

Ethics in Accounting - A Concept

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ABSTRACT

The importance of ethics in Accounting can hardly be overemphasized. Ethics is discipline dealing with what is good or bad or right and wrong, or with moral duty and obligation. We can say that ethics is a particular theory or system of moral values. Ethics is vital strategic key to survival and profitability in a highly competitive era. It plays a vital role in the accounting arena. The term ethics is of immense importance encompassing within its scope all the activities relating to accounting & controlling in an optimum manner to achieve established objectives of a company.

Keywords: *Ethics, Accounting, Controlling*

Ethics is a part of philosophy that deals with the practical applications of those actions over which we have control. Webster's Dictionary defines ethics as "The principles of conduct governing an individual or a group." It is the discipline dealing with what is good or bad or right and wrong or with moral duty and obligation. We can say that ethics is a particular theory or system of moral values.

Ethical values provide the foundation on which a civilized society exists. Without the foundation, civilization collapses. On a personal level, everyone must answer the following question: What is my highest aspiration?

The answer might be wealth, fame, knowledge, popularity or integrity. But if integrity is secondary to any of the alternatives, it will be sacrificed in situations in which a choice must be made. Such situations will inevitably occur in every person's life.

MEANING OF ACCOUNTING ETHICS:

Ethics has recently become an interesting topic in the accounting arena. Various writers argue that ethics should be cohesively implanted in accounting practices, because ethics clearly signal and distinguish right from wrong, good from bad, and justice from injustice, thus the importance of its presence in accounting is primarily in its real effects on the life of individuals in society. It was argued that accounting rules not only influence how numbers are recorded in books of account but they help to change the ways in which people see, think, talk and relate to others.¹

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Taking the same position, Francis articulates that "accounting is a practice grounded in moral discernment."² This means that the involvement of a moral agent, that is, the accountant, is crucial to the extent that he or she, through accounting, "can influence the lived experience of others in ways which cause that experience to differ from what it would be in the absence of accounting, or in the presence of an alternative kind of accounting"³. Whether a person derives ethical values from religious principle, history and literature, or personal observation and experience there are some basic ethical guidelines to which everyone can agree.

In the July 1992 issue of *Management Accounting* James Brackner, member of the IMA Committee on Ethics, stated: The universities are responding with an increased emphasis on ethical training for decision making. For the most part, however, they ignore the teaching of values. For moral or ethical education to have meaning there must be agreement on the values that are considered "right."

From another point of view, Dillard argues that accounting is a "technology". However, what he means by technology is not that which is commonly encountered and interpreted in a functionalist view, rather it is a technology that is not ideologically sterile."⁴ The "axioms, law, etc." are not based on observed phenomenon, as purportedly is the case in the physical sciences, but emanate from the social sphere. For accounting, in spite of its apparent objectivity, there are no "physical absolutes" upon which to base, and verify, the technology. The framework is a social construction. The technology is framed by ideology. The interpretation of events, and even the specification of what constitutes an event, is functions of the socio-political point of view (Dillard 1991, 9)⁵

The point of the statement is that accounting is not value free; it is a social construction which develops and changes in the social sphere. Or in other words, the appearance of accounting is greatly influenced by the values in which it socially grows and is practiced.

From this statement, we can see two implicit value-based elements that shape the appearance of accounting, that is, the reality that would be reflected and accounted for and the means that would be utilized to mirror the reality.⁶ Our perception of reality, as illustrated by Dillard (1991.9), is like gazing into a mirror, the reality that we can capture is "what is reflected back to us." And, of course, the appearance of the reflected reality depends upon the surface of the mirror, because, as he argued, "different surfaces (ideological frames [values] reflect a different reality." Dillard (1991) goes on to argue that the output from accounting, which is determined by societal values, is projected onto the mirrors (also framed by the values) and its distortions are interpreted as "objective" representations of the realities or phenomena, the interpretations then become the resources for (re) shaping the realities, that is, both the mirror (the accounting) and the reality that would be reflected by accounting.⁷

We see here that accounting (knowledge) is one of the important means of reflecting reality in that different surfaces (values) will reflect different realities. And we have to remember as well in this context that when reality has been perceived as ethically conceptualized and constructed, then it should be reflected by an appropriate means, that is, accounting which is also conceptualized and constructed based on ethical values. If it is not, accounting will reflect reality in other forms of appearance.

