

THE ROLE OF PROFESSIONAL ETHICS IN ACCOUNTING AND AUDIT

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ABSTRACT

Ethics is a comprehensive issue covering all aspects of life. Accounting includes accounting services and is one of the jobs based on discipline in the world. This profession is associated with one of the issues of people in the society, property and assets of people. Ethical principles or ethics are defined in a set of spiritual values and principles. All of us have such set of values although we don't know anything about them. If accountants and auditors working in business environment are not dependent upon professional ethics, it has harmful effect for those trusting them. Thus, accounting professional ethics is of great importance for accountants and professional auditors and those involved in auditing and accounting. The present study showed that professional ethics is a necessity for accounting job (accounting and audit). It seems accounting ethics like any accounting product needs accounting and audit. The role and duty of professional accountants to society, capital holders and other people required that they observe all general principles of good morality in all aspects and resort to the professional behavior regulation to achieve acceptance, credit and social respect as the requirement of activity in each specialized job.

Keywords: *Ethics, Professional Ethics, Accounting, Accounting Profession, Audit*

1. INTRODUCTION

Accounting is a valuable knowledge and main factor of market economy. No economic activity is possible without relying on accounting. Accounting refers to the presentation of information regarding financial situation and operation profitability. This knowledge is the basis of financial and monetary systems of the countries and plays an important role in "supervision" to create the responsiveness and clarification in economy. The high amount of fraud in which accountants and auditors, managers or executive authorities are involved, lead to some ambiguities about honesty and trust of professional accountants. The main issues in accounting profession is the exclusive advantage of legal audit that official auditors have it and also the responsiveness as the requirement of this exclusive advantage is also important. Via its superior features, the profession as autonomy, integrity and keeping public benefits protect the exclusive benefit. The relationship between these features and professional behavior is the main factors of most of the criticisms on the job during the past 30 years. In 20th century, accounting job is dependent upon ethical issues and ethics but this claim is doubted from the regulation makers, law makers, investors and stockholders (Pourianasab, 2000). The study was conducted for the following purposes:

- 1- The study of the initial concepts of ethics
- 2- The study of the necessity of observing ethical issues in accounting and audit profession

2. Definitions

2-1 What is ethics?

Ethics is a branch of philosophy considering value based on human behavior to truth or falseness of the acts or good or evil outcomes of these acts. In a broader definition, ethics is a set of ethical values. Each of us are with a set of values and consider them appropriately and sometimes we ignore them. Philosophers, religious institutions and other groups defined ideal ethical values by various methods. Some examples of ethical values determined at executional level are including rules, religious teaching, ethical principles law in commerce for professional, industrial groups and professional ethics regulations

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in organizations. In other words, ethics is a set of ethical criteria to investigate the truth or falseness of an issue (Asif, 2010).

2-2 Professional ethics

The formation of profession in economy is arising from labor division in social life and specialization of affairs in human communities. The passage of time, increasing development of knowledge and technology, complexity of social relations led into the professions development. The employed people play important role in improvement of public welfare of society and fulfilling the responsibility. The quality of presenting the services and created trust continued the life of jobs and employment of its members in history. In other words, society acceptance is the main capital and continuance of each profession. The continuance of work and keeping this capital are of great importance. Social acceptance and achieving society satisfaction are possible when presenting services is of exact principles. The system of each job is a combination of professional rules. The behavioral and ethical regulations of each job are the most important policies and some items as defining the main concepts of job, the relations of members with society and members with each other are considered. Professional ethics is the knowledge defining the appropriate behavior in each job and present practical guidance to determine the responsibilities (HosseiniKahnuj, 2013). Most of the recognized jobs formulate applied standards and principles for their professional ethics. The main goal of formulating behavioral standards is that ethical responsibilities are defined to the society, others and society. The medical jobs, engineering, lawyers, accounting, auditing and journalism besides common features have formulated professional ethics due to the social importance.

The common features in the mentioned jobs are including:

- 1- Defining the qualification to enter the job
- 2- Complexity of technology and professional knowledge
- 3- Responsibility in presenting the services to society
- 4- The need to achieve acceptability and society trust

Ethical principles in these jobs are behavioral norms. In social behaviors, what we should do and we shouldn't do is the duty of ethics (Duska et al., 2006). The main issue of professional rules is the norms. These norms are issued based on the accepted values and are described by some terms as good, bad, false and true.

Max Weber divided ethics into three sections:

- 1- Ethics in family and private life
- 2- Ethics in economic life
- 3- Ethics in politics and social relations

Thus, professional ethics in accounting and audit is the subset of business ethics and business ethics is the subset of morality in economic life (Bayat, 2008).

