PART I

PURPOSE, BACKGROUND, AND APPROACH
CHAPTER ONE

The Technical and Ethical Responsibilities in Accounting

LEARNING OBJECTIVES

By the end of this chapter you should be able to:

1. See ethics as a key feature in accounting reforms.
2. Describe recent debates and research about accounting ethics in education.
3. Explain the dual competence of the accountant as technical proficiency and ethical sensibility.
4. Describe the ethical dimensions of competency, giving attention to moral philosophy as an intellectual resource for the accountant’s moral education.
5. Explain the authors’ accounting theory: they see accounting as a cooperative enterprise that produces business knowledge and communicates it to interested users.
6. Understand accounting as discourse.
7. Understand accounting as a practice.

ACCOUNTING, ETHICS REFORM, AND YOU

By the time you open this book, you’ve probably taken several accounting courses. You have a basic practical grasp of what accountants do. You know that accounting is a profession that serves various stakeholders by communicating crucial business information. Accountants’ work, you have seen, is important for business decision making, market activity, and the economic vitality of modern society. In the classroom, you’ve solved accounting problems by applying current accounting standards and struggled through exercises to apply rules in rational decision procedures. You’ve experienced the complexity of accounting practice and faced demands for technical competency and skillful problem-solving. You’ve become acquainted with accounting standards
and principles and probably understand accounting as a rules-oriented activity within the contemporary business environment.

**STAKEHOLDER**

For a number of fields, including business ethics, a stakeholder is a person or organization that influences a decision or is influenced by the outcome of that decision. For accounting: a stakeholder is a person, group or organization that may use the knowledge that is communicated in financial statements and reports. Stakeholders can be considered as “insiders” or “outsiders” to the company whose financial status is described. Insiders are those who have access to company information in addition to its financial statements – management, board of directors, employees. Outsiders include: creditors and lending institutions, stockholders and prospective investors, and regulators.

It is likely that by now, you have an image of an accountant: a respected, well-paid professional, conservatively dressed, a “numbers-crunching,” hard-working employee. Accountants create a company’s financial statements by reviewing invoices, spreadsheets and computer print-outs of company transactions and complicated business deals. Accountants contribute to the publication of monthly, quarterly and year-end reports on “how a company is doing” – all this to satisfy management and stockholders, analysts and potential investors or creditors, even lurking government regulators or tax collectors. Accountants are valued employees, members of an honorable profession, steady fellows and solid citizens – accountants are rarely cast in a heroic mode, but in most people’s eyes neither are they villains.

But you have also heard of business fraud and mismanagement where accountants played a major role. The media and the courts have exposed significant scandals that demonstrated accountants’ failure to serve the public interest. Corporate accountants failed to provide clear, accurate pictures of the companies’ financial performance, and public accountants working in audit firms failed to notice this during the yearly audit. These accountants and auditors failed their profession and the public because they did not tell the truth about companies’ transactions. They did not disclose relevant and reliable business information that could be used by “stakeholders” for decisions to invest, loan money, or buy and sell stock. Auditors and accountants did not report large-scale fraud or warn the public that creative accounting techniques hid millions in debt as financial statements deceived the public. Auditors and accountants deliberately violated professional standards and government regulations and acted “with malice aforethought” to “cook the books” and fool the public.

**AUDIT FAILURE: KPMG AUDITORS ALTER WORK PAPERS OF TENET AUDIT, CHARGES THE SEC**

The US Securities and Exchange Commission (SEC) found improper professional conduct by a KPMG partner and a senior manager for making after-the-fact modifications to audit working papers, to create a false impression that an audit of Tenet Healthcare
You can now join with the authors of this book and ask: “How did such things happen? Why didn’t the auditors and the accountants do their jobs properly, follow their own rules, act responsibly and protect the public interest?” We wonder: “Were the company accountants and the auditors incompetent; were they simply deceived by dishonest managers or confused by complicated business deals? Were the techniques of accounting simply unable to address the complexities of business organizations and activities?” We ask: “Does the profession need new and improved rules? Do accountants need better technical training or more effective incentives, including higher pay and more public recognition, so they will work harder to detect fraud?” At the personal level, we ask: “Did these accountants lack character and have no integrity?” At the institutional level, we wonder: “Were accounting systems inadequate to deal with the rapid changes in business technology, the international scope of trade and finance, and the tremendous variety of business services and products in the market?”

To ponder these questions and consider what accountants ought to do about fraud, deception and dishonesty, to ask about the kind of persons accountants ought to be and the types of decisions they ought to make: these are the issues of morality and ethics. These questions and the answers they generate go far beyond technical matters – beyond merely focusing on rules and principles. They force us to ask about the fundamental purposes of accounting and the basic motives that influence accountants’ behavior. The scandals draw us into the complexities of accountants’ work environments and compel us to think about the structures and systems that support accountants’ activities. In particular, we note factors in the business environment that influence accounting practices, including the pressure of time constraints, pressures to cut expenses, and the desire for firms to increase their profit margins. We are challenged to consider the basic features of modern business, where accountants face the pressures of profit-taking, are tempted by the lure of professional ambition, and their own desire sometimes to
pursue selfish interests even if others are harmed and public interests are ignored. Reacting to accounting failures and faced with these pressures, we remind ourselves of the goals and purposes of accounting.

