

Financial Ethics' Function in Accounting : Maintaining Honesty

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Abstract

Financial reporting mandates that all consumers of financial systems must be familiar with generally accepted accounting standards (GAAP). In the commercial realm, precise accounting is essential. Ethical financial reporting & accounting procedures align with fundamental human needs. It establishes credibility with the public and employees. Ethics and accounting serve to safeguard the public from unethical corporations. Many accountants conceal or distort information in their professions. The majority of accounting scandals have occurred due to deceptive financial reporting. The company's management provides a misrepresentation regarding the financial statements. This is typically executed to deceive investors and sustain the company's current share price; but, in the context of contemporary business ethics, its importance is underscored by the need to address worldwide financial scandals. A direct ethical guideline is necessary to raise awareness about defending against the corporate scandals that have occurred in many regions throughout different countries, which are detrimental to both the economy and society. Accountants and managers must adhere to specific professional ethical standards about the information they provide, ensuring financial management adequacy, audit quality, and corporate ethics. This study elucidated the concept of ethics, the origins of ethical dilemmas in financial reporting and accounting, and the measures necessary to address these concerns.

Keywords : Accounting standards (GAAP), Financial Ethics, Accountants, Managers.

Introduction

In the contemporary industrial economy, finance is the lifeblood. We cannot conceive of any company formation without finance. The success of any company or organization is directly contingent upon financial adequacy and its effective deployment. However, disparate accounting standards across several countries can pose significant challenges. To foster global economic progress, it is essential to implement a unified standard, ensuring that participants worldwide obtain an equitable perspective on corporate outcomes, irrespective of their physical location. Ethics can be described in several forms, often presenting contradicting interpretations. Currently, numerous sectors of financial reporting and accounting are afflicted by ethical dilemmas, which constitute a significant concern. Ethics should play a fundamental role in business and various other domains of ethical decision-making. The dictionary definition of ethics is a system of rules that govern morality and appropriate action, as well as an ethical code. According to The Oxford Dictionary, ethics refers to moral principles or rules of action. It is a collection of moral principles or behaviors deemed acceptable or objectionable in the realm of human activity. Morality is a voluntary construct. It cannot be

compelled, but it must be influenced. Financial reporting is both directly and indirectly associated with accountancy & economics. Financial reporting plays a significant part in company governance. The reporting of finances is an accounting record of organizations or enterprises that reveals their financial situation to the government, management, and investors. The challenge of maintaining ethical standards in the accurate financial reporting of a company's assets, obligations, and profits, free from undue influence by leadership or corporate officers. The significance of ethics has elevated the importance of ethical decision-making in business, impacting investors, creditors, and other stakeholders through the financial success of firms. Unethical behaviors such as fake financial reporting, personal trading, insider trading, misuse of assets, and inadequate transparency are significant concerns within corporations. The importance of ethics in accountancy has been substantiated by historical scandals. Auditors and accountants can gain substantial knowledge from errors such as the Commonwealth Games Scam, 2G Spectrum Scam, Indian Coal Allocation Scam, Satyam Scam, and the Enron scandal. The schemes have undermined public trust and tarnished the image of accountants inside the profession. Ethics has emerged as a significant concern for the entire accounting profession following a succession of accounting scandals that highlighted this issue. There are several complex ethical considerations that complicate the integrity of financial reporting. The numerous controversies involving firms arise from ethical lapses, which reflect poorly on any organization. The effects stem from a lack of investor confidence and customer trust in the companies. It adversely impacted the growth and development of national economies.

Literature Review

1. Duska, R., Duska, B. S., & Ragatz, J. A. (2018); *Accounting Ethics* (3rd ed.); Wiley-Blackwell.

The focus of this book is to analyse the ethics of accounting and to offer a way for solving these problems. It puts stress on ethical practices, truth, and objectivity in auditor's work because trust is the key to successful work in this field.

2. Mintz, S. M., & Morris, R. E. (2016); *Ethical Obligations and Decision-Making in Accounting: Text and Cases* (4th ed.); McGraw-Hill Education.

