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Ethics in Accounting

Learning objectives :

After studying this chapter, you will be able to know about the following:

- Concept of ethics
- Definition of ethics
- Nature of ethics
- Sources of ethics
- Ethics and professional accountant
- Ethics in accounting transactions
- Window dressing

Introduction :

Ethics is not a new discovery. For centuries, philosophers have been trying to identify its various aspects in the process of understanding human behaviour. The English term 'ethics' is considered to have been derived from the Greek term 'ethos' which means 'way of living'. The subject of ethics or Neeti Shastra is a branch of philosophy, which is related to social behaviour of persons. This examines the logical justification of our behavioural decisions. This tells us what is ethically right or wrong, what is just or unjust, what is suitable or unsuitable.

Definitions :

Various definitions of ethics have been given, some of them are as follows:-

According to **R. Wayne Mondy** – "Ethics is subject, which is related with the good or bad, or right or wrong regarding ethical duties".

According to **Paul and Elder** – "Ethics is a group of concepts and principles, which tells us which behaviour will help or harm living beings.

According to **Cambridge Dictionary of Philosophy** – "The meaning of ethics is usually considered to be the ethical principles of some special tradition, group or persons."

According to **Websters New Words Dictionary** – "Ethics is subject of standards of behaviour or ethical decisions. This is a code or system for a special objective, religion, group or profession.

In conclusion, it can be said that ethics is set of such rules or principles in which mutual relations of all persons for interest of all of them are included in such a manner that respect for needs of everyone is maintained.

Nature :

The nature of ethics can be understood in the following manner:-

1. Ethics is related with human beings only. Both persons and society are included in it. This is because a person only can distinguish between good or bad and select better on ethical basis.
2. This is a branch of systematic knowledge, which is related with social science. This is a regulatory system of value

based decisions, and personal and social behaviour.

3. This is related with voluntary conduct and behaviour of human being. Conduct in ignorance or under pressure of circumstances are its exceptions. For example, killing of enemy by a soldier while safe-guarding frontiers of the nation cannot be considered as violation of policy of non-violence.
4. This includes universally acceptable rules of human conduct and behaviour. For example, telling truth, non-violence, piouness, humility, sympathy, non-hoarding, not being jealous etc.
5. The principles of ethics are not bound by the limits of time and place. These are valid always and at all places. No religion, nation or society will ever say that truth and non-violence are bad and redundant. Ethics are fundamental elements of human values therefore, these are also called Sanatan or perpetual religion.
6. For any decision to be ethical, it should contain the following features:-
 - i. Best for all related ones
 - ii. Honest
 - iii. Suitable and acceptable
 - iv. Justice must not only be resulting but should also appear to be resulting
 - v. Ethically correct
 - vi. Just and uniform

Sources of Ethics :

Two American experts in ethics George and John Stever have suggested the following sources of ethics:-

1. **Legal system** : Law in vogue in any country broadly represents the ethical standards of that country. Thus, the education of ethical side of life is obtained through law.
2. **Religion** : All religions contain teachings of ethical behaviour for persons. These teachings are important and effective sources of ethical behaviour.
3. **Hereditary Legacy** : Zoologists in their recent researches have found such evidences which indicate that the virtues of goodness related with ethical behaviour of a person may be his hereditary legacy.
4. **Philosophical Systems** : Scholars have evolved many philosophical systems regarding life and duties since ancient times. These systems outline various aspects of ethical behaviour.
5. **Code of conduct** : This may be divided in three primary groups:-
 - i. **Code of conduct of company:-** This normally portrays brief, highly generalized and major expectations about normal behaviour.
 - ii. **Operational policies of company:-** This includes complaint redressal of customers, policies about appointments, offering gifts etc. Which protect against unethical transactions.
 - iii. **Professional codes of conduct:-** Professional institutions such as Institute of Chartered Accountants of India have defined codes of conduct for their members, which accomplish important task of ensuring ethical behaviour of their members.
6. **Cultural experiences** : There are several such cultural rules, traditions and standards, which regulate the conduct and behaviour generation - after - generation. These social rules play a major role in giving proper shape to personal values.

Ethics and professional accountants :

Accounting provides financial information. Various stakeholders in business such as shareholders, loan providers, customers, employees, government etc. Come to know about the true financial position of business through accounting only. This helps all of them in decision making. Besides providing financial information, accounting plays an important role in providing safety of assets of the business. When assets are valued at correct price in accounts, their theft or other misuse is not possible.