The public spectacle of major business scandals and accounting failures forces our attention toward the flawed character of some accountants and auditors and to the misdeeds of particular firms. The sheer scope of fraud raises questions about whether institutional regulation is adequate to deal with unethical behavior on a grand scale. These scandals raise calls for reform and “more ethics” in the institutions involved in such affairs.

Concern about ethics, however, is not to be associated only with the special circumstance of business fraud and high-profile deception. Neither does accounting ethics, in particular, merely focus on scandal and wrongdoing. Nor does ethics simply alert us to bad behavior, dishonesty, and deception (however important these warnings may be). For clear thinking about the type of persons accountants ought to be and reflection on what they ought to do in their distinctive practice inspire us to affirm the highest ideals for accounting practice. As ideals for practice, ethics – the values worth pursuing, the principles and rules for decision making, the assessment of the consequences of actions, the individual’s character traits (virtues) and aptitude for moral judgment – forms the core of accounting practice itself.

We believe that honesty, integrity and a passion to exercise thoughtful, well-informed judgments and do right things are the appropriate virtues of the accountant. Accountants have the duty to tell the truth about financial matters. Given this view, we want you to think clearly about the morality of accountants and the moral choices they must make. We have high hopes that you will learn and adopt the ethical responsibilities of accounting practice. Indeed, we have a grand vision on your behalf, a sweeping agenda for your well-being. We hope that you will be motivated to act ethically, to behave as “a virtuous accountant” (as well as a technically proficient accountant). This book’s message is a call for reflection and inquiry about accounting ethics, to inspire you to reason clearly about accountants’ duties and their character, and the expectations for their ethical behavior in performing their tasks. What is more, we want you to become motivated, fully committed to acting ethically as an accounting professional.

The next sections recall the recent history of debate about accounting ethics in higher education. They present the authors’ perspective on the importance of accounting standards and the accountant’s dual competency of technical proficiency with regard to accounting standards and ethical sensibility with regard to the ability to recognize moral issues and resolve ethical dilemmas. The sections then treat accounting ethics education as a high priority, introducing moral philosophy as a useful resource for the moral development and education of accountants.

After these discussions, the chapter outlines the authors’ “accounting theory,” our understanding of the basic purposes of accounting – the foundation for our understanding of the accountant’s ethical responsibilities. This description of accounting identifies accounting as a form of discourse, wherein knowledge is produced and communicated to potential stakeholders. We also describe accounting as a practice, a cooperative endeavor with specific purposes where the creation of specialized accounting texts “embodies” or “realizes” the accountant’s distinctive virtues. The production of financial statements depends on specific character traits and intellectual
skills that are crucial for professional practice. This part of the chapter reminds us that accounting as discourse and practice are supported by accounting standards and by particular accounting institutions, as well as the cultivation of distinctive accountant’s virtues.

**A BRIEF HISTORY OF ACCOUNTING ETHICS IN HIGHER EDUCATION**

Accounting ethics courses and the inclusion of accounting issues within business ethics courses pre-date the recent wave of international business scandals and accounting failures. One scholarly article, sketching a history of reform, begins its study in the mid-1980s, calling for ethics reform in the profession and advocating ethics training in accounting education (Loeb, 2006). That study, along with others that review the past quarter-century, summarizes debates about accounting ethics in undergraduate and graduate curricula and comments on teachers’ credentials and teaching strategies. Other studies assess the effectiveness of particular courses of study and consider methods of evaluating the students’ learning of ethics. In recent decades, academic researchers and accounting professionals pose questions about who ought to teach accounting ethics courses; most prominently, there is even significant debate on whether ethics can be taught effectively within the modern university or business school.

Reviewing recent developments within the United States and Europe, accounting scholars note reform efforts in the profession and acknowledge the increased attention to ethics training in accounting education. Several professional commissions advocate programs of ethics training in undergraduate and business school education. In the past two decades, several dozen studies have reviewed these educational changes and discussed their key elements. These articles reveal an important debate about ethics training as they examine the sophisticated, highly technical educational process now deemed necessary to prepare each generation of accountants for professional practice. As major scandals rock the business world and fraud and mismanagement in large corporations involve company accountants’ and auditors’ failures, the issues of accounting ethics have become matters of public debate. These scandals have prompted a public outcry not only for new regulations and change in the accounting profession, but also for educational reform. There is a call for more course work in accounting ethics and for research to determine how classroom education can be an effective means to motivate ethical decision making (Stuart, Stuart & Pedersen, 2011; Levy and Mitschow, 2008).

