



Ethical accounting maintaining trust and credibility in financial reporting

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Abstract

Business ethics is based on the principle of integrity and fairness and concentrates on the benefits to the stakeholders, both internal and external. Stakeholder includes those individuals and groups without which the organisation does not have an existence. It includes the shareholders, the employees, the customers, the dealers, the vendors, the government and the society. Ethical issues in accounting are multifaceted and require careful consideration to maintain trust and integrity in financial reporting. Through the examination of historical context, theoretical frameworks, case studies, and strategies for ethical decision-making, this paper has provided insights into the complexities of ethical challenges faced by accounting professionals. Moving forward, it is imperative for accounting firms, regulatory bodies, and educational institutions to collaborate in fostering a culture of ethics and professionalism within the accounting profession. This may involve enhancing ethics education and training, strengthening regulatory oversight, and promoting transparency and accountability at all levels of the profession. Furthermore, as technology continues to evolve, accounting professionals must remain vigilant in adapting to new ethical challenges and leveraging technological advancements responsibly. This includes addressing issues related to data security, privacy, and the impact of automation on professional judgment.

Keywords: Accounting ethics, ethical risks in accounting, financial reporting fraud transparency, whistleblower reporting

Introduction

The word "ethics" is derived from the Greek word "ethikos" meaning custom or character. It is the science of morals describing a set of rules of behaviour. Business ethics itself is an offshoot of applied ethics. The study of business ethics essentially deals with understanding what is right and morally good in business.

Ethics is a branch of philosophy and is considered a normative science because it is concerned with the norms of human conduct, as distinguished from formal sciences such as mathematics and logic, physical sciences such as chemistry and physics, and empirical sciences such as economics and psychology. As a science, ethics must follow the same rigours of logical reasoning as other sciences.

The principles of ethical reasoning are useful tools for sorting out the good and bad components within complex human interactions. For this reason, the study of ethics has been at the heart of intellectual thought since the time of early Greek philosophers, and its ongoing contribution to the advancement of knowledge and science makes ethics a relevant, if not vital, aspect of management theory.

Understanding and upholding business ethics is essential for the overall business activities. Su (2014) opines an organisations stability and survival vastly depends on the consistency and quality of ethical financial decisions made by accountants. In fact, studies have shown that businesses with higher ethical commitment are engaged in loss earning management, have higher market valuation and are supposed to have higher corporate financial performance (Ghazali, 2015). A good number of studies have found the contribution of ethics in the performance of business. Ethical practices not only bring profitability but also increase customers loyalty, helps in retaining customers, create goodwill for the organisation and utilize the resources at the maximum level. In contrast, unethical accounting practices such as manipulating accounting figures to display higher profits, not recording expenses into appropriate time

period, recording inventories at higher values and falsification of lease assets can not only misrepresent organisational financial status but can also become a threat to its existence (Buell, 2009). For example, WorldCom Chief Executive Officer and Chief Financial Officer was sentenced in prison for directing an \$11 billion accounting fraud which has drove the telecommunication giant into the nation's largest bankruptcy. Thus, in the case of professional accountants in business, not only they have to maintain high ethical standards but also, they need to play a key role in helping businesses to act ethically.

Kannaiah and Kumar (2009) advocated that ethics education should now be integrated into accounting curricula mainly in auditing courses. Entry level accountants will only make morally dependable decisions if the business environment and universities support ethics education. Students should be first taught general business ethics. Accounting ethics topics must be integrated into each and every accounting module throughout the programme. Universities must develop a capstone course that deals with complex issues of business social responsibility and professional responsibility for senior professionals, Accounting firms need to evaluate periodically the design and operating effectiveness of the organization's compliance and ethics programmes and to assess their overall effectiveness.

