with its accounting fraud.

*Allegations:* The debts of the company were hidden and profits were inflated by more than \$1 billion.

4. WorldCom was the United States' second largest long distance telephone company. After 19 years of establishment, in 2002, the company's accounting scandal was exposed.

*Allegations:* Underreporting interconnection expenses by capitalizing on the balance sheet and \$3.8 billion cash is overstated as capital expenses rather than operating expenses.

5. Tyco international was a global manufacturing company with 118,000 employees.

*Allegations:* CEO Dennis Kozlowski and former CFO Mark H. Swartz were accused of the theft of \$600 million from the company in 2002.

6. Waste Management Inc. a waste management and environmental services company with 50,000 employees and a network of 413 collection operations.

*Allegations:* Earnings were inflated by \$1.7 billion by increasing the depreciation time length for their property and equipment in 2002.

7. Health South Corporation, healthcare services, with 22,000 employees and 100 Inpatient Rehabilitation Hospitals.

*Allegations:* Overstated and/or falsified accounts by as much as 4700 percent and \$1.4 billion inflation to meet the expectations of investors.

8. AIG, a major American Insurance Corporation with 116,000 employees.

*Allegations:* The company maintained lucrative payoff agreements, soliciting rigged bids for insurance contracts and inflated financial position by \$2.7 billion in 2005.

9. Madoff Investment, one of the top market makers, sixth largest, on Wall Street in 2008.

*Allegation:* A Ponzi scheme resulting in conviction, with estimated fraud to be \$64.8 billion, based on the amounts in the accounts of Madoff's 4,800 clients as of November 30, 2008.

10. The emerging scandal focusing on Lehman Brothers and Allen Stanford.

*Allegations:* Lehman Brothers - hid more than \$50 billion in loans by classifying them as sales. Execs and auditor, Ernst & Young, allegedly manipulated the firm's balance sheets using an accounting trick called "Repo 105." Allen Stanford – misleading investors, sale of estimated \$8 billion in certificates of deposits.

(Aguilera & Vadera, 2008; Akhigbe, Kudla, & Madura, 2005; Association of Certified Fraud Examiners, 2008; Bartkus & Glassman, 2008; Cagle & Baucus, 2006; Business Roundtable—Institute for Corporate Ethics, 2009; Chandra, 2003; Eccles, Newquist, & Schatz, 2007; Ernst & Young, 2008; Ethics Resource Center, 2009; Grant & Visconti, 2006; Haddad & Foust, 2002; Heminway, 2007; Kaplan & Kiron, 2007; Mathisen & Foley, 2007; Palmer, 2008; Rahman, Burckel, & Mustafa, 2009; Putnam & Nicotera, 2010; Scandal Scorecard, 2003; Scharff, 2005; Taub, 2002; Toffler & Reingold, 2003)

As a result of these scandals, investors who once relied on the accuracy of financial statements produced by these corporations are no longer able to trust these corporations. Additionally, the public no longer has confidence or trust in the integrity of corporate financial statements, which are the bulwarks of business and financial reporting controls. In order to rebuild trust, corporations must design and implement ethical policies, procedures and guidelines to assist in ethical decision making when preparing and communicating corporate financial statements (Hoover, 2008; International Association of Business Communication Research Foundation, 2006).

## **PURPOSE AND SCOPE**

The purpose of this study was to evaluate the knowledge and beliefs of both accounting and non-accounting professionals regarding ethics to assist in determining who should assume responsibility for the accuracy of a corporation's financial statements.

## **METHODOLOGY AND PROCEDURES**

A questionnaire comprised of 14 questions, four of which were background questions, was distributed to 100 participants. The sample was representative of various backgrounds, both economically and culturally. The respondents were asked several questions regarding ethics and the financial reporting process (see Figures 1-5).

