

## Question 1

*Answer whether the statement is correct or incorrect with brief reason:*

*'Window-dressing of financial statements will not be useful in the long run'.*

## Answer

**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 regularised 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.

## Question 2

*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'.*

## Answer

**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.

## Question 3

*State, how far a sound ethical environment in a company may be created and corporate scandals may be avoided.*

## Answer

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

**(i) Ensuring that employees are aware of their legal and ethical responsibilities.**

Some ethical organisations are having policies to train and motivate employees towards ethical behaviour. To start with, such initiation should be from the top. A number of companies in India

and abroad are being known for their quality and soundness of their ethics programmes. Companies like Raytheon, Texas Instruments, Wipro are pioneers in establishing ethical environment among the employees enabling them to take ethical decisions.

- (ii) **Providing a communication system between the management and employees so that anyone in the company can report fraud and mismanagement with out the fear of being reprimanded.**

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.

- (iii) **Ensuring fair treatment to those who act as whistle blowers :**

This is perhaps the most important and sensitive issue. Fair treatment to whistle blowers is a basic necessity to check fraud. Some acts must be appreciated and that appreciation should be extended from within the company rather than outside.

#### **Question 4**

*Explain the reasons for unethical behaviour among finance and accounting professionals.*

#### **Answer**

The reasons which lead to unethical behaviour are as follows:

- (i) **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.

- (ii) **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.

- (iii) **Economic cycles.**

In good times, companies are relaxed in their accounting procedures or disclosures, as there is a pervasive feel-good effect. But when times of hardship follow, then the hit taken by them is almost fatal, as was proved in the Enron case. So companies need to watch out for economic cycles and be vigilant in good times as well as bad.

- (iv) **Accounting rules.**

In the era of globalization and massive cross border flow of capital, 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 which may promote unethical behaviour.

**Question 5**

*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-*

- (i) *An auditor or consultant*
- (ii) *An employee in a company.*

**Answer****Self Interest Threats: Auditors: Employees:**

- (i) Self interest threats for finance and accounting professionals working as consultants or auditors are given below:
  - (a) A financial interest in a client or jointly holding a financial interest with a client.
  - (b) Undue dependence on total fees from a client,
  - (c) Having a close business relationship with a client.
  - (d) Concern about the possibility of losing a client,
  - (e) Potential employment with a client.
  - (f) Contingent fees relating to an assurance engagement.
- (ii) Self interest threats for finance and accounting professionals working as an employee are given below:
  - (a) Financial interests, loans and guarantees in the company in which the professional is working.
  - (b) Incentive compensation arrangements.
  - (c) Inappropriate personal use of corporate assets.
  - (d) Concern over employment security.
  - (e) Commercial pressure from outside the employing organization.

**Question 6**

*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.*

**Answer**

**Safeguards in the work environment:** Safeguards against threats faced by professional shall be to (i) Ensure an ethical environment, (ii) Increase the likelihood of identifying or deterring unethical behaviour and (iii) Eliminate or reduce threats to acceptable level.

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 caliber 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.

#### **Question 7**

*What are the fundamental principles of ethics applicable to the persons of finance and accounting profession?*

#### **Answer**

##### **Principles of Ethics**

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

- (i) The principle of integrity: Integrity means veracity. The principle requires all accounting and finance personnel to be honest and straight-forward in discharging their respective professional duties.
- (ii) The principle of objectivity: The principle requires accounting and financial professionals to stick to their professional and financial judgement without bias, conflicting interests, or under influence of others.
- (iii) The principle of confidentiality: The principle requires accounting and financial professionals to refrain from disclosing confidential information related to their work.
- (iv) The principle of professional competence and due care: The financial and accounting professional need to update their professional skill in the modern competitive environment.
- (v) The principle of professional behavior: The principle requires accounting and financial professional to comply with relevant laws and regulations and avoid such action which may result into discrediting the profession.

**Question 8**

*State the pressures which are faced by the finance and accounting professionals' in an organization in the compliance of fundamental principles of ethics.*

**Answer**

**Pressures faced by finance and accounting professionals:** The finance and accounting professionals are supposed to support the legitimate and ethical objectives established by the employer. As they are having responsibilities to an employing organization, may be under pressure to act or behave in ways that could directly or indirectly threaten compliance with the fundamental principles. 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 a professional standards.
- (c) To facilitate unethical or illegal earnings management strategies.
- (d) Lie to, or otherwise intentionally mislead other, 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.

**Question 9**

*Describe the safeguards which may be created by finance and accounting profession and legislation to eliminate or reduce the threats to an acceptable level to ensure an ethical environment in an organization.*

**Answer**

**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.

**Question 10**

*Which threats are existing in environment which adversely affect the fundamental principles of ethics?*

OR

*Explain the 'threats faced by an accounting and finance professional adhering to ethical principles' at the time of performing his professional duties.*

**Answer**

The dynamic environment in which businesses operate today may usher a broad range of circumstances because of which compliance with the fundamental principles may potentially be threatened. Such threats may be classified as follows :-

- (i) Self-interest threats, which may occur as a result of the financial or other interests of a finance and accounting professional or of an immediate or close family member:
- (ii) Self-review threats, which may occur when a previous judgement needs to be reevaluated by the finance and accounting professional responsible for that judgement:
- (iii) Advocacy threats occur when a professional promotes a position or opinion to the point that subsequent objectivity may be compromised :
- (iv) Familiarity threats occur when finance and accounting professional has close relationship in the work environment and such relationship impair his selfless attitude towards work.
- (v) Intimidation threats occur when a professional may be prohibited from acting objectively by threats, actual or perceived.

**Question 11**

*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.*

**Answer**

**Conflict Resolution:** While evaluating compliance with the fundamental principles, a finance and accounting professional may be required to resolve a conflict on the application of fundamental principles. The following need to be considered, either individually or together with others, during a conflict resolution process:

- (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

Having considered these issues, the professional should determine the appropriate course of action that is consistent with the fundamental principles identified. The professional should weigh the consequences of each possible course of action. If the matter remains unresolved, the professional should consult other appropriate persons within the firm or employing organization for help in obtaining resolution. 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.

It may be in the best interests of the professional to document the substance of the issues and details of any discussions held or decisions taken, concerning that issue.

If a significant conflict cannot be resolved, a professional may also obtain professional advice from the relevant professional body or legal advisors and thereby obtain guidance on ethical issues without breaching confidentiality.

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 need be.

### Question 12

*Explain the importance of 'Ethics' for finance and accounting professionals.*

### Answer

Finance and Accounts is perhaps the only business function which accepts responsibility to act in public interest. Hence, a finance and accounting professional's responsibility is not restricted to satisfy the needs of any particular individual or organization. While acting in public interest, it becomes imperative that the finance and accounting professional adheres to certain basic ethics in order to achieve his objectives.

Until recently, various surveys conducted globally had ranked finance and accounting professionals very high in terms of professional ethics. However, various accounting scandals witnessed during the past few years have put a serious question mark on the role of the finance and accounting professional in providing the right information for decision making both within and outside their respective organizations. As these finance and accounting professionals are in public practice, they should take reasonable steps to identify circumstances that could pose the conflict of interest and thus leading to follow unethical behavior.

## Exercise

1. *State the fundamental principles relating to ethics for behaving in an ethical manner.*

[Hints: The principle of Integrity, the principle of objectivity, the principle of confidentiality, the principle of professional competence and due care, and the principle of professional behavior]

2. *Explain the importance of ethics for a finance and accounting professional.*

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