Parmar (2015) ^[4] focuses on the concept of ethics and its implications on accounting professionals. Ethics has become a most topical issue of concern in accounting and finance at present owing to the series of corporate scandals that had taken place in the world affecting the credibility of the accounting profession. These scandals have placed in doubt the effectiveness of con-temporary accounting, auditing and corporate governance practices, for which accountants are responsible. Thus, the ethical code of conduct is closely linked with the accounting profession. Hence, we can say that the ethics has become an essential part for accounting professionals.

Athma and Rajyalaxmi (2017) suggested that every Company has to prepare its Code of Conduct produced by SEBI along with the Financial Statements at the end of the financial year. Some Companies are following Code of Conduct given in Clause 49 Form A, and some companies have separate code of conduct and companies can as well include voluntary information in their code of conduct. Of 131 top ethical Companies in the world, only three Indian Companies (Two BSE Listed and One NSE Listed) found place in the list indicating that other companies should strive for being more ethical. Adequate monitoring and proper enforcement of Ethical Standards will result in adherence to Ethical Standards.

Jaijairam (2017) established that ethics dimensioning for the accounting profession is essential for national professional bodies in increasing business reputation, and usefulness of financial statements, while decreasing criminal activities and fraud. The research hypothesis also proved that the accountants' role is dependent on an organization's emphasis on culture and accountability. Therefore, it is essential for the government and public governing bodies to advocate and develop ethical practices in accounting firms

Sharma (2019) observed that the role of leaders or the upper management is very important. They should have the ability to instil the ethic sense to new trainees and teach them ethics is very important even in challenging situations. When the major scandals occurred in 2001 and 2002 there were codes of ethics which already existed at that point. Regardless of these still these scandals happened. This is a big example and consequence of disregarding ethics in work. It can be concluded that accounting ethics training and awareness should be provided occasionally by all organizations dealing with Finance and Accounting. Accounting ethics courses should be included in all finance curricula so that students can get a better grasp of the ethical code of conduct and learn to abide by it from a young age.

Ethics in Accounting

Accounting is "the process of identifying, measuring and communicating economic information to permit judgements and decision-making by users of the information". It is known as the language of business that allows the passing of information and it is undoubted that the well-functioning of an economy immensely depends on accurate and reliable accounting information (Costuleanu, Dumitre and Bobitan, 2013). However, the accounting profession is experiencing its deepest crisis over the last two decades after the exposure of several accounting scandals that lead towards the collapse of some big corporations. For instance, Waste Management in 1998; Enron in 2001; WorldCom and Tyko in and 2002; HealthSouth and Freddie Mac in 2003; AIG in 2005; Madoff and Lehman Brothers in 2008 and Saytam in 2009 (Busila, 2014). The key reason behind all these scandals involved unethical accounting practices, fraudulent financial reporting and misappropriation of assets and expenses. Indeed, a survey conducted by the International Accounting Firm and KPMG reported that there is approximately 13% increase in the corporate fraudulent activities compare to five year earlier (Rahaman and Hossain, 2014). These high-profile scandals and embarrassing corporation failure have called to question the integrity of the accounting professionals and leading to increased demands for ethics.

Ethics in accounting is one of the most important, yet most misunderstood concerns in the world of business. Stonciuviene and Naujokaitiene (2013) opine that

insufficient and inappropriate understanding of the ethical norms and wrong interpretation direct accountants towards the unethical behaviour. In Support, Busila (2014) indicated that simply awareness of the professional ethical standards and code of professional conduct does not guarantee that an accountant will behave ethically. Therefore, it is necessary to understand the ethical decision-making process as significant proportion of professional judgement depends on the individual's ethical beliefs and attitudes (Richmond, 2001). An individual's ethical decision-making depends on number of demographic factors, such as culture, gender, religion, age, education, value system, moral character and sensitivity to moral issues.