Several articles by Stephen Loeb, Mary Armstrong, J.E. Ketz, and Dwight Owsen provide a good sketch of the recent debate (Loeb, 2006; Armstrong, Ketz & Owsen, 2003). Their reviews note that since the late 1980s, professional accountants and scholars consider whether or not ethics can even be taught in the classroom. As this key issue is debated, researchers discuss educational goals for accounting curricula and the types of instruction that may be effective. Other articles describe various methods of assessing faculty performance and student learning. Both researchers and working accountants debate the impact of ethics training on professional practice – especially focusing on
whether coursework enhances the ability to recognize ethical issues and resolve ethical dilemmas in “the real world,” in actual business settings (Loeb, 2006). Many articles assess teaching techniques and evaluate classroom activities designed to increase knowledge about ethics, with some scholars arguing that it is essential to go beyond just “learning about ethics” to find effective ways of encouraging ethical behavior so that students enter accounting practice with a determination to behave ethically (Mintz, 2006; Low, Davey & Hooper, 2008; Armstrong, Ketz & Owsen, 2003).

Empirical studies examine student responses to ethics education. Many studies employ the ethics concepts introduced in James Rest’s (1994) ethics model – ethical sensitivity, judgment, motivation, and character. Their authors investigate whether students are learning to think critically about moral issues. Most importantly, they ask whether students are given the proper education to become motivated to act ethically. Armstrong and her colleagues, for example, frame their review of recent research with their own variation of Rest’s four-part model. They argue that more ethics education should focus on student motivation and the enhancement of student commitment to ethical behavior. In this way, the authors seek to expand upon earlier classroom emphases on lectures, dialogue, and case studies that narrowly focused only on the recognition of moral issues and showed too little concern for empowering ethical action by students. To be sure, these authors support the development of the skills of moral reasoning, but they also seek better ways to encourage ethical behavior (Armstrong, Ketz & Owsen, 2003).

### JAMES REST: COMPONENTS OF MORALITY

In the late 1970s and early 1980s, James Rest, University of Minnesota, developed a four-part model to identify the main elements of morality. This model has been used in thousands of articles and books that treat the cognitive aspects of moral decision making: (1) moral sensitivity – ability to recognize the moral/ethical issues in a given situation; (2) moral judgment – capacity to determine the ideal course of action among several alternatives; (3) moral motivation – skill of selecting valued outcomes and ability to take action that is deemed moral; and (4) moral character – skills and perseverance to make moral decisions and maintain morality over a long-term, throughout a lifetime. (James R. Rest, “The Major Components of Morality,” in W.M. Kurtines and J. Gewirtz (eds) Morality, Moral Behavior and Moral Development, New York, Praeger, 1984.)

Additional literature treats classroom teaching, outlining proposals of curriculum reform and revisions of educational goals for accounting ethics, as well as teaching strategies and various methods of assessment (Cheffers & Pakaluk, 2005; Mintz, 1995, 2006). Scholars examine the relationship between business ethics courses and more specialized courses in accounting ethics, with attention given to professionalism and the ethical responsibilities within public accounting (Jennings, 2004; Levy and Mitschow, 2005; Williams, 2010). Efforts to link the specialized courses in business, accounting ethics and professional ethics to the several traditions of moral philosophy reveal a lively debate on whether a focus on moral philosophy is particularly helpful when accounting ethics is understood as “applied ethics” (Dolfsma, 2006).
THE AUTHORS’ PERSPECTIVE

The authors of this book participate in these debates over accounting ethics. We review research on business and accounting ethics courses and the development of several professional codes of conduct. We also consider numerous international proposals for change in the governmental regulation of accounting. This book emerges from our perspective that accounting is a type of applied ethics, grounded in principles, expressed in standards and rule-oriented behavior, and aimed at particular beneficial consequences for businesses and society. The main message of this book is to highlight the ethical features of accounting and to equip students for making ethical decisions and taking ethical actions in accounting practice.

Competency in accounting practice, we maintain, presupposes technical knowledge and skills, ethical awareness, and steadfast motivation for ethical behavior. In short: for the working accountant, technical proficiency and ethical sensibility go hand in hand. By technical proficiency, we mean knowledge of the vocabulary, concepts, and decision procedures of accounting and stated principles and rules as this knowledge is applied in making accounting decisions. Knowledge of the accounting standards and the methods of making decisions recognized as authoritative by the standards setting institutions are learned in the classroom and through the early stages of the accountant’s working experience. This knowledge comes into play when accountants use the skills they have learned and employ practical judgment to apply standards in making appropriate accounting decisions.

TECHNICAL PROFICIENCY

The technically proficient accountant has gained the knowledge of accounting standards and learned the skills of accounting decision making. This knowledge includes the basic vocabulary and concepts of accounting, its fundamental principles and specific rules for recording financial information, and the decision procedures of accounting practice. To be technically proficient means having the ability to apply accounting standards and exercise knowledge-based (knowledge-informed) judgment to making accounting decisions.