IMPORTANT ASPECTS RELATED TO ETHICS:

Ethics approach to accounting lays emphasis on three important aspects, which are following:

- Justice - Reports should provide JUSTICE to all.
- Truthful Presentation - Reports should present TRUE and ACCURATE Statements and facts and figures.
- Fair Presentation - Reports should FAIRLY present.

Justice (Equitable Treatment)

It is neither possible nor economical to prepare separate reports to each group of external parties keeping in view the specific requirements of that group. Because, it is practically not possible to prepare separate reports for each group of external parties such as equity shareholders, redeemable preference shareholders, participating preference shareholders, irredeemable preference shareholders, financial institutions, trade unions, consumer forums, controller of capital issues, securities and exchange board, etc. Therefore, what the industrial enterprises will do is, it prepares the report commonly to all these externals and the report so prepared is expected to serve the data-requirements of all these parties. The above practice necessitates the accountants to ensure justice to all the parties who are entitled to receive the reports and who rely on these reports for the purpose of taking a number of decisions. The accounting procedure followed at different stages must be in the interest of all the parties but not in the interest of only one group or one individual. The annual reports should therefore be prepared keeping in view the interest of all the parties but not one or a few, because the reports should not aim at serving any one group or a few groups. It is therefore necessary to keep the interest of all the parties in mind while preparing the annual reports.

With the objective of providing justice to all the external parties, it is necessary on the part of the accountants to keep the following aspects in their mind while preparing the corporate annual reports.

- (i) The Provisions of Companies Act, 2013 which specify the contents, format etc of the annual reports;
- (ii) Common data-requirements of all the external parties having reasonable right to receive the corporate reports; and
- (iii) Besides the above commonalties in the requirements of external parties, it is also necessary to incorporate some specific information which are very essential for different groups of external parties for the purpose of taking proper decisions. Consideration should be given to incorporate these data, at least to the minimum extent, in the annual reports.

In addition to the above, the companies may also furnish some other information which they feel necessary and which they wish to furnish. In conclusion, it may be said that:

"The accounting procedures must provide equitable treatment to all interested parties."

Truthful Presentation

The second important aspect of ethical approach is the truthful presentation of annual reports. This is considered as most important as the external parties rely primarily on the information furnished to them by the companies through the annual reports,

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The very purpose of preparing and circulating the corporate reports annually among the external parties will be defeated if the reports contain wrong facts and figures, misrepresented figures, obscured or distorted or untrue facts and figures and if the reports omit any material fact because this type of misrepresentation results in the users taking wrong decisions. This will have a number of repercussions. Once the users take decisions and implement them, the effects of the same are irreversible with sizable loss. The users who have taken the wrong decisions will realize the fact that they had taken wrong decisions and therefore they were forced to incur loss and put to a number of inconveniences. When they realize that they have taken the wrong decisions because of the wrong facts and figures furnished to them by their company, they will lose confidence in their company and its reports and do not rely in future on the contents of the annual reports. Consequently, the usefulness, utility, etc, of the annual reports will be impaired and the very purpose of annual reports will be defeated. Truthful presentation of statements without any misrepresentation is therefore a necessity.

The above analysis explicitly brings out the need for preparing the annual reports incorporating only the facts and figures reflecting the true operating results and financial position.

But, one of the difficulties encountered in this exercise is what constitutes a true statement or an accurate statement or true facts and figures. What is true to one group or at one point of time may not be true to another group or at another point of time. For instance "Historical costs are normally regarded as representing true figures. These figures are supported by solid evidences. But the same historical cost may be considered by other parties as irrelevant due to the perennial changes that have been taking place in the price level. Therefore, they may consider these figures is not true. They may consider the current costs as true. Yet there may be third group. This group may be of the opinion that both the historical costs and the current costs do not represent the true costs. And this group may feel that only those figures which are computed on the basis of the well established procedures are representing true figures."⁸

Even the established procedures have been dubbed as not providing adequate foundation for measuring truthfulness. This is evident from the opinion of Hendriksen, which is reproduced as:"The established rules and procedures provide an inadequate foundation for measuring truthfulness...."⁹

From the above detailed analysis, two things become very clear. They are:

- (i) Need for truthful presentation of corporate reports, and
- (ii) Difficulty in finding out what constitutes a true statement.