Ethics in accounting is a critical aspect that underpins the integrity and reliability of financial information, ensuring transparency and trust in business transactions. According to the American Accounting Association (AAA), ethics in accounting refers to the principles that guide accountants and auditors in their professional conduct, encompassing honesty, integrity, objectivity, and responsibility. As noted by Velasquez (2019), ethical behaviour in accounting is essential for maintaining the public interest and upholding the profession's credibility.

Accounting ethics has deep historical roots, tracing back to ancient civilizations such as Mesopotamia and ancient Egypt, where scribes were responsible for recording financial transactions with accuracy and honesty (McPhail, 2018). Over time, the development of double-entry bookkeeping by Luca Pacioli in the 15th century laid the foundation for modern accounting practices, emphasizing the importance of balance and accuracy in financial records (Bragg, 2019).

In contemporary times, ethical considerations in accounting have become increasingly complex due to globalization, technological advancements, and the growing complexity of business transactions. The Enron scandal of 2001, for instance, highlighted the devastating consequences of unethical accounting practices, leading to the collapse of one of the largest energy companies in the world and sparking widespread calls for regulatory reform (McLean and Elkind, 2003).

Numerical data underscores the significance of ethical lapses in accounting. According to the Association of Certified Fraud Examiners (ACFE), organizations lose an estimated 5% of their annual revenues to fraud, with financial statement fraud being one of the most prevalent forms of misconduct (ACFE, 2020). Furthermore, a survey by Deloitte found that 47% of executives believe their organizations are not adequately prepared to manage ethical risks, highlighting the need for greater attention to ethical considerations in accounting (Deloitte, 2020).

Historical Background of Accounting Ethics

Accounting ethics has evolved over centuries, shaped by cultural, legal, and philosophical developments. Ancient civilizations such as the Mesopotamians and Egyptians laid the groundwork for ethical accounting practices through meticulous record-keeping and accountability (Reiter, 2017). The Code of Hammurabi, dating back to 1754 BCE, emphasized honesty and fairness in commercial transactions, reflecting early recognition of ethical principles in accounting (Pohle, 2016).

In the medieval period, the contributions of scholars like Luca Pacioli significantly influenced the development of

accounting ethics. Pacioli's seminal work, "Summa de Arithmetica, Geometria, Proportioni et Proportionalita," introduced the concept of double-entry bookkeeping, emphasizing the importance of accuracy and transparency in financial records (Zucchetti, 2019). This marked a pivotal moment in the history of accounting ethics, as Pacioli's principles became widely adopted across Europe and beyond.

The Industrial Revolution brought new challenges to accounting ethics, as rapid economic growth and industrialization fuelled the need for more sophisticated financial reporting systems. The emergence of corporate entities led to increased demand for reliable financial information, prompting the establishment of professional accounting standards and regulatory bodies (Carson, 2018). For instance, the formation of the American Institute of Certified Public Accountants (AICPA) in 1887 aimed to promote ethical conduct among accounting professionals in the United States (AICPA, 2022).

Numerical data underscores the significance of historical developments in accounting ethics. For example, a study by Hirst and Ye (2019) found that adherence to ethical principles in accounting positively correlates with financial performance, indicating the long-term benefits of ethical behaviour for organizations. Additionally, research by Trotman and Trotman (2018) highlights the role of historical precedents in shaping contemporary accounting ethics frameworks, underscoring the importance of understanding historical context.

Theoretical Framework of Accounting Ethics: Indian Context

In the Indian context, accounting ethics is influenced by cultural, legal, and philosophical factors unique to the region. How key ethical theories apply to accounting practice in India and their significance within the Indian regulatory framework have been elaborated hereunder.

Dharmic Ethics

Dharmic ethics, rooted in Indian philosophical traditions such as Hinduism, Buddhism, Jainism, and Sikhism, emphasizes moral duties and responsibilities (Bhattacharya, 2017). In accounting, dharmic principles guide ethical behaviour by promoting honesty, integrity, and fairness in financial reporting and business transactions. For example, the concept of "Satya" (truthfulness) is fundamental to accounting ethics in India, encouraging accountants to adhere to ethical principles even when faced with challenges or temptations.

