Concept Paper: Audit of Ethics in Organizations – Specifically Financial Reporting

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Abstract

The question of ethics is time and again raised in corporate world. Doing the things ethical way is time and again repeated and the history continues to repeat itself with the selfish motives of the corporate. It may be Enron, Satyam or the subprime cries the corporate world looks at fulfilling their selfish motives which affects the other stakeholders. This makes a strong case of looking at ways and means to curb such motives. The current mandatory reporting is not playing its role in curbing these motives even in western world. One of the ways is Audit. The researcher looks at option of Audit of Ethics. Researcher concludes that a detailed code of conduct for Ethics is must for such audit with a assumption that the auditor will strictly abide by his code of conduct and such audit report is to be mandatorily made public so that all the stake holders are aware about the practices that the corporate are involved into. It is also assumed that the auditor will take the text of the guidelines n correct spirit and not correct text. This will help in changing the approach of the corporate on practices that are correct in law as per text but not correct in the spirit of the law.

Key words: Ethical Practices, Financial reporting, Audit, Corporate reporting, Ethical reporting, Ethical Control, management ethics, Ethics in audit, unethical practices

Introduction

The financial reports of organizations are published so that the stake holders can know the financial health of the company and accordingly make financial decisions. The creditors use the financial reports for the purpose of decisions of credit policy, so is the analysis made for the deciding the credit demand to be made to the vendor. The investors are interested in the same for investing decisions, and the lenders to decide the ability to repay. The revenue authorities look at the financial reports from the point of view for the tax liabilities, and the competitors look at it as a guiding document for their performance comparison. All in all the financial reports are one of the most red after and analysed document of any corporate

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organization. This makes a strong case for providing true and fair picture of financial reports to be provided to all stake holders.

The legal system in India gives a very high importance to the intention of an act by a person; this is highlighted more so in the Criminal laws of the country (Indian Penal Code). Similarly the guidelines text given by the authorities are to be taken in correct spirit than in correct text as it happened in case of Enron, where Anderson focused on the “letter of the law” rather than understanding if the accounting is apparently ethical & fair (Reinstein, 2002).

The intent in financial reporting is very important. The true and fair picture of the books of accounts should be represented in the financial reports. The same was found wanting in the Satyam Case.

Objective

1. To study the conceptual viability of the audit of Ethical Practices in organization

Ethical Practices and Role of Auditor

The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with SAs and relevant ethical requirements enables the auditor to form that opinion. (Institute of Chartered Accountants of India, 2007). The objective of audit is to reduce corruption & unethical practice (Chopra, 2011). The same was highlighted in an interview on the sidelines of the international taxation conference. The objective of the auditor is to respond appropriately when documents containing audited financial statements and the auditor’s report thereon include other information that could undermine the credibility of those financial statements and the auditor’s report. (ICAI, 2007).

If one assumes that all the auditors follow the standards provided by the institute of chartered accountant of India strictly, the books of accounts will present true and fair picture. This is not all; the auditor presents his opinion based on the information provided. Hence even though the auditor follows all the standards in correct spirit, still there are chances that the financial reports are not actually giving true and fair picture. Thus the blame shifts to the management that they have to be ethical in their reporting.

Audit of Ethics

Edward Freeman's (Freeman, 1994)theory of "The Separation Thesis" gives out the idea that the business and morality are separable in certain ways, to which (Sandberg, 2008) supports with argument that the thesis has many interpretations going around and the individual understanding is required for interpretations. He continues that there should be further strong evidence to reject the thesis. Harris (Harris & Freeman, 2009) counter the argument of separation theory given by Sandberg (Sandberg, 2008) based on integrative questions of business and morality.

(Berrone, Surroca, & Tribó, 2005, April), draw their argument that, stronger the corporate ethical identity stronger is the stake holder satisfaction from normative and instrumental stakeholder theory. However they agree that the ethics are not alone responsible for the economic performance.

(Society for Human Resource Management, 2009) In their fourth quarter report of 2009 say that transparency, fairness & communication are the main factors to establish & maintain ethical work place. They base their conclusions on the argument that to promote ethical behaviour, human resource professionals, people managers and senior management need to be knowledgeable about business ethics which in turn is inherited from leadership, codes of conduct and related legislation to compliance.

(The Ethics Resource Center and The ERC Fellows Risk Assessment Working Group, 2010) In their report relate Enterprise risk Management (ERM) to the involvement of ethics & compliance (E&C). The argument put forth is that the cross sectional experience put forth by E&C helps in developing regulations to be accounted for by ERM. E&C also highlight the cultural factors which are important in the ERM.

The institute of management accountants has given the Standards of Ethical Conduct for the management accountants. (Haywood & Donald, 2004) Put forth that the time has come that the strict implementation of the code of conduct of the standards given for the management accountants is done by the members. Extending the logic further a case is made for a new type of audit which is brought out of the preview of the management and the same being made a separate mandatory requirement with a code of conduct for reporting of ethical practices.

Need of the Hour

The current situation in the corporate world demands the practice of audit of ethics. Practices for promoter benefits are increasing, which are highlighted through the recent Satyam case. Recently Anil Ambani accepted a settlement fine and restrictions on group companies and individuals for activities related to the secondary markets with acceptance that "there were lapses in control in spite of checks and balances" (ET Bureau, 2011). In July 2010 Goldman Sachs paid $550 million to settle charges that it defrauded investors while selling securities linked to subprime markets (ET Bureau, 2011). This highlights the requirement of the peer audit or the audit of ethics. This type of audit is undertaken in the medical sciences which is given out by (Bhatt, 1989) who says that the peer review in the field helps in improving the quality and practices in medical sciences.

Conclusion

There is a strong case for audit of ethics in financial reporting by the corporate. In view of this the Ethical code of conduct definition becomes mandatory to set a bench mark for audit also reporting of this audit should be made mandatory along with the financial reports. This will help all the stake holders assured about the practices followed in stating the financial reports, so as to make learned decisions about the policy to be adopted towards their stakes in the reporting corporate.

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