## **LITERATURE REVIEW**

Ethical values provide the foundation on which civilized society exists. Ethics should be the foundation for all accounting functions within a company. Thus, the power of good ethics running through the veins of companies should mitigate unfair practices from occurring. This rings true in so many reports that are presented on a daily basis in the media (Business Roundtable—Institute for Corporate Ethics, 2009; Cagle & Baucus, 2006; Ethics Resource Center, 2009; Heminway, 2007; Smith & Smith, 2003; Verschoor, 2006; Xifra, 2009).

How many times have we heard of a company being “shut down” because of unethical practice? Greenawalt (2001) believes ethics in accounting is of utmost importance to accounting

professionals and those that rely on their services. This importance in the profession of accounting is implementing an abundance of change within the industry. Subsequently, this new era of ethical standing within the accounting profession has bloomed into the idea that if the accountants are not coached and groomed on the right ethical behaviors there may not be responsible parties managing the numbers. This reasoning is evidenced in today's volatile financial environment; no other single issue is of greater concern to accountants in industry and public accounting than ethics. If the public cannot place confidence in accountants and business people in general, then survival of the U.S. economic system and the world economy may be placed in jeopardy (Ernst & Young, 2008; Ethics Resource Center, 2009; Grant & Visconti, 2006; Heminway, 2007; Holder-Webb & Cohen, 2007; Scandal Scorecard, 2003; Smith & Bain, 1990; Xifra, 2009).

When it comes to the ethical sovereignty of a company the accounting department will usually see the effects before anyone else. This is why so much focus has been placed on the accounting profession. The governing bodies of the accounting profession have spent many hours in the past few years developing ways to monitor ethical behavior. This focus has been put in place to protect multiple stakeholders: business, professionals, and clients (Association of Certified Fraud Examiners, 2008).

The effect of this focus is the creation of the Professional Ethics Executive Committee (PEEC) by the American Institute of Certified Public Accountants (AICPA). Ethical standards are enforced by this committee. According to the AICPA, this committee is in place to interpret and enforce the AICPA's Code of Professional Conduct. The Professional Ethics Executive Committee also gathers and discusses standard-setting activities, case investigation and other enforcement matters. These governing bodies renew confidence in the profession because ethics is now a consistent part of the review process (AICPA, 2002).

Accordingly, the AICPA has taken ethical review a step further. The AICPA's new requirement is that members joining after the year 2000 must have completed 150 semester hours of education at an accredited institution. Ethics in the accounting curriculum should include a triad of ethics instruction comprised of an ethics philosophy course, ethical coursework in the accounting curriculum, and a capstone ethics and professionalism course (AICPA, 2002; Association of Certified Fraud Examiners, 2008; Bean & Bernardi, 2007). This emphasis on ethical accounting environments, which focus the new breed of Certified Public Accountants, provides rationale for curriculum modifications with respect to graduates understanding the importance of upholding their ethical standing. These educational requirements are relied upon to reinforce the justification for having an untarnished ethical reputation.

Understandably, the implementation of ethics driven courses causes discussions about the role of accounting educators in teaching ethics (Cagle & Baucus, 2006; Ethics Resource Center, 2009; Gaa & Thorne, 2004). These discussions are leading to improved teaching methods and measurable learner outcomes that can be used to continue modifying the curriculum. The educators posit and support ethical behavior as the key to a long career in this industry.

Mirroring this behavior, more accountants are realizing that the accounting world will be held liable for the unethical behavior of clients and employers. According to Orin (2008), the

Sarbanes-Oxley Act (SOX) of 2002 mandated the publication of corporate codes of ethics. This mandate was issued because legislators wanted companies to really evaluate their companies from an ethical stand-point and commit to their claims. Requiring ethics codes to be written and published mandate companies' to understand the role of ethics, thus, holding companies accountable for upholding claims and expectations.

