

6. ETHICS IN ACCOUNTING AND FINANCE

Success in business requires training, discipline and hard work. But if you're not frightened by these things, the opportunities are just as great today as they ever were.

- David Rockefeller

Q.No.1. What are the fundamental principles of ethics applicable to the persons of finance and accounting profession? (A) (RTP M - 16)

PRINCIPLES OF ETHICS: The fundamental principles relating to ethics as applicable to accounting and finance professionals are as follows:

- 1. The principle of integrity:** Integrity means veracity ^(=sincerity). The principle requires all accounting and finance personnel to be honest and straight-forward in discharging their respective professional duties.
- 2. The principle of objectivity:** The principle requires accounting and financial professionals to stick to their professional and financial judgment without bias, conflicting interests or under influence of others.
- 3. The principle of confidentiality:** The principle requires accounting and financial professionals to refrain ^(=avoid doing) from disclosing confidential information related to their work.
- 4. The principle of professional competence and due care:** The financial and accounting professionals need to update their professional skills in the modern competitive environment.
- 5. The principle of professional behavior:** The principle requires accounting and financial professional to comply with relevant laws and regulations and avoid such actions which may result into discrediting ^(=harm the reputation) the profession.

SIMILAR QUESTIONS:

1. What are the principles that are to be followed by accounting and finance professionals to behave ethically in their profession?
A. Ans: Refer the above answer.
2. "The principle of integrity is a fundamental principle relating to ethics for all accounting and finance professionals." Comment.
A. Refer to point No1. in the above answer.

Q.No.2. State, how far a sound ethical environment in a company may be created and corporate scandals may be avoided. (C) (PM)

A sound ethical environment in a company may be created and corporate scandals may be avoided by adopting the following methods:

- 1. ENSURING THAT EMPLOYEES ARE AWARE OF THEIR LEGAL AND ETHICAL RESPONSIBILITIES.**
 - a) Some ethical organisations are having policies to train and motivate employees towards ethical behaviour.
 - b) A number of companies in India and abroad are being known for their quality and soundness of their ethics programmes.
- 2. PROVIDING A COMMUNICATION SYSTEM BETWEEN THE MANAGEMENT AND EMPLOYEES. SO THAT ANYONE IN THE COMPANY CAN REPORT FRAUD AND MISMANAGEMENT WITHOUT THE FEAR OF BEING REPRIMANDED** ^(=CRITICIZED). In India, Wipro has introduced a helpline comprising of senior members of the company, who are available for guidance on any moral, legal or ethical issues that an employee of the company may face.

3. **ENSURING FAIR TREATMENT TO THOSE WHO ACT AS WHISTLE BLOWERS:** This is most important and sensitive issue. Fair treatment to whistle blowers is a basic necessity to check fraud.

SIMILAR QUESTIONS:

1. What are the measures that a business organization has to put in place to ensure ethical environment in a company?

A. Refer the above answer.

Q.No.3. State the pressures which are faced by finance and accounting professionals' in an organization in the compliance of fundamental principles of ethics. (B)
(PM, RTP - N14)

PRESSURES FACED BY FINANCE AND ACCOUNTING PROFESSIONALS:

1. The finance and accounting professionals are supposed to support the legitimate and ethical objectives established by the employer.
2. As they are having responsibilities to an employing organization, they may be under pressure to act or behave in ways that could directly or indirectly threaten compliance with the fundamental principles.
3. Such pressures may be explicit or implicit which may come from supervisor, manager, director or another individuals.

SUCH PRESSURES WHICH ARE BEING FACED BY FINANCE AND ACCOUNTING PROFESSIONALS MAY BE STATED AS FOLLOWS:

- a) To act contrary to Law or Regulation
- b) To act contrary to technical and professional standards.
- c) To facilitate unethical or illegal earnings management strategies.
- d) Lie to, or otherwise intentionally mislead others, in particular the auditors of the employing organization or Regulators.
- e) To issue or otherwise be associated with, a financial or non-financial report that materially misrepresents the facts, including statements, in connection with. For example:
 - i) The financial statements
 - ii) Tax compliance
 - iii) Legal compliance, or
 - iv) Reports required by securities regulators.

SIMILAR QUESTIONS:

1. State the professional obligations that a Finance and Accounting Professional as an employee has to comply with.

A. Refer the above answer.

Q.No.4. Explain the importance of ethics for finance and accounting professionals. (C)
(For Student Self - Study)

1. Finance and Accounts is perhaps the only business function which accepts responsibility to act in public interest. Hence, finance and accounting professional's responsibility is not restricted to satisfy the needs of any particular individual or organisation.