In the light of the above, the reporting authority has a very difficult task before it.. It is necessary to analyze each and every transaction carefully so that suitable accounting treatment can be followed. And in case where we find a number of alternative accounting treatments, utmost care to be applied to select the best alternative considering the nature of the problem and also the fundamental validity of the accounting treatment selected. Because it is this fundamental validity on which the truthfulness of the report depends. This point is substantiated with the help of what Hendriksen has opined in this regard. He opines that:"The truthfulness of the financial reports depends on the fundamental validity of the accepted rules and principles."¹⁰

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Considering all these aspects, it is necessary on the part of reporting authority to ensure that the annual reports contain only those facts and figures and statements which are arrived at and prepared on the basis suitable to accounting principles and practices. The most important point is that the figures are not biased intentionally or deliberately keeping in view the specific interest of one or a few individuals. Scott has therefore said that: "The financial reports should present a true and accurate statement without misrepresentation..."¹¹

Fair Presentation

Another important aspect of ethical approach to corporate reporting is fairness"¹² which suggests that report should present fairly to reporting authority. Kohler has defined the word 'fairness' as: "The ability of financial statement to convey unambiguous adequate information, to present fairly the detail required by convention for depicting financial position and operating results."¹³

There are two important aspects. Firstly, the companies have to report about their operating results and financial position. While reporting about these twin aspects, it is necessary to report properly so that the users or the parties get a clear idea about the quantum of profit earned and the assets-liabilities status. These figures should not be biased, because, figures showing profit, assets, etc can be manipulated even by adhering to the generally accepted accounting principles and procedures. This should not be the case with the reporting authority.

Secondly, the companies have to report fairly and the report should contain only the unbiased data they should be prepared impartially without serving its own interest or the special interest of one or a few groups. The financial statements should be fair from the viewpoint of all the parties. They should not be fair to one group and unfair to another group. At the time of deciding the accounting method to be used to account for a particular problem, interest of all the parties should be kept in mind by the reporting authority. Because, though a number of alternative solutions are available,"¹⁴ only one solution is the best solution for a particular problem in a given situation. The following excerpts substantiate this point.

(i) It is very well known that for a few important accounting problems (such as inventory pricing, computation of annual depreciation, amortization of fictitious assets, etc), a number of alternative accounting treatments are available. In the light of this, Graham Wilson has said that: "Different accounting treatments can, for instance, be applied to the same facts, with intangible assets a classic example."¹⁵

(2) Though a number of approaches or accounting treatments are available to each of problems, only one is fair in a given situation. In this regard, this is said that: "Only one accounting treatment of a given phenomenon is fair to all parties."¹⁶

It is therefore necessary to select and use the best alternative solution by which reports can fairly be prepared and presented to the external parties. Let us conclude this with what Scott has said in this regard. He has said that: "The accounting data should be fair un-biased and impartial without serving special interest."¹⁷

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NEED OF ETHICS:

The need of accounting reports is to provide management and investors with accurate information on the financial status of their company, The report should present a true and accurate statement as far as possible, without misrepresentation.

Sometimes, management uses accounting to hide problems. They change consignment sales to normal sales, use intercompany transactions to boost sales, underestimate royalty exposure or capitalize expenses, which should be expensed.

If the reports contain wrong facts and figures, misrepresented figures, obscured or distorted or untrue facts and figures, the very purpose of preparing and circulating the general reports annually among the external parties will be defeated. Because this type of misrepresentation results in the users taking wrong decisions. This will have a number of repercussions. This approach will not only violate accounting standards but also hide the true problem from scrutiny. It does not solve the root cause of the problem. It allows the problem to grow, often times to a point where the survival of the company is threatened

Nowadays accountants are functioning under various pulls and pressures as they have to:

- (i) Follow certain rules and procedures
- (ii) Company with provisions of a few application acts.
- (iii) Satisfy the data-requirements of various parties etc.

These necessitate the accountants to observe certain ethics while preparing the reports for the use of external parties.

PURPOSE OF ETHICS:

The purpose of ethics is to direct businessmen and women to abide by a code of conduct that facilitates public confidence in their products and services. In the accounting field, the accountants should keep certain ethical level of conduct during the performance of their duties, so that the financial reports could present a true and accurate statement, as far as possible without misrepresentation. When the users realize that they had made wrong decisions because of the untrue or wrong facts & figures furnished to them by their company, they lose confidence in their company and its reports and do not rely in future on the contents of the annual reports.

