Business ethics and the accounting profession

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Introduction

Business ethics emerged as a major public concern following a spate of corporate collapses during the 1980s and early 2000s. Corporate collapses such as HIH and Harris Scarfe in Australia; Enron, Worldcom and Global Crossing in the US; and Parmalat in Europe, have questioned the business and accounting practices of these firms and the role played by their accountants and auditors. According to Armstrong et al, (2003, p. 1), “one can hardly pick up a business publication today without noting some reference to an accounting scandal …. The sheer number of accounting abuses serves as prima facie evidence that something more is needed in terms of accounting ethics”.

Poor business ethics in Australia and corporate collapses in the early part of this century were categorised by Gittins (2002) as arising from a ‘new age of materialism,’ underpinned by greed, poor corporate governance and unethical behaviour. In America, research by a leading American social psychologist, David Myers, arrived at similar conclusions. In his book on *The American paradox - spiritual hunger in an age of plenty*, Myers (2000) provided evidence for similar changes in values in the United States. The goal of monetary success, as a measure of materialism, generates strong pressures to succeed, including the motivational dynamic for greed. This type of pressure unwittingly increases the tendency to exploit regulatory controls for monetary gain (Choo and Tan, 2007). In Australia, MacKay (2000) observed that corporate greed is as much about morality and culture as about economics. Furthermore, the Hon. Justice Owen, HIH Royal Commissioner, in his review of the HIH Insurance collapse, lamented the fact that suggested remedies and regulatory changes will not fix a problem that was profoundly a failure of morality~~ (Brearley, 2003)~~. Given the above context, the objective of this paper is to consider the ethical challenges facing the accounting profession and the action it is taking to resolve them.

The latest crisis

Easy access to new-found riches from the dot.com revolution contributed to a culture of commercialism that enticed participants from all sectors of the economy, including investment banks, law firms and accountants. In the new age of materialism as identified by Gittins (2002), the choice was to participate or be left behind. It has been argued by Scott (2002) that auditors, the traditional gatekeepers, became servants to the new players rather than remain as the independent guardians, and the traditional brakes on the system no longer worked. All too often, those whose mandate it was to act as a gatekeeper were tempted by misguided compensation policies within their firms, to forfeit their autonomy and independence (American Assembly at Columbia University, 2003). Under pressure to meet income targets, the culture of accounting firms had increasingly emphasised profit that eventually influenced auditors to accept additional audit risk (Wyatt 2004~~; Zeff 2003~~).

It wasn't that long ago when the accounting profession witnessed the seminal event of the implosion of the then Big 5 accounting firm, Arthur Andersen, resulting in 85,000 of its employees worldwide being dissipated to other firms or losing their jobs. A firm that had taken 90 years to build an enviable reputation founded on 'integrity' had lost it all in 90 days. It has been argued that Arthur Andersen's changed culture accounted for its demise. ~~(Toffler and Reingold, 2003)~~. When the consulting practice surpassed the audit function and became the most profitable division, the generation of revenue took priority. As observed by Toffler and Reingold (2003), Arthur Andersen came down from its lofty perch to wrestle in the mud in search of more fees, more power, more political clout – more everything. Arthur Andersen had embraced the new age of materialism discussed above ~~articulated by Gittins (2002)~~

~~and Myers (2000),~~ and arguably, through its unethical behaviour, lost its objectivity and independence. It eventually imploded, along with its famous clients such as Enron, WorldCom and Global Crossing.

Challenges facing the profession

It is not common for audit failures to be the result of methodological or technical issues; rather, they occur from errors in judgment. Questionable judgments sometimes arise because of the complexity of the problem, or arguably more often where a lack of attention has been given to the ethical and professional values of honesty, integrity, objectivity, due care and the commitment to the public interest (Brooks 2004~~, Jennings, 2004; and Parker, 2005~~). Much of the criticism that has been levelled at the accounting profession has centred on the failure of accounting documents to reveal a more accurate reflection of the financial wellbeing/ill health of organizations; the collusion of accountants in the preparation and validation of those documents; and the failure of the accounting profession to satisfactorily take account of the public interest. At the heart of the criticisms levelled at the accounting profession is the moral base of the profession (Lovell, 1995).

Kohlberg's (1969) theory of cognitive moral reasoning and development examines how judgements are made and why one formulates judgement. Generally, higher levels of moral reasoning are indicative of higher ethical standards. A number of studies have examined and compared the moral judgement levels of various groups, including the accounting profession. Researchers in accounting ethics have discovered positive associations between auditors' level of moral development and the dependency of auditors on management and the ability to resist management pressure (Sweeney and Roberts, 1997~~; Windsor and Ashkanasy, 1995~~), as well as the propensity of internal auditors' to blow the whistle (Arnold and Ponemon, 1991). However, the moral reasoning of accountants differs in a number of ways from both the general population and from other occupational groups. The e~~E~~mpirical evidence indicates that the moral reasoning levels of accounting professionals, as well as accounting students, do not compare favourably with similar occupational groups or the adult population~~ (Gaa 1995)~~. Consequently, accountants' ability to maintain high ethical reasoning standards is arguably diminished.