This text explores the issues of ethical decision making in accounting basics, specifically those occasions when truth and ethical misconduct occurred in the profession.

3. Armstrong, M. B., Ketz, J. E., & Owsen, D. M. (2016); "Ethics Education in Accounting: Moving Toward Ethical Motivation and Ethical Behaviour." *Journal of Accounting Education*, 36, 73–84.

Using ethical cognition as the focus, this article assesses whether ethical education can inspire the accountants to engage in honest behaviours and adhere to ethical principles.

4. Cooper, D. J., & Neu, D. (2017); "Ethics and the Profession of Accounting." *Accounting, Organizations, and Society*, 63, 32–48.

The authors explain what ethical standards apply to the occupation and why it is crucial to remain truthful with the public.

5. Smith, M., & Smith, P. (2019); "Financial Ethics and the Role of Integrity in Accounting Practices." *Journal of Business Ethics*, 158(2), 347–360.

The current research demonstrates the link between ethical behavior and accurate reporting of the financial statements with a focus on integrity as part of the accounting ethical system.

6. Gray, R., & Bebbington, J. (2018); "Sustainability, Accountability, and Ethics in Accounting"; *European Accounting Review*, 27(3), 431–452.

In this study, the authors discuss what they believe should be the ethical framework that guides accountants in as far as honesty and transparency when presenting sustainability reports are concerned.

Objective of the research

To examine the issues and challenges related to ethical considerations in financial reporting & accounting within the corporate sector.

Methodology of research

The research study utilized secondary data sourced from many research publications, journals, and websites. The current study employs descriptive as well as analytical research methodologies.

Obstacles In Financial Reporting and Accounting

1. The ongoing challenge is the notion of going concern: The economic conditions are afflicted by a persistent issue, wherein the going concern notion is not unequivocal in certain company scenarios. The corporation must make a determined decision regarding judgments linked to the going concern idea. The business will possess an infinite lifespan and will not undergo liquidation in the foreseeable future. The company entity is assumed to continue indefinitely and function profitably for the foreseeable future unless evidence suggests otherwise.

2. past accounting: current issues in financial reporting and accounting are rooted on past cost. This principle is rigorously adhered to by corporations. Companies do not reflect the resulting modifications in the market value of assets in their accounts. The preparation of financial statements disregards current market prices, resulting in an inaccurate representation of asset value. This information is not pertinent to the accounting participants.

3. Challenges in assessment: Any alterations in measurement directly and indirectly impact the financial results and statements of organizations, affecting nearly all societal users. The measurement of financial reporting is mostly focused on conventions, rather than addressing the measurement problem itself. The measurement of financial reporting and accounting encompasses five principles: fair value, value in use, realizable value, deprival value, and historical cost. It is a difficulty for a corporation to operate effectively and to measure the trustworthiness of its output in certain situations and for specific purposes.

4. Consistency challenges: Once a company's management selects and adopts accounting policies, these must be adhered to consistently throughout accounting periods. If a corporation wishes to amend its policies, it must declare the existence of an issue that necessitates resolution. Occasionally, consistency also reflects outward coherence. Comparing the financial statements of different companies is beneficial, but this is feasible only when the companies employ same processes and procedures in their financial reporting. It is often challenging for firms to achieve flawless outward uniformity.

5. Evolution of IFRS: The adoption of IFRS will significantly challenge company interests and exert a considerable influence on financial statement users. The International Accounting rules Board (IASB) produced the International Financial Reporting Standards (IFRS), which constitute a collection of accounting rules. The Companies Act 2013 presents several modifications to IFRSs concerning joint ventures, consolidation, fair values, financial reporting, and accounting. India has decided to align its existing accounting standards with IFRS to deliver high-quality solutions that are comprehensible, transparent, and comparable in financial statements and reporting. It enables investors to make economic judgments based on current facts. However, this is feasible only when the company's management fully discloses facts with appropriate evidence.