By ethical sensibility, we mean the accountant’s ability to recognize moral issues that are encountered in business circumstances and the capacity to identify the key features of a moral problem and grasp the significant aspects of ethical dilemmas. Ethical sensibility further involves the skill of judgment to identify options for resolving ethical dilemmas. This judgment includes the ability to choose among these alternatives. Finally, the ethically sensible accountant is empowered to act ethically. Combining knowledge of standards with practical judgment and the capacity to choose among alternatives, the accountant is motivated and acts with integrity. In brief, the accountant’s discernment of the key features of moral problems plus the ability to make decisions results in ethical actions.
This understanding of the accountant’s dual competency assumes that the technical aspects of accounting practice are very important and are closely linked to the ethical demands of accounting. This textbook is itself a resource for technical training as it presents ethical issues in relation to the technical matters of professional practice – its regulations, rules, and prescribed patterns of decision making. Indeed, the book assumes the fundamental necessity of technical proficiency as a key mark of professionalism. Accountants should comply with the standards of accounting practice and follow its principles and rules in their most up to date form. The authors believe that one of the professional’s most important ethical obligations is to comply with the standards of accounting.

Some Examples of Technical Knowledge, Knowledge of the Relevant Accounting Standard

Consider, for example, that an accountant reviews a company’s transactions and notes that specific products are sold, to be shipped one month from the date of purchase. When is the revenue expected from the sale to be recognized in the financial statements? There is an accounting standard to address this question. The technically astute accountant will know that revenue is recognized when a service is provided or a product is shipped and the company expects to be paid. (Recognize revenue, then, on the date the products are shipped.) In another situation: an auditor notices that a financial statement lists as “current liabilities” the moneys owed to a company due in 18 months. He or she wonders: “Is this money a current liability or might it be a long-term liability?” Technical knowledge of the relevant accounting standard will give the answer. “Current liabilities are moneys owed, to be recorded at the cash to be paid – within one year. Moneys owed as a result of borrowing cash or purchasing goods or services, to be paid in more than one year, are long-term liabilities. They are recorded at the present value of the future cash flow.” (So the money owed for 18 months is a long-term liability!)

Accounting standards require the company to distinguish between operating leases and capital (financing) leases. Knowledge of the standards and knowledge about the terms of a given lease must be part of the technical knowledge of the accountant. Operating leases are recorded as expenses; the asset used by the company based on the lease agreement is not recorded on the financial statements of that company. By contrast, capital or financing leases are recorded as if the company had purchased the asset. The asset is recorded on the balance sheet under long-term assets. A capital (finance) lease asset is depreciated over the life of the lease.

ETHICAL SENSIBILITY

The ethically sensible accountant makes use of several intellectual and moral capacities: (1) an ability to recognize moral problems and dilemmas in accounting situations, (2) insight to identify the key features of an ethical dilemma, (3) capacity to determine and choose among alternatives in resolving ethical dilemmas, and (4) motivation to act ethically; that is, “to do the right thing” as the fulfillment of one’s own responsibility.
A brief note on ethical sensibility in relation to accounting standards: the accountant is responsible for knowing and following the accounting standards in each of the above situations. In effect – these decisions are ethical, as well as technical, responsibilities. If the accountant were pressured by management or by some desire to misrepresent the financial situation of the company and then chose to violate the accounting standard, that action would be unethical.

The authors think that the technically proficient accountant needs also to be the ethically sensible accountant. We might say: “The technically good accountant should also be a virtuous accountant; that is, an ethically sensible accountant.” By this we mean that the accountant who performs his or her tasks skillfully by technical standards does this at the same time he or she acts virtuously (i.e., reveals the admirable quality of his or her character by taking ethical actions within the accounting decisions). For the competent accountant, both technical skill and ethical sensibility will be demonstrated in accounting decisions that produce accounting texts. As an obligation placed upon the accountant by the practice itself, the technically proficient accountant will always strive to make ethical judgments and act with integrity.

We develop the themes of the book to emphasize first and foremost that accountants and auditors adhere to the standards of accounting practice and follow its principles and rules. In this context, learning the standards, developing the skills to apply them, and exercising judgment in decision making will necessarily include both technical elements and an ethical dimension – with competency for the accountant demonstrated as technical proficiency and ethical sensibility put into practice.

COMBINING TECHNICAL PROFICIENCY AND ETHICAL SENSIBILITY: FOUR TYPES OF ACCOUNTANTS

Our perspective on accounting ethics claims that the accountant’s competency has two dimensions – technical proficiency and ethical sensibility. Assuming this: a given accountant may be technically proficient or not and may be ethically sensible or not. Taken together, this means that we envision four types of accountants based on the degree to which the accountant is technically proficient and ethically sensible.