Ethics education for accountants

Ethics education is considered one solution to the problems identified above. Ethics interventions, which are deliberate educational attempts designed to promote ethical awareness and decision-making, can improve ethical ~~awareness~~sensitivity of accountants when it forms part of their education. The support for ethics interventions, which can take the form of either a discrete and required course in ethics, or ethics subject matter integrated into a required course in accounting, is based on the premise that ethical awareness and decision-making can be enhanced through the educational process (Cooper et al, 2008). However, whilst there has been a general increase in the extent of ethics education in the accounting curricula, many researchers continue to claim that ethics education in accounting is still not covered in a significant way in most institutions of higher learning (Fisher et al, 2007~~, Swanson, 2005~~; Gaa and Thorne, 2004). It has been noted by Gaa and Thorne (2004, p.1) ~~note~~ that "…it is apparent that ethics has not been given the prominence in the classroom that it requires" and they quote a study on the accounting curriculum by PricewaterhouseCoopers (2003), which indicated that ethics is not a consistent and integrated part of the education of most accounting students.

Furthermore, it has been claimed that accounting students often display lower levels of ethical maturity than students in other disciplines (~~Ponemon and Glazer, 1990;~~ McPhail and Gray, 1996). McPhail (2001) suggests that accounting education fosters the dehumanization of accountants by developing professional accountants who lack empathy toward others. Contributing to this problem is the traditional accounting curriculum, which emphasizes technical competencies at the expense of a broad based education. Representing events and people in quantitative terms reduces the moral significance of the decisions based on accounting information. Therefore, according to McPhail (2001), humanising accounting education is critical to developing an attachment or empathy ~~to~~with others, a fundamental aspect of ethical behaviour.

The ~~implications from the~~ findings in the above studies suggest that accounting ethics interventions can have a positive effect on students' ethical sensitivity and reasoning.

McWilliams and Nahavandi (2006) contend that many studies show that ethics education leads to more complex and flexible thinking. By exposing students to ethical concepts and applications, they can be prepared for the challenges they may eventually face in practice. Therefore, courses in ethics can be a powerful means of raising awareness (McDonald and Donleavy, 1995) and promoting moral development and teaching students how to handle complex situations (Williams and Dewett, 2005). Research by Dellaportas (2006) found that a discrete intervention emphasising dilemma discussion has a positive and significant effect on students' moral reasoning and development. The findings suggest that the salient influences on moral judgment development include learning ethics theory, particularly Kohlberg's theory of cognitive moral reasoning and development, peer learning and moral discourse. However, with limited ethics coverage in the business and accounting curriculum, it is unlikely that accounting students and trainees will have sufficient training in ethics and so the accounting professional bodies have a responsibility to reinforce the need for proper ethical behavior.

Action by the profession

In July 2003, the International Federation of Accountants (IFAC)[1] released a research report entitled, *Rebuilding public confidence in financial reporting – an international perspective*. The report identified several key weaknesses in organisations from a review of a number of corporate collapses worldwide. Also in 2003, IFAC issued International Education Standard 4 (IES4) ~~4~~ *Professional Values, Ethics and Attitudes*. The aim of IES 4 (2003, para 2) is to "ensure that candidates for membership of an IFAC member body are equipped with the appropriate professional values, ethics and attitudes to function as professional accountants."

Following the release of IES 4, IFAC turned its attention to ethics and commissioned in 2004 a global research project on approaches to the development and maintenance of professional values and ethics in accounting education programs

[1] IFAC is the global organisation for the accountancy profession. It works with its 163 member organisations in 120 countries to protect the public interest by encouraging high quality practices by the world's accountants. IFAC members represent 2.5 million accountants employed in public practice, industry and commerce, government, and academe. http://www.ifac.org/About/

(IFAC, 2006). From this research, conflicts of interests, including self-interest threats, were perceived by professional bodies to be the most likely occurring ethical issues faced by accountants in all sectors including public accounting practice, business entities, government and not-for-profit organisations. The findings indicate that key ethical risks include self-interest; failure to maintain objectivity and independence; improper leadership and poor organisational culture; lack of ethical courage to do what is right; lack of ethical sensitivity; and failure to exercise proper professional judgement.

In 2005, IFAC issued the *Code of Ethics for Professional Accountants.* This code adopts a conceptual framework for applying the fundamental principles of professional conduct, which include integrity, objectivity, professional competence, confidentiality and professional behaviour. Unlike traditional codes that provide a menu list of principles, this Code has been further developed by establishing a conceptual framework for the application of the principles of professional conduct. The conceptual approach is a self-assessing test of threats and application of safeguards. Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances. Such threats must first be identified, so that any offsetting safeguards can be applied to eliminate or mitigate such threats to an acceptable level. These categories of threats include self-interest, self-review, advocacy, familiarity and intimidation. When such threats cannot be eliminated or reduced to an acceptable level, the accountant should decline or resign from the service or client. The Code separately addresses the issues facing accountants in business and accountants in public practice.

In conclusion

Responses to unethical behaviour at the regulatory, professional and industry levels have been well-documented. However, according to Smith (2003, p. 47), new laws "will not restore confidence in capital markets ……….confidence will only be restored by ethical leadership from the accounting profession, business community, and government". Puxty et al. (1994) claim that professional accountants are induced to act ethically through two aspects of their socialisation, namely, the education process and the influence of work experience and role models who show what it means to be ethical.

Students learn principles of good conduct in their education and then receive advice and observe how significant others behave in the workplace. A professional accountant exposed to ethics training is more likely to embrace moral behaviour when working in an ethical climate. Conversely, in an unethical environment, accountants may sometimes be reluctant or unable to use their ethics training for fear of jeopardising one's career and maintaining loyalty to company traditions (Appelbaum et al., 2005). McDonald and Donleavy (1995) claim that the difficulties experienced in the transfer of ethical training to the business environment should not signal the demise of ethics education, but is an indication that ethics education should pay more attention to the mechanisms by which the transfer becomes effective. In conclusion, moral education should be a life time commitment that begins with formal tertiary education and is reinforced throughout an accountant's career, through continuing professional development in the workplace.

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