

Ethical Challenges in Accounting: an Indian Case

Receipt: 10 , 2 , 2012 Acceptance: 25 , 4 , 2012

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Abstract

Accountant working in the private or public sector companies must remain impartial and loyal to ethical guidelines when reviewing a company or individuals financial records for reporting purposes. People are expecting a lot from the professional community and the quality of the complex services provided by the accounting profession have confidence. Of The information provided by accountants should significantly efficient, reliable, genuine and disinterested, then not only should be qualified accountants and professional competence are But also enjoys a high degree of honesty and integrity, professionalism and professional reputation is their most important assets. The Moral Accounting for Professional Accountants And those who rely on accounting services is very important. Businesses rely heavily on accounting ethics, whether they're aware of it or not. Unless investors, creditors and managers can be reasonably confident that the financial record keeping practices of their accounting professionals are honest, straightforward and consistent with industry standards, it is unlikely they can trust their records' accuracy. From Enron, and Satyam, it appears that corporate accounting fraud is a major problem that is increasing both in its frequency and severity. Research evidence has shown that growing number of frauds have undermined the integrity of financial reports, contributed to substantial economic losses, and eroded investors' confidence regarding the usefulness and reliability of financial statements.

Keywords: Ethics, Accounting Ethics, Ethical Challenges, Accounting Frauds, case study, India (Satyam). USA (Enron)

1. Introduction

The right way is not always the popular and easy way. Standing for right when it is unpopular is a true test of moral character.'

- **Margaret Chase Smith**, first woman elected to both houses of Congress

When the characters shake people in the community, the community is vulnerable to catastrophic. Viability and survival of a people or a culture depends on the people with moral values simple things like courage, altruism, respect for others and the law. A nation will not survive unless the people who possess the incentives beyond personal profit. Law, respect for human lives and properties, love of family, support of national goals, helping the poor and the payment of taxes, all personal virtues such as bravery, loyalty, honesty, forgiveness, charity, sympathetic, courteous, depend decency and sense of duty. Ethics is a subject that is inclusive of all aspects of human life cover. Growing human populations and more complex social relationships, created new needs. The emergence of various professions, born of an effort to respond to these requirements as conditions change over time and gradually shaped the course of evolution spend . The profession because of the need for division of labor and specialization of tasks are becoming more coherent and play their part in improving the general welfare of society. Survival of the profession and its members depends on the type and quality of employment services that provide credibility and Confidence as a result of providing these services to gain. The main asset of any business is to maintain its credibility and trust are of paramount importance. This task requires that the basic purpose of any profession and its members, community service and personal interests in the context of providing these services to interpret and follow. The business ethics is a high profile matter due to sensational corporate scandals that had occurred in many countries producing extensive compensations to the economy and society. These corporate scandals interrogated the ethics of businessmen in general and accountants in particular. It is

debated that the accountants have been the main contributors to the failure in ethical standards of a business. International Federation of Accountants (IFAC) has in its research report on 'Rebuilding public confidence in financial reporting – an international perspective' (2003) issued a conscious in the aftermath of the collapse of Enron and WorldCom in 2002. The conclusions of this report revealed that financial scandals experienced in the recent times were indications of bottomless problems and identified that enhancement of ethical standards, adequacy of financial management, reporting mechanisms, audit quality and strengthening of governance regimes as means to improve public confidence in financial reporting. The accounting profession has accountability towards these areas, whose deficiencies have led to corporate scandals and collapses. Hence, today, ethical conduct of accounting professionals has become a topical issue.

2. Literature Review

Pacioli (1494) called father of accounting wrote on accounting ethics in his book that, ethical standards have since then been developed through government groups, professional organization, and independent companies. These various group have led accountants to follow several codes of ethics to perform their duties in a professional work environment. In 1905 **AAPA** (American Association Public Accountants) has issued the first ethical codes were formulated to educate its member. And **AICPA** (American Institution Certificate Public Accountants) developed five divisional ethical principles that its members should follow:

- Independence , integrity and objectivity
- Competence and technical standards
- Responsibility to clients
- Responsibility to colleagues
- As well as other responsibilities and practices.

Each of these divisions provided guidelines on how a Certified Public Accountant (CPA) should act as a professional. They have also

issued a strict warning for the CPA's regarding the failure to comply with the guidelines could have caused them to be barred from practicing. When developing the ethical principles, the AICPA have also considered how the profession would be viewed by those outside of the accounting industry.

3. Business and Accounting ethics

Robert H. Montgomery "Accountants and the accountancy profession exist as a means of public service; the distinction which separates a profession from a mere means of livelihood is that the profession is accountable to standards of the public interest, and beyond the compensation paid by clients."