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This book originates from the authors’ criticism of their own profession. Despite the many calls for reform and the introduction of ethics in accounting programs over the past decades, we see that scholars and practitioners often give highest priority to the technical aspects of the profession – its standards and prescribed procedures – to the relative neglect of research about ethics and the encouragement of ethical commitment on the part of accountants. We want to change educational priorities to remedy this shortcoming. We think technical proficiency must be matched with ethical behavior. Accounting practice is a type of applied ethics; accordingly we criticize scholars and accountants for their all-too-frequent failure to acknowledge and appreciate the ethical dimensions of accounting practice. The ethical nature of accounting practice is not yet emphasized enough in the training of accounting professionals. The recent accounting scandals and subsequent calls for reform in education and accounting practice do indeed suggest that scholars and accountants must continue to give high priority to refining technical standards. There is much need to construct rules appropriate for addressing the complexities of businesses that are large in scale, engaged in international trade and finance, and equipped with rapidly changing technologies. But such efforts must also be matched by comparable emphases on honing the skills of ethical decision making and motivating the present

**The Destructive Accountant** is characterized as lacking both technical and ethical competence. If such an accountant enters the practice, he or she is surely the opposite of what accounting education aims to produce. Such an accountant is neither able nor willing to act in accordance with accounting standards.

**The Good-hearted Accountant** is characterized by ethical sensibility, but lacks technical competence. Such an accountant is essentially well meaning, but has a knowledge problem, in the sense that he or she is not able to act in accordance with standards. This problem can be overcome by increasing the accountant’s knowledge and skill in applying the accounting standards.

**The Opportunistic Accountant** is characterized by being technically proficient while not being ethically sensible. This means that he knows the standards well enough to use them well, but he is willing and able to exploit loopholes to benefit himself or those whom he favors. Such accountants are in a narrow sense competent, but they have a motivation problem, in the sense that they do not place the common good ahead of their own self-interest. This is a problem that can be addressed either by strengthening the moral character of the accountant, or by putting control measures in place that will hinder him from acting unethically.

**The Virtuous Accountant** is characterized by being technically proficient and ethically sensible. This means that he or she integrates technical and ethical knowledge in accounting decisions. Such an accountant will follow standards and act to promote the common good.
generation of accountants to be ethically aware as well as technically skillful. In brief, we need more support for developing competence in both technical matters and in ethical decision making.

ACCOUNTING EDUCATION: TRAINING FOR COMPETENCY AND MORAL PHILOSOPHY AS A RESOURCE

Accounting is a cooperative enterprise – a practice – that is crucial for business and society. Accountants create business knowledge and communicate it to various individuals and groups (stakeholders) who use this knowledge in business decision making. In this practice, accountants are guided by standards (principles, rules, and codes of conduct) and supported by professional societies, legislation and regulatory bodies. Adherence to these principles and compliance with the rules of practice includes both a technical and an ethical dimension; competency in accounting is the demonstration of technical proficiency and ethical sensibility in the completion of the distinctive tasks of the practice.

ACCOUNTING STANDARDS

Accounting standards establish the guidelines and formats for preparing financial statements and reports, thus governing accounting practice at the practical level. The standards establish the appropriate manner of recording financial transactions in the financial statements. Standards include the prescribed rules, procedures, and criteria for measurement that determine appropriate accounting practice, including broad guidelines (principles) and detailed procedures (rules). Accounting standards are established in the US by the Financial Accounting Standards Board (FASB). Internationally, the standards are set by the International Accounting Standards Board (IASB).

In response to recent accounting and audit failures, many have advocated reforms in accounting education and changes in the regulation of accounting practice. Technical matters predominate in these reform efforts as new laws, rules, and prescribed procedures are introduced. By contrast, the authors of this book respond to the crisis of business scandal by highlighting the significance of accounting as a form of “applied ethics”. We emphasize that accounting decision making includes not only technical compliance to standards and rules but also ethical sensibility – awareness of moral issues, capacity to resolve dilemmas, and a commitment to behave ethically. The book supports this attitude: we hope that students develop both technical and ethical competences as they prepare to enter the accounting profession so that they will “tell the truth” about financial matters by demonstrating technical knowledge of accounting standards, steadfast integrity and persistent commitment to ethical behavior throughout their practice.

It is a complicated process to learn the technical skills of accounting practice and to develop the intellectual judgment to identify accounting issues, recognize moral problems, and resolve dilemmas. The issues and study questions presented in the
following chapters are intended to assist you in identifying moral issues in accounting situations and to support moral reasoning and making ethical judgments. The authors believe that moral education in accounting includes both “learning about ethics” (developing moral discernment – the capacity to recognize moral issues and the skills of moral reasoning) and supporting efforts to “act ethically” (developing habits of moral commitment and the ability to do “the right things for the right reasons”).

This book expresses faith that accounting ethics education will “make a better person out of the student”; that is, study and engagement in the classroom will enhance students’ capability to fulfill the distinctive tasks of accounting practice. Students should develop the competency of technical proficiency and ethical sensibility. This dual competency is crucial for producing accounting knowledge and communicating clear, accurate and truthful financial information to stakeholders who will then use that accounting knowledge for their own business decision making.

Within the accounting classroom, the engagement of students with each other and their teachers continues an initiation into the professional duties of accounting practice. By means of reading, discussion, and problem-solving exercises, the educational program will blend the learning of technical standards – principles, rules, and decision procedures – and the skills of ethical sensibility. Our approach to these tasks will make use of the history of ethics inquiry, as well as current discussions within moral philosophy. The intellectual tradition of philosophical inquiry in ethics – concepts, issues, decision making – can become a significant foundation for students’ ethical decision making. Within the classroom setting, students and their mentors will address historical and contemporary philosophical studies to learn how various moral traditions have conducted ethics inquiry. This learning strategy assumes that aspects of philosophical ethics can be useful as a “toolkit” of concepts, arguments, and moral reflection that can guide accounting decision making.