The Sarbanes-Oxley Act was enacted because of the scandals of the late 1990's and early 2000's. This act has forced companies to create stronger internal audit functions to conform to the laws that have been developed (Massimo, 2008). Can ethical behavior be legislated? Will the Sarbanes-Oxley Act finally put an end to corporate greed and financial scandals? Many supporters believed that the legislation was a huge step toward restoring public confidence. A main reason being that the legislation introduced and established the Public Company Oversight Board (PCOB); a private sector, non-profit organization. The PCOB has many government functions such as: responsibility for overseeing, regulating, inspecting, and disciplining accounting firms in their roles as auditors of public companies. The purpose of the board is to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports (AICPA, 2002).

For example, the internal audit function serves as a "reviewing" procedure designed to avoid conflict between external audit groups on behalf of investors. These internal audit functions are in place to identify problem areas for management and provide solutions to remedy these problems. However, because of their holistic access to the entire company, most of the identification of unethical behavior in industry is identified first by these accountants. For instance, the identifying whistle-blower at WorldCom was an internal auditor. The procedures in place provide whistle-blowers and auditors an opportunity to step forward with respect to reporting unethical practices. Many countries have implemented laws that protect employees that uncover unlawful acts. One method governments use to promote whistle-blowing is to prohibit retaliation against employees who report wrongdoing in good faith (Bailey, 2008).

Without these protections: there would be more unethical behavior in industry, limitless worry about getting caught, selfish acts of self preservation rather than acting in the interest of investors or the public. The Sarbanes-Oxley Act protects investors by improving the accuracy and reliability of corporate disclosures and by providing for civil and criminal action to protect whistle-blowers (Aguilera & Vadera, 2008; Beard, 2007; Orin, 2008). Whistle-blowing protection has created a new dynamic in the accounting world that enables accountants to pursue their careers with confidence and not be intimidated by the laws that govern their profession.

## **FINDINGS**

The questionnaire consisted of questions focused on ethics and accounting standards as well as participant background information. The questionnaire was distributed to 100 participants, ages ranged from 20 to 60. It was distributed equally between males and females and was representative of various ethnic and cultural backgrounds. The highest level of education ranged from undergraduate to graduate school. Based on the results of the questionnaire, education and age were not determining factors in decisions about ethics and accounting standards.

All respondents believed that ethics and accounting standards should follow the same guidelines. The participants rated the questions on a scale from 1= low to 4= high. The responses varied from medium= 3 to high= 4 regarding the importance of each question. Results regarding the responsibility for reporting false financial information are revealed in Figures 1 and 2.



**FIGURE 1**

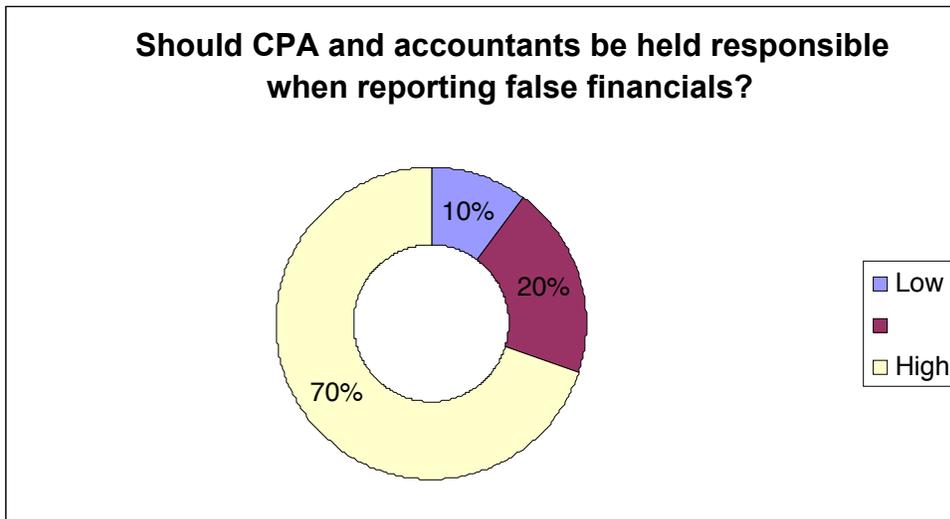
Interestingly, the majority of respondents, 80 percent, believed that a company’s accountants should be held accountable if false financial statements are prepared. It is plausible to reason from this finding, given media coverage of “ongoing” accounting scandals and implementation of new laws and regulations, that the respondents’ recognized the importance of identifying the “most likely” source for unethical practices to occur.