2-3 Accounting and audit profession

Accounting and audit due to effective role in business are considered by various communities from the past. This profession dates back to the early human being civilization. Indeed, when trading was started, recording the transactions and reporting was taken into attention. In ancient civilizations, tax and assets of government were maintained. In 3600 years before and in ancient civilization of Sumerians, there was a comprehensive financial system indicating the amount of grains, livestock and the estates of government. In ancient civilizations of Lidi, Iran and Egypt, the incomes and expenditures of government were kept carefully. In the 13, 14 century and with the growth of industry, trading and banking, considerable progress was made in holding the accounts. Finally, in 1800, balance sheet and profit and loss statement was common. After the industrial revolution, the manufacturing operation of capital markets was wide.

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By separating the ownership of the enterprises from the management and establishment of partnership companies, accounting was of great importance. In Iran and trading law approved in Ordibehesht 1932 regarding the duties of companies' inspector, some rules were made and for the first time expert accountants association in Iran in 1985 formulated the discipline regulation and professional behavior (Shalile, 2004).

2-4 Ethics in accounting and auditing

The scandals of financial fraud and collapse of some great companies as Enron and Worldcom and Parmalat showed that observing the technical regulations are not adequate in professional responsibilities. Professional accountants besides observing the technical regulations should be committed to professional ethics. Enron is one of the active companies in energy and went bankruptcy due to fraud, false account, selling projects at loss to bureaucratic companies and registering false claims in financial statements and 90 billion dollars was the loss of the stockholders of this company. Audit institution of Arthur Anderson by giving up to the requirements of Enron Company and ignoring audit evidences and false perception of "important deviation" had adverse effect on audit position of investors. Another Shocking news was on June 2002 in US capital market. Worldcom Company went bankruptcy and its founder was imprisoned for 85 years for fraud. Worldcom company was established in 1983 called LDDS and was developed by "borrow, develop" policy by purchasing and integrating smaller companies was turned in to the second far distance telecommunication company with 80,000 employees and 20 million users all over the world. After development of activity field of the company, it was found that there is no demand as the created capacity. Today, about 90% of total 39 million miles optical fibers in US are not used and are as dark fiber. The managers of the company during 2001 and 2002 and to avoid the stock fall, made some false accounts and hid the loss. But financial scandals were not effective in saving the company and the company with the value of each share more than 60% went bankruptcy and it was at loss of 180 billion dollars. Financial fraud of 18 billion \$ of Parmalat is another ethical issue in recent years. In the late 2003 and by achieving the maturity of paying 180 million \$ for buying from small stockholders in Brazil, the financial authorities of Parmalat couldn't fulfill their obligations. The financial offices of a branch of Parmalat showed 5 billion \$. The problem was changed by losing the invoice of the accounts and financial fraud was revealed when the auditors stated that it has not 5 billion dollars in US bank despite its claims. It was found that the documents on the bank sheet regarding the existence of 5 billion dollars were not valuable and the bank signature was forged. By this scandal, Delloitte& touch audit institution in a statement defined that Parmalat company management deceived the institution regularly and Parmalat founder with his assistants were charged with accounts manipulation. It seemed Parmalat managers manipulated the accounts to present a profitable image of company performance and to keep the value of its stock but later studies showed that some of them embezzled great amount of money. Parmalat company as it started by a local shop in Parmay of Italy and turned into a company with 36 thousands employees in 29 countries in the world stated bankruptcy by financial scandal (Bayat, 2009).

2-5 The reasons of ethics in accounting

2-5-1 Fraud: Fraud is purposeful act of one or some managers, employees or third party being done with the aim of

false financial statements and includes the followings:

2-5-1-1 Manipulation, forgery or changing the documents

2-5-1-2 Registering the transactions with positive documents

2-5-1-3 Registering the incomplete or ambiguous offices

2-5-1-4 False presentation of financial effects of transactions or eliminating them of documents

2-5-1-5 The lack of observing financial and tax rules

2-5-2 Misusing the assets

2-5-3 Ignoring internal controls for misuse

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- 2-5-4 Obliging the subordinates for false registering of transactions
- 2-5-5 Collaboration with auditor for the lack of financial disclosure scandal
- 2-5-6 False application of accounting procedures
- 2-5-7 Not giving information of trading or presenting false information to auditor and related organizations
- 2-5-8 Disclosure of confidential information of employee to the competitors
- 2-5-9 Not providing adequate reserve to reduce invoice value and non-registered costs
- 2-5-10 The lack of presentation of information or giving false information to capital market to affect stock price