Business ethics are important for managing a sustainable business mainly because of the serious consequences that can result from decisions made with a lack of regard to ethics. Even if you believe that good business ethics don't contribute to profit levels, you should be able to recognize that poor ethics can have a detrimental effect on your bottom line in the long term. Accounting ethics is primarily a field of applied ethics the study of moral values and judgments as they apply to accountancy. The nature of the work carried out by accountants and auditors requires a high level of ethics. Shareholders, potential shareholders, and other users of the financial statements rely heavily on the yearly financial statements of a company as they can use this information to make an informed decision about investment. They rely on **the opinion of** the accountants who prepared the statements, as well as the auditors that verified it, to present a true and fair view of the company. Knowledge of ethics can help accountants and auditors to overcome ethical dilemmas, allowing for the right choice that, although it may not benefit the company, will benefit the public who relies on the accountant/auditor's reporting.

4. Need of ethics for professional accountants:

Now the question is why ethics in accounting and auditing profession has a special

significance? The reasons for this are as follows:

- 1) Professional accountants to the attention of the public interest and maintain the credibility of the accounting profession in charge, the personal interest should not be considered above the public interest.
- 2) Professional accountant considers itself responsible for the Employer. His mission is to solve problems and create value for his Employer.
- 3) In terms of technical, professional accountants should comply with the technical standards of professional service and professional conduct.

5. Principles of accounting ethics

Necessary to achieve the objectives of the accountancy profession by the professional accountants, compliance with fundamental ethical principles of accounting. It aims to provide professional accounting ethics are as follows:

- 1) **Integrity:** professional accountant in performing professional services must be honest.
- 2) **Neutrality:** professional accountant should not allow any prejudice, bias or influence others, his impartiality in professional services, is flawed.
- 3) **Competence and caring Professional:** professional accountant should perform professional services with accuracy, competence and diligence and maintain the knowledge and skill at a level that would ensure.
- 4) **Privacy:** professional accountant should be confidential information acquired in the course of their professional services focus.
- 5) **Conduct professional:** professional accountant should act in a way that is consistent with his professional reputation.

6. The Development of Business Ethics

The study of business ethics has evolved through five distinct stages—(1) before 1960,

(2) the 1960s, (3) the 1970s, (4) the 1980s, and (5) the 1990s—and continues to evolve in the twenty-first century

Table-1: Major Ethical Dilemmas.

1960s	1970s	1980s	1990s	2000s
Environmental Issues	Employee militancy	Bribes and Illegal contracting practices	Sweatshops and unsafe working conditions in Third-world countries	Cyber crime
Civil Rights Issues	Human rights issues	Influence peddling	Rising corporate liability for personal damages (for example, cigarette companies)	Financial misconduct
Increased employee – employer tension	Covering up rather than correcting issues	Deceptive advertising	Financial mismanagement and fraud	Global issues, Chinese product safety
Changing Work Ethic	Disadvantages consumers	Financial fraud (for example, savings and loan scandal)	Organizational ethical misconduct	Sustainability
Rising Drug Use		Transparency issues		Intellectual property theft

Source: Adapted from “Business Ethics Timeline,” Ethics Resource Center, <http://www.ethics.org/resources/business-ethics-timeline.asp> (accessed May 27, 2009). Copyright © 2006, Ethics Resource Center (ERC). Used with permission of the ERC, 1747 Pennsylvania Ave., N.W., Suite 400, Washington, DC 20006, www.ethics.org.

According to this survey that: The global financial crisis took a toll on consumer trust of financial services companies. A study of 650 U.S. consumers by Light speed Research and Cohn & Wolfe revealed that 66 percent of respondents did not feel that the financial services industry would help them to regain the wealth that they lost during the recession. Words used to describe this industry included greedy, impersonal, opportunistic, and distant. Table -2summarizes the results. Largely in response to this crisis, business decisions and activities have come under greater scrutiny by many different constituents, including consumers, employees, investors, government regulators, and special interest groups. Additionally, new legislation and regulations designed to encourage higher ethical standards in business have been put in place.

Table-2: American Distrust of the Financial Services Industry

Negative responses related to the Industries	%
Greedy	32
impersonal	32
Opportunistic	26
Distant from me	22
Positive Responses Related to Industry	%
Trustworthy	13
Honest	10
Ethical	5
Transparent	3
Sympathetic	3

Source: New US Consumer Survey Shows High Distrust of Financial Services Companies,” Business Wire, January 20, 2009, http://findarticles.com/p/articles/mi_m0EIN/is_2009_Jan_20/ai_n31202849/ (accessed May 27, 2009).