2. While acting in public interest, it becomes imperative that the Finance and Accounting Professional adheres to certain basic ethics, in order to achieve his objective. Until recently, various surveys conducted globally, had ranked finance and accounting professionals very high in terms of professional ethics.
3. However, various accounting scandals witnessed during the past few years have put a serious question mark on the role of Finance and Accounting Professionals in providing the right information for decision making both within and outside the organizations.
4. As these finance and accounting professionals are in public practice, they should take reasonable steps to identify circumstances.

SIMILAR QUESTIONS:

1. Outline the importance of ethics for finance and accounting professional.
A. Refer Above.
2. Why should the accounting and financial professional follow ethical principles? (PM)
A. Refer Above.

Q.No.5. What are the various threats, which can be faced by a finance and accounting professional, while working as an auditor, consultant or an employee in an organisation? (A) (PM, M 14 – 4M, M 15 – 4M)

The dynamic environment in which businesses operate today, may give rise to a broad range of circumstances which may cause threats. Such threats may be classified as follows:

- a) **SELF - INTEREST THREATS**: Which may occur as a result of financial or other interests of a Finance and Accounting Professional or of an immediate or close family member;
- b) **SELF - REVIEW THREATS**: Which may occur when a previous judgment needs to be reevaluated by the Finance and Accounting Professional responsible for that judgment;
- c) **ADVOCACY THREATS**: Which may occur when a professional promotes a position or opinion to the point that subsequent objectivity may be compromised;
- d) **FAMILIARITY THREATS**: Which may occur when a Finance and Accounting Professional has close relationships in the work environment and such relationships impair his selfless attitude towards work.
- e) **INTIMIDATION THREATS**: Which may occur when a professional may be prohibited from acting objectively, by threatening him.

SIMILAR QUESTIONS:

1. Write about various threats posed by the environment. (or) What kinds of threats could finance and accounting employee expect, while working as an auditor, consultant or an employee in an organization? The Finance and Accounting Professional has to work under severe pressures of various threats. – Elaborate.
A. Refer The above Answer.

Q.No.6. Explain the reasons for unethical behaviour among finance and accounting professionals. (B) (PM, RTP N15, N16, M09 - 5M, N13 – 3M)

THE REASONS WHICH LEAD TO UNETHICAL BEHAVIOUR ARE AS FOLLOWS:

1. **Emphasis on short term results**: This is one of the primary reasons which has led to the downfall of many companies like Enron and Worldcom.
2. **Ignoring small unethical issues**: It is a known fact that most of the compromises we make are small but however they lead us into committing large infractions. And ignoring minor lapses, lead to bigger and more huge mistakes.

3. **Economic cycles:** In good times, companies are relaxed in their accounting procedures or disclosures, as there is a feel-good effect. But when difficult times follow, then they will resort to unethical practices. So companies need to be vigilant in good times as well as bad times.

4. **Accounting rules:**

- *In the era of globalization, accounting rules are changing faster than ever before.* The rules have become more complex and it is difficult to identify deviations from these complex set of requirements.
- The complexity of these principles and rules and the difficulty associated with identifying abuse, are reasons of unethical behaviour.

SIMILAR QUESTION

1. Describe various reasons which could lead one, to be unethical.

A. Refer the Above Answer.

Q.No.7. Self-interest threats may occur as a result of financial or other interests of finance and accounting professional. Give three examples each of such threats when the accounting professional is working as-

(1) An auditor or consultant.

(2) An employee in a company.

(C)

(PM, M 08 - 5M)

Self Interest Threats - Auditors: Self-interest threats for finance and accounting professionals working as consultants or auditors are given below:

- A financial interest in a client or jointly holding a financial interest with a client.
- Undue dependence on total fees from a client.
- Having a close business relationship with a client.
- Concern about the possibility of losing a client,
- Potential employment with a client.
- Contingent fees relating to an assurance engagement.

Self Interest Threats - Employees: Self-interest threats for finance and accounting professionals working as an employee are given below:

- Financial interests, loans and guarantees in the company in which the professional is working.
- Incentive compensation arrangements.
- Inappropriate personal use of corporate assets.
- Concern over employment security.
- Commercial pressure from outside the employing organization.

SIMILAR QUESTIONS:

1. Give examples for self-interest threats, which can be faced by a finance and accounting professional, while working as (A) auditor or consultant and (B) employee in a company.

A. Refer The Above.

Q.No.8. Give some examples for self-review threats, which can be faced by Finance and Accounting Professional while working as (A) an auditor or consultant and (B) an employee in a company. (C) (SM) (For Student Self - Study)

1. AN AUDITOR OR CONSULTANT:

- a) Discovery of a significant error during a re-evaluation of the professional's work.
- b) Reporting on the operation of the financial systems designed and implemented by the professional himself.
- c) A member of the assurance team being, or having recently been, employed by the client in a position to exert direct and significant influence over the subject matter of the engagement.