Numerical data highlights the importance of dharmic ethics in the Indian accounting profession. According to a survey by the Institute of Chartered Accountants of India (ICAI), 89% of respondents believe that adherence to ethical principles is crucial for maintaining public trust in the accounting profession (ICAI, 2020). This underscores the pervasive influence of dharmic ethics on accounting practice in India.

Gandhian Ethics

Gandhian ethics, inspired by the teachings of Mahatma Gandhi, emphasize the principles of truth, non-violence, and selflessness (Gandhi, 1927). In accounting, Gandhian principles advocate for ethical conduct that promotes the well-being of society and uplifts the marginalized. For instance, ethical decisions related to financial reporting

should consider the impact on stakeholders such as employees, customers, and the wider community, aligning with Gandhian ideals of social justice and equality.

Empirical research sheds light on the application of Gandhian ethics in Indian accounting practice. A study by the Gandhi Research Foundation found that accounting professionals often integrate Gandhian values such as honesty and transparency into their ethical decision-making processes, reflecting a commitment to ethical conduct that transcends mere compliance with regulations (Gandhi Research Foundation, 2018).

Legalistic Ethics

Legalistic ethics, influenced by India's legal system and regulatory framework, emphasize compliance with laws and regulations as the primary determinant of ethical behaviour (Singh, 2019). In accounting, legalistic principles dictate adherence to statutory requirements and professional standards prescribed by regulatory bodies such as the Institute of Chartered Accountants of India (ICAI) and the Securities and Exchange Board of India (SEBI). However, it is important to note that legal compliance alone may not always align with ethical principles, necessitating a broader ethical perspective.

Qualitative research provides insights into the interplay between legalistic ethics and accounting practice in India. Interviews with accounting professionals conducted by Singh (2019) revealed that while compliance with laws and regulations is important, ethical dilemmas often require accounting professionals to consider broader ethical implications beyond legal requirements.

Ethical Issues in Accounting

Ethical issues in accounting pose significant challenges to maintaining integrity and trust in financial reporting. Some of the most prevalent ethical issues encountered by accounting professionals, along with their implications have been examined hereunder.

Financial Reporting Fraud

Financial reporting fraud involves deliberate misrepresentation or manipulation of financial information to deceive stakeholders and inflate the financial performance of an organization (ACFE, 2020). Common forms of financial reporting fraud include revenue recognition manipulation, fictitious transactions, and asset overvaluation.

Numerical data underscores the prevalence and impact of financial reporting fraud. According to the Association of Certified Fraud Examiners (ACFE), financial statement fraud accounts for a significant portion of occupational fraud schemes, with a median loss of \$954,000 per scheme (ACFE, 2020). High-profile cases such as the Enron scandal have brought attention to the devastating consequences of financial reporting fraud on investors, employees, and the broader economy (McLean and Elkind, 2003).

Earnings Management

Earnings management involves the manipulation of financial results to meet or exceed analyst expectations or to achieve desired outcomes, such as securing financing or influencing stock prices (Healy Wahlen, 1999). Techniques used for earnings management include income smoothing,

cookie jar reserves, and real earnings management strategies.

Research indicates the prevalence of earnings management practices in corporate accounting. A study by Roychowdhury (2006) found evidence of income smoothing behaviour among Indian firms, highlighting the pervasive nature of earnings management in emerging markets. Earnings management can distort investors' perceptions of a company's financial health and undermine market efficiency (Schipper and Vincent, 2003).

Conflicts of Interest

Conflicts of interest arise when accounting professionals face competing loyalties or interests that may compromise their objectivity and independence (Hanno *et al.*, 2015). Common sources of conflicts of interest include personal relationships with clients, financial interests in client companies, and pressure to maintain lucrative business relationships.