For this reason, the pen of an accountant is said to be very powerful. This is necessary that accountants

appreciate their capacity and responsibility and behave ethically while preparing accounts. In fact this is due to complete ethical adaptation in accounting that the profit of business is justifiably distributed among various stakeholders and economic security of business is ensured. Many such examples have appeared in India and abroad which showed that because of non adoption of ethics in accounting, large business organisations got demolished and various stakeholders had to face economic injustice.

The most precious asset of an accountant is his honest image. Professional accountant has an important role to play in the society. Investors, employees, loan providers, government and public at large depend on professional accountant in many ways. They provide financial report of high quality, effective financial management, and effective advice regarding matters related with business and taxation. The conduct and behaviour of professional accountants in providing such services affect economic well-being of the nation. Professional accountants world wide are expected to provide their best services to the society, which are absolutely in compliance with the ethical needs. Various institutions of professional accountants such as the American Institute of Certified Public Accountants, the Indian Institute of Chartered Accountants of India etc. have issued codes of conduct for their members, so that high ethical behaviour of the members may be ensured.

While doing accounting, it should be ensured that all entries are according to rules and these are based on vouchers. A procedure should be adopted so that the possibility of making entries in a fraudulent manner and manipulating the same is ruled out. This can be understood with respect to various transactions as follows:-

a. Regarding cash receipts :

- i. All the vouchers related with cash receipts should bear serial number and these should be arranged in order.
- ii. All vouchers bear the signature of authorities.
- iii. All accounting entries must have reference of serial number of voucher.
- iv. All cash receipts should be related to business.
- v. Bank receipts should be recorded on the basis of counter foils of pay-in-slip or any other voucher.

b. Regarding cash payments :

- i. Every payment should be recorded based on the printed receipt issued by the receiver. This should also be authenticated by the signatures of officer of the organisation.
- ii. Payment should be related to business.

c. Regarding goods :

- i. The accountant should ensure genuineness of invoice while entering purchase of goods. This should be seen that the invoice bears name of seller, date and amount and the same should have been issued in the name of the business.
- ii. Regarding purchase return of goods, accountant should ensure appropriateness of debit note sent by the supplier. Such a note should bear the name of the supplier, date, particulars of the goods returned and amount in a clear manner and should also bear signature of authorizing person.
- iii. Goods sold are recorded on the basis of sales invoice. Such invoices should bear name and address of customer, date, particulars of goods, rate of trade discount and amount in a clear manner and should bear the signatures of authorizing person.
- iv. While entering sales returns into accounts, the credit note sent by the organisation to the customer returning goods is based upon. This credit note should bear name of customer, date, particulars of goods returned and amount in clear manner, signatures of authorised person. This has been found that the unethical accountants used to enter goods related transactions without any proper basis. Generally the objective of such treatment is to exaggerate the figure of sales.

d. Regarding other assets and liabilities :

- i. While making accounting entries for other assets such as plant, machinery, buildings etc., the accountant

should have vouchers in support, which are properly authenticated by signatures of authorized officer. These vouchers should show that

1. The ownership of asset is with the organisation, and
 2. The asset actually exists.
- ii. While entering various liabilities such as loans received from persons or organisations, the accountant should have sufficient proof in the form of voucher, which should show that
1. The liability is related with business, and
 2. The same is authenticated properly.

Window dressing :

In order to show the financial position better than the actual one, the accountants often resort to window dressing of transactions. Normally, this practice is adopted at the end of the financial year. Some examples of the same are as follows:

- ❑ In order to motivate the debtors to make complete payment before the end of the accounting year, an offer of discount is made. This motivates debtors to make early payment and due to rise in cash balance, liquidity position of the business appears to become better than the actual one.
- ❑ Making alteration in the valuation method of stock for the purpose that its value gets inflated and profits consequently are also inflated.
- ❑ Altering the method of depreciation on asset so that depreciation is understated, income of the asset is increased and thereby the profits are overstated.

The objective of such transactions is to alter the actual position of accounts. Therefore, this is not ethical. This hampers providing correct information to stakeholder through the accounts of the business.

Questions for Exercise

Very short answer type questions :

1. What is ethics?
2. How was the term ethics evolved?
3. With what is ethics related?
4. Who discovered ethics being hereditary?

Short answer type questions :

1. What characteristics should a decision contain in order to be ethically correct?
2. How many types of codes of conduct are normally there?
3. How is professional accountants are related with ethics?
4. What points should be considered while making accounting for goods in an ethical manner?
5. Write a note on window dressing?

Essay type questions :

1. Define ethics and explain its concepts.
2. Throw light on the nature of ethics?
3. Explain various sources of ethics?
4. How the accounting of cash receipts and cash payment can be done on ethical basis?