2. EMPLOYEE IN A COMPANY:

- a) Such threats occur when business decisions or data is subjected to review. Justification is required to be given by the same professional, who was responsible for such decisions or preparing the data.
- b) The professional may be under pressure from his seniors to compromise with his moral professional and legal obligations.
- c) He may be asked to act contrary to technical/professional standards and regulations. The professional may be required to justify the decision/data that he himself created.

Q.No.9. Give some examples of advocacy threats which can be faced by a Finance and Accounting Professional while working as (A) an auditor or consultant and (B) employee in a company. (C) (SM) (For Student Self - Study)

1. AN AUDITOR OR CONSULTANT:

- a) Promoting shares in a listed entity, when that entity is a Consultancy or a Financial Statement Audit Client.
- b) Acting as an advocate, on behalf of an assurance client, in litigation or disputes with third parties.



2. WORKING AS EMPLOYEE:

- a) Making false and misleading statements on the company's position, when furthering legitimate goals and objectives of their employers.
- b) But, if such statements are neither false nor misleading, then such actions generally do not create an Advocacy Threat.

Q.No.10. Give some examples for familiarity threats, which can be faced by a Finance and Accounting Professional while working as (A) an auditor or consultant and (B) employee in a company. (C) (SM) (For Student Self -Study)

1. AN AUDITOR OR CONSULTANT:

- a) A member of the engagement team, who have a close and immediate family relationship with a director/officer of the client.
- b) A former director/officer of the client being a partner of the audit firm.
- c) Accepting gifts or preferential treatment from a client.
- d) Long association of senior personal with a client.

2. WORKING AS EMPLOYEE:

- a) Possible benefit to a close family member from the influence exercised by the professional on business decisions and financial reporting.
- b) Long association with business contacts, influencing business decisions.
- c) Acceptance of gifts or preferential treatment, unless the value is clearly insignificant.

Q.No.11. Give some examples for intimidation (fear/pressure) threats which can be faced by a finance and accounting professional, while working as (A) an auditor or consultant and (B) employee in a company. (C) (SM) (For student self-study)

1. AN AUDITOR OR CONSULTANT:

- a) Being threatened with dismissal or replacement.
- b) Being threatened with litigation.
- c) Being pressured to reduce the scope and extend of the work done, inappropriately, to reduce fees.

**2. EMPLOYEE:**

- a) Threat of dismissal / replacement of the Finance and Accounting Professional or a close / immediate family member.
- b) This could be over a disagreement about the application of an accounting principle.
- c) It could also be the way in which the financial information is to be reported for external use, as well as decision making purposes.
- d) The attempt of the boss to influence the professional's decision.



Q.No.12. Finance and accounting professionals working as employees in an organisation have to face various threats which make it difficult for them to comply with fundamental principles relating to ethics. Explain the safeguards in the work environment which may be created by a business enterprise to overcome such threats. (A) (PM, N 07 - 5M, M 10 - 5M, N 14 - 4M, M16 - 4M)

SAFEGUARDS IN THE WORK ENVIRONMENT: Safeguards against threats faced by professional shall be:

- i) To ensure an ethical environment,
- ii) To increase the likelihood of identifying or deterring unethical behaviour and
- iii) To eliminate or reduce threats to acceptable level.

SAFEGUARDS CREATED BY THE PROFESSION, LEGISLATION OR REGULATION ARE AS FOLLOWS:

- i) Educational, training and experience requirements for entry into the profession.
- ii) Continuing professional development requirements
- iii) Corporate governance regulations
- iv) Professional standards
- v) Professional or regulatory monitoring and disciplinary procedures.
- vi) External review by a legally empowered third party of the reports, returns, communications or information produced by concerned professionals.

THE FOLLOWING SAFEGUARDS MAY BE CREATED BY A BUSINESS ENTERPRISE IN THE WORK ENVIRONMENT:

- i) The employing organisations' systems or corporate oversight or other oversight structures.
- ii) The employing organisation's ethics and conduct programmes.
- iii) Recruitment procedures in the employing organisation emphasizing the importance of employing high calibre competent staff.
- iv) Strong internal controls.
- v) Appropriate disciplinary process.
- vi) Leadership that stresses the importance of ethical behaviour and expectation that employees will act in an ethical manner.
- vii) Policies and procedures to implement and monitor the quality of employee performance.
- viii) Timely communication of the employing organisation's policies and procedures, including any changes to them, to all employees and appropriate training and education on such policies and procedures.