Significant Ethical Concerns in Accounting and Financial Reporting

1. Financial reporting is deceptive: Over the past two decades, financial scandals have focused emphasis on misleading financial reporting. The company's management is deliberately misappropriating funds with the purpose to deceive investors and artificially inflate the company's share price. The primary domain of fraudulent actions is the presentation of fictitious revenue, the premature recognition of income, and the manipulation of revenue through misstatement entries. In a brief timeframe, when the company's stock price

is elevated, but over an extended period it adversely impacts the enterprise's financial condition, it becomes evident to business stakeholders that the financial reporting misrepresents their accounts.

2. Asset misappropriation: A significant ethical concern in accounting is the misuse of assets at the individual employee level. It influences the company's employee morale and reputation both directly and indirectly. The company's management engaged in asset misappropriation by manipulating accounting and fabricating erroneous invoices and papers. Misappropriation of assets through the utilization of company resources for purposes unrelated to company interests.

3. Full Disclosure: reporting on finances encompasses subtopics of fraud, while disclosure infringements are ethical faults arising from negligence. When information is not presented in accordance with GAAP as well as accounts aren't created with integrity, it should be regarded as financial reporting involving fraudulent acts. Individuals engaged in the business sector may find that a lack of comprehensive disclosure hinders success for investment. Consequently, business entities may alter their investment selections if financial reporting is deemed false.

Constraints of Accounting and Financial Reporting

1. Antithetical structure and regulations of accounting: Accounting is commonly referred to as the language of business. Entities conducting business globally must adhere to a unified set of accounting rules. The Framework of Indian Accounting Standards (IAS) is predicated on historical values and regulations. International Financial Reporting Standards (IFRS) permit the utilization of accounting procedures for the preparation of financial statements. To ensure that all organizations adopt a universal business language, facilitating clarity and comparability of financial accounts across various international jurisdictions. To resolve this issue, it has been determined to integrate the current accounting rules with IFRS. Consequently, information is conveyed to users via accounting records and reports.

2. Professional Judgment: The notion of professional judgment is articulated by the Institute of Chartered Accountants of Scotland (ICAS). It is a crucial part of producing and reviewing the financial statement. The exercise of professional judgment should occur within a reasonable timeframe when the circumstances and facts render the information more useful and accurate. It is a challenge for regulators to assess the preparer's judgment post-event. Prior to writing the judgment report, several concerns must be considered, including accounting assessment, comprehensive knowledge collection and analysis, and document evaluations.

3. Verification factual evidence: A company's accounting data must be verifiable, devoid of personal prejudice, and unequivocal. All accounting operations must be substantiated by business documents and evidence, such as invoices and sales bills, which may be verified by an auditor at a later time. Verifiability does not guarantee the validity of facts; however, it is essential to ensure that the material presented is logically coherent. Illustrative Enron scandals occurred within a prominent American firm cantered in Houston, specializing in commodities, energy, and services. When Enron was declared bankrupt, its share price was \$0.26 per share. It was permeated with unverifiability. It will be accomplished by maintaining substantial debts off the balance sheet.

4. Employment of historical cost principle: All transactions are documented in the accounting records at their acquisition monetary value. Valuation of assets according to historical cost. In the ledger, various financial obligations and assets are documented at their acquisition cost. The purchase price will be deferred annually, regardless of its current value. The financial statement we created does not accurately represent the true value of the assets.

5. Restricted predicting value: Predictive value assists investors in forming expectations regarding the future. The financial statement is based on the historical performance of organizations and possesses limited predictive power regarding future outcomes, which is a crucial consideration for investors.

6. *Fraud and error*: Companies will deliberately manipulate financial figures to achieve specific results. WorldCom scandal. The internal audit department will facilitate this process by underreporting line costs through capitalization instead of expensing, as well as inflating revenue with fictitious accounting entries.

Solution To Ethical Issues Concerning Financial Reporting and Accounting

Specific laws and regulations govern financial reporting & accounting standards during the preparation of financial statements. The financial statement must adhere to GAAP, Securities and Exchange Commission regulations, investment accounting disclosure rules, as well as International Financial Reporting Standards norms.