Philosophical ethics provides a valuable resource for recognizing and addressing ethical issues that arise within the special domain of accounting practice. By gaining some awareness of its several traditions, accountants will not “have to reinvent the wheel” whenever they grapple with moral dilemmas communicating business knowledge. As they encounter business complexities and try to construct clear, accurate financial reports, acquaintance with the philosophical traditions can frame the manner in which they approach ethical issues. The authors believe that this introduction to moral philosophy will help student-accountants to work their way toward practical solutions to moral dilemmas in accounting. The philosophical background will inform their reasoning processes and support their efforts to act with integrity and to persist in ethical behavior. Such study should equip them to resist the pressures to break rules, manipulate financial reports, and deceive the public.

MORAL PHILOSOPHY

Moral philosophy or philosophical ethics is the branch of philosophy concerned with inquiry into the nature of human action-behavior in particular situations and conduct over the long term. Ethics offers rational argumentation on how people “ought to live their lives”. Ethics considers questions of right and wrong, principles and rules for behavior, and the consequences of actions.
It must be emphasized that the intellectual and practical exercises of the classroom are not intended simply for the sake of "studying about ethics". The primary objective of ethics education in accounting is to develop a practical capacity for judgment which will inform and motivate ethical behavior in accounting tasks. Ethics education should inspire accountants and auditors to serve their companies, clients and the public interest. Using the toolkit of moral philosophy, students will recognize moral issues, resolve dilemmas, make ethical decisions in a process of moral education in the classroom. In this practically oriented educative process, actions shaped by technical knowledge and expressing the student’s integrity will form the habits of sound judgment and thus provide the moral foundation for acting ethically. As one of the traditions of moral philosophy (virtue ethics) describes the process: the student will gain important intellectual and moral virtues (character traits and skills) vital to professional practice. Emerging from this process, the accountant will be able to act virtuously, taking the character traits and skills that are learned to perform the special duties of accounting practice.

For accountants, the domain of ethical activity is the preparation, review (auditing and assurance services) and communication of financial information to potential users. The principal goal of accounting practice is the transmission of clear, accurate, and trustworthy information to people who depend on such knowledge for their business decision making. Within this domain of ethical activity, accountants are expected to adhere to the principles of their profession, comply with its rules “in service to principles,” and exercise judgments (technical and ethical), so that financial knowledge can be conveyed impartially to those who would make use of it. By subordinating his or her own interests to the task of serving others, the accountant fulfills a moral obligation that is critical for business and society. In the ethical performance of accounting tasks, the accountant and auditor will likely earn the trust and respect of those who depend on this crucial service.

ACCOUNTING THEORY AND ETHICS

A few scholars research the history of accounting, the origins and development of its distinctive vocabulary, key concepts, principles and rules. They describe accountants’ historical and current methods of recording and reviewing financial information. They analyze the functions of accounting institutions – audit firms, professional societies and regulatory agencies. These scholars examine the role of accounting in capital markets, manufacturing and trade.

As part of their description and analysis of the place of accounting in modern business and society, the scholars evaluate accounting. In effect, they criticize the ideals of the practice – the goals and purposes of the accounting enterprise – and they assess the rules and decision-making procedures that shape everyday accounting actions, for better or worse. Most significantly, these researchers and critics offer prescriptions for accountants and their activity; that is, they advocate specific ideals which accountants should institutionalize, “best practices” that ought to shape accountants’ decisions. They often suggest agendas of reform to address the complexity of the marketplace and remedy accounting failures. The systematic presentation of such issues by accounting scholars forms a special subfield of research called accounting theory.
Accounting theory is the systematic, logical analysis of the history and current practice of accounting. It describes the purposes, ideals, and principles of accounting, as well as the actual practice of accountants. Accounting theory discusses how the rules and prescribed decision procedures of accounting apply to particular business circumstances; theorists examine specific accounting practices to determine whether or not they reflect principles, rules, and prescribed procedures. Accounting theory elaborates on the institutions that set accounting standards and regulate, monitor, and support accountants in their work. The field of study describes the role played by accounting in business and society and assesses the effectiveness of current practice. Following contemporary research, theorists discuss alternatives to current practice, addressing the limitations and problems of accounting in the contemporary business environment. They offer explanations of how accounting information is used by various stakeholders. Accounting theory not only describes, but it also criticizes, evaluates and prescribes changes for the field of accounting. This means that theorists are not content only to describe aspects of current practice, but they also suggest what ought to happen; they advocate reform and suggest possible changes in practice.