To identify that the which response from the above has a significant impact in relation to the positive and negative responses a data from 202 students, teachers and managers were gathered from the Udaipur district of India. The data collected were later-on analyses with the hypotheses. The first hypothesis was related to the positive responses. Following hypothesis was developed:

- H_{0(a)}**= There is no differences in the positive responses related to ethics in India
- H_{1(a)}**= A significant differences exists in the positive responses related to ethics in India

To test the hypotheses responses were gathered with a well draft questionnaire on six points Likert Rating scale corresponds to nine chosen scale item. The one sample t test was used with SPSS-19 software as a statistical tool with statistical significance at 95% confidence level. The results have been shown in table -3 as under:

The output of the ‘one sample t test’ in the table-3, reveals that significant gap exists between the hypothesized test value (Never, Rarely, No Opinion, Sometime, Often, Always) with the calculated sample statistics

for the reported employees misconduct in selected organisations. For variables Greedy, impersonal, Opportunistic and Distant from me the value of $t_{201} = 14.249$, $p = 0.00 < 0.05$, $t_{201} = 22.799$, $p = 0.00 < 0.05$, $t_{201} = 23.475$, $p = 0.00 < 0.05$ and $t_{201} = 20.873$, $p = 0.00 < 0.05$, at 5% level of significance. This revealed the acceptance of alternative hypothesis. Further, the respondents have exhibited a fair amount of agreement and significant positive gap. Hence, it revealed that the responses were in favour that all the above four were the negatively affect the use of ethical practices in accounting.

To identify that the which response from the above has a significant impact in relation to the negative responses a data from 202 students, teachers and managers were gathered from the Udaipur district of India. The data collected were later-on analyses with the second hypotheses which were developed as under:

- H_{0(b)}**= there is no differences in the Negative responses related to ethics in India
- H_{1(b)}**= A significant differences exists in the Negative responses related to ethics in India

Table-3: One-Sample T Test

One-Sample Statistics

	N	Mean	Std. Deviation	Std. Error Mean
Greedy	202	4.40	1.397	.098
impersonal	202	5.17	1.355	.095
Opportunistic	202	5.18	1.319	.093
Distant from me	202	5.04	1.389	.098

One-Sample Test

	Test Value = 3					
	t	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
					Lower	Upper
Greedy	14.249	201	.000	1.401	1.21	1.59
impersonal	22.799	201	.000	2.173	1.99	2.36
Opportunistic	23.475	201	.000	2.178	2.00	2.36
Distant from me	20.873	201	.000	2.040	1.85	2.23

To test the hypotheses responses were gathered with a well draft questionnaire on six points Likert Rating scale corresponds to nine chosen scale item. The one sample t test was

used with SPSS-19 software as a statistical tool with statistical significance at 95% confidence level. The results have been shown in table -4 as under:

Table- 4: One-Sample T Test

	N	Mean	Std. Deviation	Std. Error Mean
Trustworthy	202	4.40	1.397	.098
Honest	202	5.17	1.355	.095
Ethical	202	5.18	1.319	.093
Transparent	202	5.04	1.389	.098
Sympathetic	202	4.72	1.377	.097

One-Sample Test

	Test Value =3					
	t	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
					Lower	Upper
Trustworthy	20.873	201	.000	2.040	1.85	2.23
Honest	17.735	201	.000	1.718	1.53	1.91
Ethical	21.141	201	.000	2.059	1.87	2.25
Transparent	28.778	201	.000	2.475	2.31	2.64
Sympathetic	22.553	201	.000	2.089	1.91	2.27

The output of the 'one sample t test' in the table-4, reveals that significant gap exists between the hypothesized test value (Never, Rarely, No Opinion, Sometime, Often, Always) with the calculated sample statistics for the reported employees misconduct in selected organizations. For variables Trustworthy, Honest, Ethical, Transparent and Sympathetic the value of $t_{201} = 20.873$, $p = 0.00 < 0.05$, $t_{201} = 17.735$, $p = 0.00 < 0.05$, $t_{201} = 21.141$, $p = 0.00 < 0.05$, $t_{201} = 28.778$, $p = 0.00 < 0.05$ and $t_{201} = 22.553$, $p = 0.00 < 0.05$, at 5% level of significance. This revealed the acceptance of alternative hypothesis. Further, the respondents have exhibited a fair amount of agreement and significant positive gap. Hence, it revealed that the responses were in favour that all the above four were the Positive Responses used as ethical practices in accounting.

7. Ethical accounting scandal:

Fraud is a worldwide phenomenon that affects all continents and all sectors of the economy. Fraud encompasses a wide-range of illicit practices and illegal acts involving intentional deception or misrepresentation. According to the Association of Certified Fraud Examiners (ACFE, 2010), fraud is "a deception or misrepresentation that an individual or entity

makes knowing that misrepresentation could result in some unauthorized benefit to the individual or to the entity or some other party.