Qualitative research sheds light on the challenges posed by conflicts of interest in accounting practice. Interviews with accounting professionals conducted by Cunningham and Maloney (2018) revealed that navigating conflicts of interest requires careful consideration of ethical obligations and professional responsibilities.

In summary, financial reporting fraud, earnings management, and conflicts of interest are among the most common ethical issues encountered by accounting professionals. By addressing these issues proactively and adhering to ethical principles and regulatory requirements, accounting professionals can uphold the integrity and credibility of the profession.

Implementing Accountability Mechanisms

Accountability mechanisms hold individuals and organizations responsible for their actions and decisions, reinforcing ethical standards and deterring misconduct.

Accountability may be executed by

- **Establishing Reporting Channels:** Organizations should establish clear reporting channels and whistleblower protections to encourage employees to report unethical behaviour without fear of reprisal (Ferrell *et al.*, 2013). Timely investigation and appropriate action demonstrate a commitment to accountability and fairness.
- **Rewarding Ethical Behaviour:** Recognizing and rewarding ethical behaviour reinforces desired conduct and incentivizes employees to uphold ethical standards (Barnett *et al.*, 2000). Incentive structures aligned with ethical performance promote a culture of integrity and excellence. We may opine that ethical leadership and organizational culture are essential for promoting integrity and ethical conduct within accounting firms and corporations. By fostering a culture of transparency, accountability, and continuous improvement, organizations can strengthen their ethical foundation and build trust with stakeholders.

Mitigating Ethical Risks in Accounting

Mitigating ethical risks is essential for preserving the integrity and credibility of accounting practices. The

strategies and mechanisms for identifying and addressing ethical risks within organizations include

- **Identifying Ethical Risks:** Organizations should conduct regular risk assessments to identify potential ethical risks and vulnerabilities in their operations (ACFE, 2020). This involves evaluating factors such as organizational culture, internal controls, and external pressures that may contribute to ethical misconduct.
- **Implementing Internal Controls:** Strong internal controls are crucial for preventing and detecting unethical behaviour in accounting. Organizations should establish robust control mechanisms, such as segregation of duties, dual authorization processes, and regular audits, to mitigate the risk of fraud and misconduct (Singleton *et al.*, 2010).
- **Promoting Ethical Leadership:** Ethical leadership sets the tone for organizational culture and helps mitigate ethical risks by fostering a climate of integrity and accountability (Brown and Treviño, 2006). Organizations should invest in developing ethical leaders who prioritize ethical considerations in decision-making and inspire trust among employees.
- **Encouraging Whistleblower Reporting:** Whistleblower reporting mechanisms provide employees with a safe and confidential means to report unethical behaviour without fear of retaliation (Ferrell *et al.*, 2013). Organizations should establish clear reporting channels and whistleblower protections to encourage transparency and accountability.

By implementing these strategies, organizations can effectively mitigate ethical risks in accounting and uphold the highest standards of integrity and professionalism.

Summing-up

Ethics has become a key area of concern in accounting at present owing to the series of corporate scandals that had taken place in the world questioning the credibility of the accounting profession. These scandals have placed in doubt the effectiveness of contemporary accounting, auditing and corporate governance practices, for which accounting profession is responsible for. Thus, recognition of the accounting profession is closely linked with the maintenance of highest ethical standards.

Ethics holds an essential role in accounting in order to ensure efficiency, integrity, accuracy, confidentiality and presentation of accurate financial information for any corporation. There are number of factors that directly and indirectly influence ethical decision-making such as culture, gender, religion beliefs, moral reasoning and ethical codes and principals. However, the significance of these variables on ethical decision-makings differs under certain circumstances. Culture has a substantial influence on individual's ethical decisions and moral reasoning ability which is confirmed through empirical studies.

By prioritizing ethical conduct and embracing continuous learning and improvement, accounting professionals can uphold the highest standards of integrity and contribute to

the sustainability and trustworthiness of the accounting profession in the years to come.

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