The authors’ participation in the debate about accounting ethics reflects their understanding of the nature of accounting as a modern business enterprise. Their concerns about ethics in accounting education are based on the crucial role that accounting plays in the modern marketplace. In effect, this perspective represents a key aspect of the authors’ accounting theory. In making the argument that ethics is important in accounting, the authors think it essential to examine the ideals of accounting and to consider accountants’ actual practice, their behavior in relation to accounting standards – the principles, rules, and decision procedures that are supposed to guide accountants in the performance of their duties.

Here we do not offer a lengthy account of theoretical matters, but we do want to examine the ideals of accounting and elaborate on specific accounting practices as a necessary introduction for describing the ethical responsibilities of the accountant. In this context, we maintain that the basic purpose of accounting prescribes a dual competency for the accountant. Every accountant should first possess the knowledge...
of accounting standards and the skills to apply these standards in decision making. They should also be competent to recognize moral issues and resolve dilemmas they will be encounter in business circumstances. In short: our accounting theory prescribes the accountant’s dual competency as technical proficiency (in “following the rules”) and as ethical sensibility that supports ethical judgment and motivates ethical behavior. This ethical sensibility includes an intellectual and emotional disposition that commits the accountant to behave ethically in the performance of accounting tasks.

What follows, then, is our own modest version of “accounting theory”. We describe the place of accounting in business and society, its principal goals and purposes, and the relationship of its ideals and prescriptions for best practice. When this task is completed, we will sketch out our understanding of the professional responsibilities of accountants in terms of their dual responsibility of acting on the basis of the technical standards of their profession and fulfilling their ethical duties in decision making and action (i.e., demonstrating technical proficiency and ethical sensibility).

**ACCOUNTING DISCOURSE: KNOWLEDGE PRODUCTION AND COMMUNICATION**

As we have seen: accounting has technical and ethical dimensions. Accounting is a technical enterprise bound to accounting standards. These principles, rules, and prescribed decision procedures set the patterns for appropriate accounting practice. Company accountants should record financial information according to contemporary technical standards. Auditors review these specialized financial statements and seek evidence to verify their accuracy. Auditors determine whether or not companies have prepared financial statements that comply with accounting standards, even as the auditors themselves are expected to follow the laws, regulations, and professional codes that govern auditing as a special field of accounting.

In addition to its technical demands, ethical decision making is crucial to accounting. This expectation of ethical sensibility is set by law, accounting regulations, and professional codes. The accounting standards not only establish the technical guidelines for accounting but also provide the basis for ethical decision making. Because accounting is both a technical and an ethical enterprise, individual accountants must exercise a dual competency in their accounting tasks. As we stated earlier: they must demonstrate both technical proficiency and ethical sensibility as they produce and transmit accounting texts.

This book calls for balancing the extensive practical attention now given to technical proficiency in accounting with thoughtful treatment of the ethical sensibility needed in the normal course of accounting duties. In this context, we believe that recent studies of accounting have often missed the mark. Scholars have not adequately analyzed the role of accounting in society or described the responsibilities of the accountant. They have also neglected ethical concerns. Despite the widespread public debate about accounting ethics in the wake of business scandals, ethics research has not yet become a high priority for scholars. Even today ethics education plays but a minor role in business school and accounting curricula: technical training prevails.

By contrast with the prevailing scholarship, the authors believe that professional conversation about accounting and research and their role in business and society
should highlight ethics as a key aspect of accounting’s social responsibility. What is more, ethics training should play a more central role in accounting education. This agenda emerges from our accounting theory, an understanding which emphasizes the ethical dimensions of professional ideals and best practices. This ethics-oriented conversation and an expansion of practical ethics training is likely to lead to a richer, more realistic understanding of accounting’s role in business and society; that is, a richer and more realistic assessment of accounting than can be expressed when concern for ethical sensibility is neglected.

Our understanding of the ethical dimensions of accounting motivates this book project in ethics education. As a primary objective, we seek the development of technically skillful and virtuous accountants who are able to demonstrate technical expertise and moral insight in the contemporary business environment. Our educational agenda for the classroom presupposes that the enterprise of accounting is already embedded with an ethical dimension which is presupposed by accounting standards and regulatory institutions. Indeed, along with the technical demands, the ethical obligations at the center of accounting ought to drive the decision making of individual accountants.

To summarize: the authors of this book call attention to the fact that ethical concerns are not yet a high enough priority for academic research or accounting education. Even with the recent, widespread debate about accounting ethics, the curriculum expansion of ethics training in business education, and public concerns about ethics in the wake of accounting scandals, there is still significant need for more emphasis on the ethical dimensions of accounting practice. To overcome this deficiency in research and education, we advocate building upon technical knowledge and supplementing technical training with ethics education. For even as there are critical demands for technical skill – for accountants to follow technical principles, rules, and procedures – so also are there ethical responsibilities in the day-to-day practice of accounting. This point will be developed throughout the following section as we treat accounting as discourse and as practice.