Mirroring Figure 1, the survey suggested that both CEO’s and CFO’s should be accountable for the information contained in their corporate financial statements. The questionnaire showed that 60% of the respondents believed that CEO’s and CFO’s should be accountable for such information and 40% indicated accountability at a medium level. These findings support the need for “mission” statements that specify actions (i.e. person responsible for preparing financial documents, communication roles, legal and ethical implications) that affect “stakeholders.”

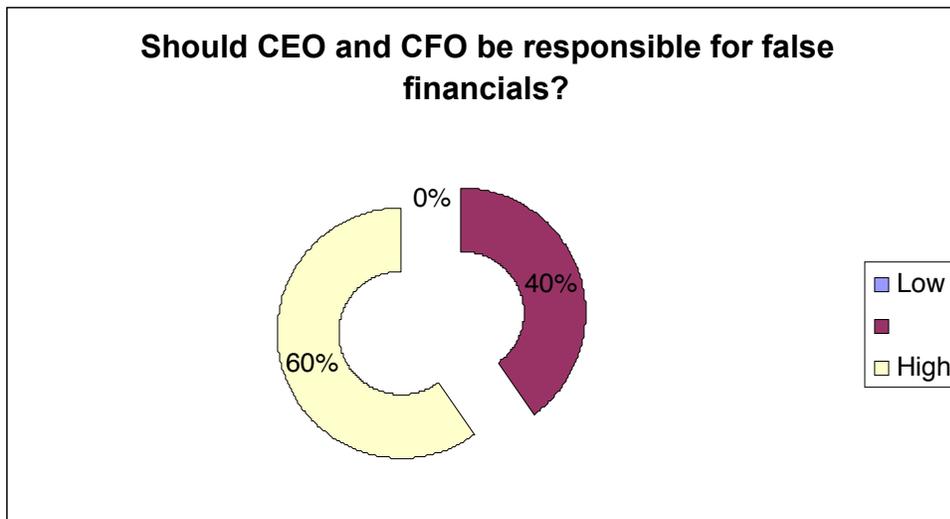
Aila and Jyvaskyla (2004) found in their study that ethics in accounting depends on the act and practice of individuals and on their morality. Further, they found that an act is morally correct for an accounting professional if it is consistent with legislation and provides value for stakeholders and society.

It was also interesting that the majority (70%) of the respondents in Figure 2 believed that the CPA should bear more responsibility for producing false financial statements and 60% of the respondents in Figure 3 felt the company’s CEO and CFO should be responsible. When most people think of these types of reports, they think of accountants. Hence, it is more probable that

one would expect the CPA to be the most responsible for these financial statements, since they deal with these reports directly.



**FIGURE 2**



**FIGURE 3**

Corporations need to recognize that although their business operations are within the letter of the law, they conversely may not be executing operations ethically. Companies can increase investor confidence by reporting transparent financials instead of incorrectly reporting gains over losses.

As global markets continue to mature and competition increases, some companies seek to report inaccurate information in order to continue positive relations with investors. Many businesses comply with regulated laws; however, further actions can be taken to increase ethical operations. First, new regulations, such as the Sarbanes-Oxley Act increase the transparency of business operations to investors. Second, ethical training classes improve employee awareness of issues in many aspects including diversity, teamwork, and employee interaction. Third, every company

should incorporate a general Code of Ethics in order to increase ethical behavior along with policies to counteract ethical dilemmas. These requirements could result in employees understanding how the company must act ethically as well as being equipped to resolve issues that arise.