8. Accounting Scandal at Enron Enron Company Profile

Enron was the largest energy trading company in the world providing products and services relating to Oil & Natural Gas, Electricity and Communication.

Through its subsidiaries and numerous affiliates, the company provided products and services related to natural gas, electricity, and communications for its wholesale and retail customers. Enron transported natural gas through pipelines to customers all over the United States. Chair Ken Lay, chief executive officer (CEO) Jeffrey Skilling, and Chief Financial Officer (CFO).

Technical reasons for Collapse of Enron

The following are the 2 main technical reasons for the collapse of Enron

- **Marked to Market Accounting Method** – This method required estimation of future income when a long term contract is signed. This means that estimated income from projects were

included in Enron's books even though the money was not yet received.

- **Special Purpose Entities**— Enron created many Special purpose entities worldwide to handle assets either by funding of risk management. However these special purpose entities were not only used to dodge the traditional accounting conventions but also so they could underestimate and hide debt and overestimate equity.

Learning's from the Enron case

I do believe Enron will be the morality play of the new economy. It will teach executives and the American public the most important ethics lessons of this decade. Among these lessons are:

- 1) You make money in the new economy in the same ways you make money in the old economy - by providing goods or services that have real value.
- 2) Financial cleverness is no substitute for a good corporate strategy.
- 3) The arrogance of corporate executives who claim they are the best and the brightest, "the most innovative," and who present themselves as superstars should be a "red flag" for investors, directors and the public.

9. Accounting Scandal at Satyam:

Satyam Computer Services Limited was founded in 1987 by Mr. B RamalingaRaju . The company offers consulting and information technology services spanning various sectors, including engineering and product development, supply chain management, client relationship management, business process management and business intelligence. It had also won the Prestigious Golden Peacock Award from Government of India for the best governed company in the year 2007

Technical Reason for collapse of Satyam:

The key reasons for the collapse of Satyam Computers includes Inflated revenues through fake invoicing, fake transaction in bank

accounts and appropriation of money by diverting funds through fake salary accounts in to the personal account of promoters. Diversion of funds to loss making sister companies by promoters – Mr. Raju promoted 2 real estate companies by the name of Maytas Properties and Maytas Infrastructure Ltd. However when these companies made huge losses Mr. Raju proposed to the Board of Satyam to take over these companies at a per share price which was very high as compared to the prevailing market price of their shares.

10. Ethics Breaches:

In the forgoing examples of the accounting scandals at Enron & Satyam the following ethical and moral breaches are glaringly obvious:

- 1) Unlimited Greed
- 2) Complete Disregarding for accountability on the part of top management.
- 3) Only concern was growth and profitability.
- 4) Unlimited risk taking/blind risk taken.
- 5) Irresponsibility & greed on the part of banks who invested in these companies of their oversea subsidiaries.
- 6) Dishonestly in preparing financial statement.
- 7) Falsification of basic facts/figures and key financial data.
- 8) Breach of trust by the Auditors.
- 9) Personal wealth accumulation of the cost of public loss and loss to society.
- 10) Corruption involving government & public servant to benefit corporate by subverting the law.
- 11) Using short cuts as replacement for hard work.

11. CONCLUSION

The hypothesis testing under this paper revealed that Greed, impersonal, Opportunistic and Distant from me putnegatively affect the use of ethical practices in accounting and Trustworthy, Honest, Ethical, Transparent and Sympathetic have the positive responses used as ethical practices in accounting. Further from the study of these two cases that Enron's culture encouraged fierce competition, not only

among employees from rival firms, but also among Enron employees themselves. And such behavior creates a culture where loyalty and ethics are cast aside in exchange for high performance. The arrogant tactics of Jeffrey Skilling and the seeming ignorance of Lay as to what was going on in his company further contributed to an unhealthy corporate culture that encouraged cutting corners and falsifying information to inflate earnings. The allegations surrounding Merrill Lynch and Arthur Andersen involvement in the debacle demonstrate that rarely does any scandal of such magnitude involve only one company. Financial cleverness is no substitute for a good corporate strategy. Government regulations and rules need to be updated for the new economy, not relaxed and eliminated. With the view it is essential for the government to tightening the regulations and ensuring regulatory compliance, so as to studiously avoiding the recurrence of scams like Satyam's. The Indian capital market regulator SEBI should follow two distinct approaches—preventive and palliative. Palliative measures should aim at detecting similar cases by introducing new processes and additional verification methods. These proactive measures would help build investor confidence. Preventive measures are more important as they are likely to be more effective in the long run. The Central Government could introduce a simple and brief Act that makes accounting mis-statements criminal, and impose tough penalty both financial and imprisonment. The financial penalty should be reflecting the size of the fraud. With a view to enforcing the law and to expedite justice, special courts could be created.

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