1. *A good evidence-based approach*: the supporting material must be adequately organized and provisions made for its continual updating.

2. *Importance of uniformity*: uniformity is a critical concern for users across companies. Financial reports provide an accurate and impartial representation of the enterprises' financial statements.

3. *Engagement in information technology systems*: effective utilization of various data systems that are beneficial during financial closing and reporting operations, such as material workflows, account chart updates, and participant experiences, among others.

4. *Management and Internal Support*: A senior and knowledgeable management representative must deliver business presentations on various accounting problems and engage with external stakeholders, which are crucial for any company. Additionally, it addressed internal corporate matters, such as risk management and the evaluation of organizational structure.

Conclusion

In the current day, hardly one inquiry about companies' financial reports when circumstances seem favourable. The system of reporting on finances relies on the accuracy of information and trustworthiness, fundamentally depending on individual decisions and actions that affect both companies and society as a whole. To wow shareholders by delivering relevant company information, this is more beneficial for investors in making investment and economic decisions. Numerous financial scandals have occurred due to the inadequate implementation of financial reporting & accounting rules in accounting practices. There is a necessity to promote understanding of the code of ethical conduct through education in accounting and societal norms. It endeavoured to achieve equilibrium among economic, social, and professional obligations. Encouraging employees and management to embrace ethical behaviour can help deter fraud and foster pride in our profession via contributions to accountancy.

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From a legal perspective, "ethics and compliance in financial reporting" means **adhering to not only the letter of the law regarding financial disclosure but also upholding ethical principles like transparency, fairness, and accountability, ensuring that a company's financial statements accurately reflect its financial position and performance, thereby maintaining public trust and avoiding potential legal repercussions for non-compliance**; this often involves following established accounting standards, internal controls, and corporate governance practices to prevent fraudulent reporting and other unethical behaviors. [1, 2, 3, 4, 5]

Key points to consider: [1, 2, 6]

- **Legal Framework:** Various laws and regulations govern financial reporting, including Securities Act, Sarbanes-Oxley Act (SOX), and International Financial Reporting Standards (IFRS), which set standards for disclosure, internal controls, and auditor independence, creating a legal foundation for ethical behavior. [1, 2, 6]
- **Ethical Principles:** Beyond legal compliance, ethical principles like integrity, objectivity, professional competence, and confidentiality are crucial for accountants and financial professionals to ensure reliable financial reporting. [1, 2, 3, 7]
- **Consequences of Non-Compliance:** Companies that engage in unethical financial reporting can face severe legal consequences including fines, penalties, lawsuits, reputational damage, and potential criminal charges against executives. [2, 4, 6]
- **Internal Controls:** Companies should implement robust internal controls to mitigate the risk of financial fraud and ensure accuracy in financial reporting, including segregation of duties, proper documentation, and regular reviews. [1, 2, 8]
- **Corporate Governance:** Strong corporate governance practices, such as independent board oversight, ethics committees, and whistleblower protection, are essential for promoting ethical conduct and compliance within an organization. [1, 6, 9]

Examples of Ethical Issues in Financial Reporting: [2, 5]

- **Earnings Management:** Intentionally manipulating financial results to meet market expectations. [2, 5]
- **Related Party Transactions:** Failing to disclose significant transactions with parties closely associated with the company. [5]
- **Misclassifying Assets and Liabilities:** Improperly categorizing financial items to improve financial performance. [2, 5]
- **Non-Disclosure of Material Information:** Withholding crucial information from investors that could affect investment decisions. [2, 5, 10]

How to Promote Ethical Financial Reporting: [1, 8, 9]

- **Develop a strong Code of Ethics:** Establish clear guidelines for ethical conduct and financial reporting within the organization. [1, 8, 9]

- **Employee Training:** Regularly educate employees on ethical standards and compliance requirements. [1, 6, 9]
- **Independent Audit Function:** Engage independent auditors to verify the accuracy of financial statements and identify potential issues. [2, 3, 5]
- **Whistleblower Protection:** Create a safe environment for employees to report suspected unethical behavior without fear of retaliation. [1, 6, 8]

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