SIMILAR QUESTIONS:

1. What are the various safeguards, which have to be adopted by finance and accounting professional, to counter/overcome threats.
 - A. Refer the Above.
2. The Finance and Accounting Professional has to follow some safeguards to keep himself safe of threats. – Comment.
 - A. Refer the Above.

Q.No.13 Explain briefly the matters to be considered and the steps that may be taken by a Finance and Accounting Professional when he is required to resolve an ethical conflict in the application of Fundamental principles. (B) (PM, M 07- 5M)

1. **CONFLICT RESOLUTION:** A Finance and Accounting Professional may be required to resolve a conflict on the application of fundamental principles of ethics.
2. During a conflict resolution process, following points need to be considered:
 - a) Relevant facts,
 - b) Ethical issues involved,
 - c) Fundamental principles related to the matter in question,
 - d) Established internal proceedings and
 - e) Alternative course of action
3. Having considered these issues, the professional should determine the appropriate course of action that is consistent with the known fundamental principles.
4. The professional should weigh the consequences of each possible course of action.
5. If the matter remains unresolved, the professional should consult other appropriate persons within the firm or employing organization for help in obtaining resolution.
6. During times where a matter involves a conflict with or within an organization, the Finance and Accounting Professional should also consider consulting those charged with governance of the organisation, such as the Board of Directors.
7. It is best for the professional to document the essence and details of, any discussions held or decisions taken, concerning that issue.

8. If a significant conflict cannot be resolved, a professional may also obtain professional advice from the relevant professional body or legal advisors, on ethical issues without breaching confidentiality.
9. If, after adopting all strategies, the ethical conflict still remains unresolved, a professional should try to disassociate from the matter causing the conflict or even from the organization, if necessary.

SIMILAR QUESTIONS:

1. Discuss briefly, 'the ethical conflict resolution', in the context of finance and accounting.
 - A. Refer The Above.
2. Just like any other conflicts, ethical conflicts also could be resolved – discuss.
 - A. Refer The Above.

APPLICATION ORIENTED QUESTIONS

**Q.No.14. Answer whether the statement is correct or incorrect with brief reason:
'Window-dressing of financial statements will not be useful in the long run'. (A)**

Correct:

- In window-dressing, efforts are made to show a 'good balance sheet' by manipulating accounting entries. This can help companies to boost their market image and obtain further capital from the market for some time.
- Window dressing is on the assumption that next year performance will be better and accounts will be regularized next year.
- Window dressing can go on for 2 or 3 years, but not more. It will lead to the downfall of the company in a few years.

**Q.No.15. Answer whether the statement is correct or incorrect with brief reason:
'Ensuring fair treatment to whistle blowers will help in creating good ethical accounting environment in a business enterprise'. (B)**

Correct:

- A whistle blower is an employee/person who reports fraud, mismanagement or unethical practices to the appropriate levels of management.
- Fair treatment and appreciation of whistle blowers is necessary to check fraud. This will help in creating good accounting environment in a business enterprise.

**Q.No.16. State whether the following Statement is Correct or Incorrect:
Small Ethical Lapses do not result into Unethical Behaviour. (C) (N13 – 3M)**

Incorrect: It is known fact that most of the compromises we make in the start are small. However, these lead us to large problems. Therefore, Companies need to Develop where small ethical Lapses are taken seriously so that these are not repeated in future. Toleration of such small lapses could lead to larger problems. Thus, ignoring small Unethical Issues may Result into Unethical Behaviour.

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To **MASTER MINDS**, Guntur

TEST YOUR KNOWLEDGE

1. Mr. Yeswanth is a Qualified Chartered Accountant, working as an Auditor in a well-known Company. He has taken a gift from his client. Then, he is going to face a threat in nearby future. What is the name of the threat? And how can he overcome it?
2. "Long association with clients helps to grow in accounting and financial profession" – as a financial and accounting professional, do you agree? Justify your answer.
3. Acting as an advocate, on behalf of an assurance client, in litigation or disputes with third parties. What is the name of this threat faced by accounting professional?
4. Discovery of a significant error during a re-evaluation of the professional's work. What is the name of this threat?
5. Mr. Y, a Chartered Accountant has long associations with clients, which lead to some amount of threats. How can you name this threat?
6. Mr. Prabhakar, acting as an advocate, on behalf of an assurance client, in litigation or disputes with third parties. Which kind of threat does Prabhakar face in future? Miss. Rajani, a well-known accounting professional is facing a commercial pressure from outside the employing organization. How can you call this threat?

THE END

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