The followings are considered in audit field

- 1- Not observing professional qualification
 - 2- Auditor giving up to abnormal pressures inside or outside organization
 - 3- The participation of auditor in activities in contradiction to the profession rules
 - 4- Financial dependency or employment on employer or required economic unit
 - 5- Purposeful selection of the sample as it doesn't indicate the population
 - 6- Purposeful mistake in generalized the discovered mistakes (of sample to total population)
 - 7- False conclusion to hide important mistake or distortion
 - 8- Statement of auditor before evidences discovery (before internal control test and content test) and prejudice
 - 9- The non-disclosure of the transactions with affiliated people (faculty members and managing director)
 - 10- Non-disclosure of the events between balance sheet date and audit report
- The auditor should design some methods to estimate risk to be sure of discovering the false presentation or fraud or mistakes.

2-6 Ethical guidance in accounting and audit

The professional ethical guidance includes two parts of fundamental and rules. Principles define professional responsibility to society, employer and members. Rules show practical use of principles (committee on formulating audit guidance, 1997). The major principles in professional ethics of accounting and auditing are including:

- 2-6-1 Considering the beneficiary benefits: Professional accountant should consider the benefits of all beneficiaries including society, employer, creditor and employees.
- 2-6-2 Responsibility: Deep understanding of professional, ethical and legal responsibilities is the necessities of works in this profession.
- 2-6-3 Doing work truly: Resorting of professional accountant to general ethical principles
- 2-6-4 Impartiality in judgment: The professional accountant should have a judgment without benefits contradict and others influence and don't prejudice.
- 2-6-5 Autonomy: The ability of professional accountant to keep impartiality and the independent auditor shouldn't have direct benefits or important indirect benefits in the unit.
- 2-6-6 Confidentiality: The information of employer should be confidential. The auditor is not obliged to disclose the employer confidential information without his permission and the disclosure is only in legal courts.
- 2-6-7 Observing the type of service: This principle shows that the limitations of services are observed and the work is compatible with the professional role.
- 2-6-8 professional qualification: The professional accountant should have adequate information of techniques in professional work and should have required skills and experiences.
- 2-6-9 Observing the technical regulations: Observing the accepted accounting and auditing standards is obligatory. The professional accountant should consider professional care in the work as observing law,

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report form, timely report, and accuracy in figures, work appropriate method, quality standards and other accepted standards.

2-6-10 Professional behavior observation: Observing the position of professional accountant is necessary. The accountant should behave as making the job creditability problematic (Ali Madad, 2004).

2-7 Fundamental principles of ethics

The instruction of international federation of accountants regarding ethics for professional accountants presented 5 fundamental principles as:

2-7-1 *Integrity*—A professional accountant should be straightforward and honest in all professional and business relationships.

2-7-2 *Objectivity*—A professional accountant should not allow bias, conflict of interest or undue influence of others to override professional or business judgments.

2-7-3 *Professional Competence and Due Care*—A professional accountant has a continuing duty to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques. A professional accountant should act diligently and in accordance with applicable technical and professional standards when providing professional services.

2-7-4 *Confidentiality*—A professional accountant should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties without proper authority unless there is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of the professional accountant or third parties.

2-7-5 *Professional Behavior*—A professional accountant should comply with relevant laws and regulations and should avoid any action that discredits the profession (Moheb and Moradi, 2012)

2-8 Rules

Rules are divided into three sections:

2-8-1 The rules executed for professional accountants are including:

2-8-1-1 *Integrity and impartiality*: It is avoiding benefits contrast and avoiding the relations being influenced by others involvement, assurance of the resorting of the co-workers to the impartiality and avoiding to receive gifts and etc.

2-8-1-2 *Confidentiality*: A professional account should be confidential about the employer information and only in case of the following conditions can disclose information: Agreement of employer, legal obligation, observing professional principles, keeping professional benefits in legal claims and qualitative investigations by profession formation

2-8-1-3 *Tax services execution*: It is including maintaining documents and tax reports, awareness of the employer of final responsibility, awareness of the employer of probable problems of tax statement and etc.

2-8-1-4 *advertisement*: Regarding advertisement, the following rules should be considered:

Adaptability of tools with profession positive in expressing the academic history and experience and don't express negative items about the other professional accountants.

2-8-2 The rules executed about independent professional accountants: It is including legal and real entities doing the professional services, partners and owners of professional institutions and all professional managers and employees working in each part as:

2-8-2-1 *Autonomy*: It means that interest of the professional accountant has no effect on his work.

2-8-2-2 *Professional qualification*: An independent professional accountant should avoid accepting professional services without any qualification.