## **SUMMARY AND CONCLUSION**

If one is bound by sound business ethics, then the probability of being persuaded to falsely reflect maximum profit and value for stockholders or to serve and please greedy agendas, could be lessened. Ethics is like revenue, it's needed to produce success and longevity. When ethics and accounting principles, laws and regulations are not followed, the potential risk of multi-million dollar lawsuits or imprisonment increase exponentially. Both of these punishments could jeopardize a reputation, career, and life.

In general, most corporate accountants are required to have a four year degree in either finance or accounting while many Certified Public Accountants (CPA's) must possess a business degree, as well as 30 additional hours, which should include a course in ethics as well as continuing education courses. Accountants must possess a level of confidentiality as well. Accounting professionals should also have objectivity, which is clear judgment without emotional influences or personal prejudice. Some standards that help companies and individuals maintain good character are the Generally Accepted Accounting Principles (GAAP), the Financial Accounting Standards Board (FASB), and the American Institute of Certified Public Accountants (AICPA). If one pledges to remain competent, maintain confidentiality, integrity, and objectivity, then there should not be engagement in dishonest acts and unlawful accounting practices.

The CEO and CFO are at the top level of management and must exercise good, ethical judgment at all times. They are sworn to certify the audit report accuracy, free of falsified information and provide all the necessary disclosures. Their job is to analyze cash flow which should assist them in being able to identify major discrepancies or misstatements. The most common financial statement consists of four reports: the balance sheet, the income statement, the statement of cash flows, and a statement of retained earnings.

There are organizations that enforce a code of professional conduct. Some of these organizations include: The Institute of Management Accountants (IMA), the American Institute of Certified Public Accountants (AICPA), and the Institute of Internal Auditors (IIA). One initiative of the AICPA is to require 150 hours of continuing education which enables accountants to learn about unknown ethical practices. Another effort by government is the Sarbanes-Oxley Act of 2002, which holds companies accountable for preparing fraudulent financial statements.

A company's ultimate goal is to increase shareholder value without compromising its mission statement or code of conduct. These two core fundamentals help to establish reputable companies who hire individuals that behave honestly and ethically. It has now become more evident than before, especially after numerous corporate scandals and scares in accounting practices, that ethical values must take priority over greed and obsession of wealth. As scandals continue to occur, consumers are losing confidence and trust in business and industry. Corporate scandals are a vicious cycle which can be avoided with the honest acts of individuals, lawful

practices, and corporate willingness to maintain moral character. In today's society, one must insist on ethics and good decision making. Without this foundation, capital markets will suffer. Companies would fail and have minimal public investment with exclusion of honest accountants, managers, and employees.

Ethical standards and accounting practices are still an area for concern. Scandals continue to be a part of the business world, although history has proven that unethical behavior leads to corruption. The results of the study highlighted a number of factors. The questionnaire revealed: (1) education and age were not determining factors in the respondents' decisions about ethics and accounting standards; (2) ethics and accounting should follow the same guidelines; (3) the CPA is the most responsible for financial statements; (4) the CEO and CFO are accountable for financial information and the ethical stability of the organization; and (5) the findings support the need for "mission" statements that specify actions that affect stakeholders.

Overall, if everyone in business understands ethics and is committed to complying with the laws, standards, guidelines, and policies and procedures, then the outcome of personal decisions made by individuals would be much more profitable for the company in the long run. Even though CEOs and CFOs are directly responsible for the accuracy of corporate financial statements, people who prepare these financial statements should be honest, ethical, and trustworthy. If the individuals who prepare them lack professional standards or ethical values, then questionable review of the company's financial statements will exist.

This study supports the concept that there are several standards that everyone must adhere to in order to maintain a level of ethics with regard to accounting practices and the preparation of financial statements. These ethical standards include competency, honesty, fairness, responsibility, confidentiality, integrity, and objectivity.

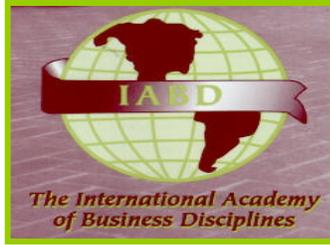
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