Therefore, the AICPA maintains and enforces a code of professional conduct for public accountants. The Institute of Management Accountants (IMA) and the Institute of Internal Auditors (IIA) also maintain a code of ethics. Professional accounting organizations recognize the accounting profession's responsibility to provide ethical guidelines to its members

At some time point in life, ethics must be taught. People are not born with innate desires to be ethical or to be concerned with the welfare of others. The role of the family includes teaching children a code of ethical behavior that includes respect for parents, siblings, and others. The family bears chief responsibility for ensuring that children will receive the necessary education and moral guidance to become productive members of society. The basic values such as honesty,

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self-control, concern for others, respect for legitimate authority, fidelity, and civility must be passed from one generation to the next, fundamental processor the family

IMPORTANCE OF ETHICS:

Attention to ethics provides numerous benefits. They are as follows:

- 1) A focal point on ethics in the workplace shows and alerts leaders and staff on how they should act. An attention to ethics in the workplaces helps ensure that when leaders and Managers are struggling in time of crises and confusion, they retain a strong moral focus.
- 2) Ethical accounting practices build trust and promote loyal, productive relationships with users of accounting information
- 3) Ethics project emphasized the role that ethics plays in the company must be pervasive, extending to hiring, training, oversight, recognition and reward, review for adherence, and channels for reporting problems.
- 4) Ethical analysis is very important in decision making so it is institutionalized as an integral input into all phases of the decision making process.
- 5) Ethics programs are an insurance policy they help ensure that policies are legal attention to ethics ensures highly ethical policies and procedures in the organization
- 6) Ethics programs promote a strong public image Attention to ethics is also strong public relations... admittedly, managing ethics should not be done primarily for reason of public relations. But, frankly, the fact that an organization regularly gives attention to its ethics can portray a strong positive to the public.
- 7) Attention to ethics in the workplace helps employees face reality, both good and bad, in the organization and themselves. Employees feel full confidence they can admit and deal with whatever comes their way
- 8) Ethics programs help avoid criminal acts of omission and can lower fines. Ethics programs tend to detect ethical issues and violations early on so they can be reported or addressed. In some cases, when an organization is aware of an actual or potential violation and does not report it to the appropriate authorities, this can be considered a criminal act.
- 9) Managing ethical values in the work place legitimizes managerial actions strengthens the coherence and balance of the organization's culture improves trust in the relationships between individuals and groups, supports greater consistency in standards and qualities of products, and cultivates greater sensitivity to the impact of the enterprise's values and messages.
- 10) Most formal attention to ethics in the workplace is the right thing to do so.
- 11) Many companies and professional organisation, such as the institute of Management Accounting (IMA), have written codes of ethics, which serve as guides for employees.

EXAMPLE:

IMA CODE OF ETHICS FOR MANAGEMENT ACCOUNTANTS

Four areas of responsibility:

1. Maintain professional competence.
2. Treat sensitive matters with confidentiality.
3. Maintain personal integrity.
4. Be objective in all disclosures.

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Competence: It can be maintain by following these grounds (a) Follow application laws, regulations and standards.

- (b) Maintain professional competence.
- (c) Prepare complete and clear reports after appropriate analysis.

Confidentiality: It can be maintain by following these grounds:

- (a) Do not disclose confidential information unless legally obligated to do so.
- (b) Do not use confidential information for personal advantage.
- (c) Ensure that subordinates do not disclose confidential information.

Integrity: It can be maintain by following these grounds.

- (a) Avoid conflicts of interest and advise others of potential conflicts.
- (b) Do not subvert organization's legitimate objectives.
- (c) Recognize and communicate personal professional limitations. Avoid activities that could affect your ability to
- (d) And perform duties.
- (e) Refrain from activities that could discredit the profession.
- (f) Refuse gifts or favours that might influence behavior.
- (g) Communicate unfavorable as well as favorable information

Objectivity:- It can be maintain by following these grounds:

- (a) Communicate information fairly and objectively, (b) Disclose all the information that might be useful to Management.

Resolution of ethical Conflict:

1. Follow established policies.
2. For unresolved ethical conflicts;
 - Discuss the conflict with immediate superior
 - If immediate superior is the CEO, consider the board or the audit committee.
 - Except where legally prescribed maintain confidentiality
3. Clarify issue in a confidential discussion with the objective advisor.
4. Consult an attorney as to legal obligations.
5. The last resort is to resign.

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