2-8-2-3 *Observing the fee regulations of independent professional accountant*: The received fee should be consistent with the followings:

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Required skill and knowledge, education level, responsibility and time (technical committee, regulations of accounting and auditing, 1998).

2-8-2-4 Activities inconsistent with accounting job: An independent professional accountant should avoid accepting and doing inconsistent activities with job

2-8-2-5 replacing an independent professional accountant: The independent professional accountant should investigate the professional reason of replacing in accepting the new work. The minority owners rights should be considered in changing professional accountant and the previous professional accountant rights should be maintained.

2-8-2-6 Advertisement: The presented information should be complete, appropriate and realistic and avoid measurements not consistent with the above principle as creating unrealistic expectations, pretending to have influence on official authorities and institutions, self-praise, unjustified claims and etc. Information is allowable in the following items:

Changes and appointing (membership in professional associations), books publishing, articles, interview, speech, educational pamphlets, employees' employment, inserting the name of independent professional accountant in the documents published by employer and etc.

2-8-3 The rules executed about professional accountants being employed:

2-8-3-1 Observing law

2-8-3-2 Observing professional regulations

2-8-3-3 Avoiding presentation of misleading information

2-8-3-4 Don't permit his name is mentioned in the documents that are false

2-8-3-5 The professional opinion differences should be resolved in organization.

2-8-3-6 Resigning if necessary

2-8-3-7 Supporting the professional co-workers

2-8-3-8 Professional qualification

2-8-3-9 Presenting information based on correct regulations and standards

2-9 The need of professional accountants to ethics

The question is raised why ethics is of great importance in accounting and audit? There are some reasons as followings:

1. Professional accountants are responsible to public benefits and credit of accounting profession and personal benefits shouldn't be better than best public benefits.
2. Accountants for the behalf of their employers are faced with some issues and they have access to confidential information
3. and auditors claim the present independent opinion.
4. Professional accountant considers himself responsible to the employer. His mission is solving the employer problem and creating required value for him. If such value is not created and such problem is not solved, the professional accountant hasn't done his duty well. An accountant only after achieving required result of employer does his duty well by doing all the measurements achieving the result.
5. Technically, professional accountants should do professional services in accordance to appropriate technical standards. Professional accountants are obliged to do the requirements of the employers as consistent with the requirements of integrity, impartiality and if the professional accountants are formal accountants with autonomy feature should be consistent (Asif, 2010).

To be familiar with the consistency with ethical principles, the professional accountant should follow the technical and professional standards stated from the following references:

- 1- International Federation of Accountants (IFAC) regarding International Standards of Auditing (ISA)
- 2- International Accounting Standards Committee(IASC)

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- 3- Professional accounting institutions
- 4- The rules of great companies and the institutions regulating the law and law making

3. DISCUSSION AND CONCLUSION

Ethics is rooted in human nature (wisdom and emotion). Human spirituality is a natural and infinite reality and observing ethics is one of the manifestations of this spirituality and the initial basis of social life. In accounting and auditing, professional ethics is the measurement index of appropriate behavior and a tool to determine true and wrong relations. Indeed, Ethical principles in this profession determine the professional accountant responsibility to the society, employer and other beneficiaries. The reality is that now we can not trust others without ethics. Also, we can not have a good contact with environment and the world. In other words, as we are involved with small works, or when we participate in a simple dialogue or when we consider social life and professional responsibilities, we need ethical principles. Professional behavior regulation and ethics in accounting and auditing is an attempt to respond these needs.

It is obvious; all accounting institutions continue high level of studies about ethical principles for volunteers and most of the proposed courses of institutions are associated with ethical principles. Thus, auditors should observe the instruction of ethical principles and maintain their autonomy during assurance and giving their opinions to financial statements. Accounting has important general responsibilities. As professional accounting institutions presented adequate researches about ethical principles to professional accountants, the auditors are obliged to execute these studies in practice to be sure of responsiveness and trust. Accounting and auditing and accounting ethics beside other innovations can reduce the ethical offences and scandals. This ethical accounting and auditing at individual level can be done in accounting institutions even for accountants working business. If we keep independent audit job for future of the society, we should eliminate the ethical and value problems by considering the benefits. If we resolve these problems by other methods, we ignored our right to have a professional social condition and a suitable professional destiny is not considered for us. Expressing the fundamental principles of ethics and professional behavior in journals and approving the regulations are useful measurements but without formulating a long-term plan to increase the knowledge of accountants regarding this issue and development of professional behavior and ethics can not be effective. Although educational plans are necessary, they can not organize the affairs. To improve ethics and professional behavior in the country, a complete attempt should be made by professional accounting communities, professional institutions and professional accountants in three levels of rules, training and execution.

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