Let us now consider accounting as a type of discourse. Accounting is one of the languages of the business world (Morgan, 1988). Through concepts, narratives, and, most commonly, numbers, accountants represent business realities by producing knowledge and communicating it to others. In producing and transmitting business knowledge, accounting can be understood as a community-oriented discourse. Engaging in this discourse, accountants produce knowledge and communicate it so it can be received by stakeholders. The stakeholders can then use the knowledge to make business decisions; in effect, they can decide to alter human experience and transform society according to their own goals and purposes. Accountants play a distinctive role in producing specialized forms of knowledge about business entities from financial data; auditors review these statements and gather evidence to affirm the reliability of statements by publishing their own special texts, called audit opinions, for stakeholders. In this discourse, accountants and auditors create specialized texts that communicate accounting knowledge in accessible modes for stakeholders’ analysis and use. Accountants and auditors through their specialized discourse serve the public interest and the interests of business stakeholders, including companies, current and prospective investors, lenders, and creditors.
This book assumes that accounting is a specialized discourse crucial for modern business and society (Arnold & Oakes, 1998; Llewellyn & Milne, 2007). In their discourse, accountants create knowledge and communicate it through distinctive forms to stakeholders – company managers, investors and creditors, government regulators. The book emphasizes that accounting follows a standards-based framework for the construction of knowledge, with particular technical and moral claims on accountants who are responsible for providing usable, unbiased information to various stakeholders (Morgan, 1988). In other words, accounting discourse in its content and specialized formats communicating knowledge should follow sound technical procedures as established by accounting standards. In addition, the (accountant) creators of such knowledge will find themselves bound to an explicitly ethical outlook that is mandated by those same accounting standards. The book will illustrate how the accounting standards and institutions support technical and ethical decision making as accountants demonstrate their dual competency.

### DISCOURSE

Discourse is the language used by members of a specific intellectual discipline, field of inquiry or practice. It includes the development of a special language – vocabulary, concepts, numbers, and measurements – used by members of a discipline or practice to produce knowledge and communicate this knowledge to those who will use it. In accounting, the discourse includes the specialized written texts of financial statements, reports, and audit opinions that communicate accounting knowledge of business entities to interested users (stakeholders).

Both accountants and auditors participate in accounting discourse. As decision-making agents within business entities, company accountants construct specialized texts – financial statements (income statements, balance sheets, and statements of cash flow) – while other accountants, namely, auditors, review these specialized accounting texts (analyze and critique these forms of knowledge). These auditors gather evidence and record their findings in the special language of work papers. The auditors then issue audit opinions that are, in effect, an evaluation of the discourse of the company accountants and its management. Such knowledge production and its review, with the communication to stakeholders, are governed by accounting and auditing standards (the principles and rules of a distinctive practice). The discourse is subject to legislation, the regulation of professional associations, and the oversight of government agencies.

A generation of critical and mainstream scholars has characterized accounting as a creative discursive practice, a cooperative enterprise wherein accountants process financial information to produce knowledge (Francis, 1990; Hines, 1988). Accountants are responsible for creating intelligible forms to represent business realities – transactions and the financial status of companies. Accountants order information into clear, meaningful patterns expressed in written texts so that this communication of business knowledge can become useful for decision making (Arrington, 2007; Llewellyn & Milne, 2007). Using specialized forms – that is, financial statements,
quarterly and annual reports, and audit opinions—accountants examine and classify financial data in the process of creating explicit knowledge about the tangible and intangible assets of business entities. Viewed as a complex process oriented to modern industrial society, accounting discourse takes place within a social and institutional context that encompasses business entities, government institutions, professional societies, and voluntary associations (Burchell et al., 1980). The agents of this discourse—accountants as creators of financial statements and stakeholders as recipients of the mediated accounting texts—can be described as the “producers” and the “consumers” of accounting knowledge. This discursive interaction is community-oriented, as the accountant “knowledge-producers” and the stakeholder “knowledge-consumers” make decisions that will not only change the behavior of individuals but will also influence groups and institutions throughout society (Arrington & Francis, 1993).

Accountants gather information about the financial status of an entity (company, government agency or social organization). Ordering and classifying data into useful knowledge, they determine how best to represent the structures and the activities (the assets and transactions) of the entity they address. To guide accountants in this process, regulatory institutions create standards—principles and rules—to establish appropriate patterns for the specialized texts—financial statements and accounting reports. These institutions also set the standards for the auditors of this discourse, the texts that are to represent the financial reality of the companies under consideration. In brief, these accounting principles and rules provide the technical and ethical framework for proper accounting decision making to produce and transmit financial information.

ACCOUNTING AS PRACTICE: THE REALIZATION OF INTERNAL GOODS AND VIRTUES

Alasdair MacIntyre, an American student of virtue ethics, provides us with a good way to deepen our reflection about accounting as the discourse of a community of specialized craftsmen (accountants) and their interested audience (stakeholders of various kinds). In a widely cited section of After Virtue (1984), he elaborates the nature of a practice:

By a “practice” I . . . mean any coherent and complex form of socially established cooperative human activity through which goods integral to that form of activity are realized in the course of trying to achieve those standards of excellence which are appropriate to and partially definitive of, that form of activity, with the result that human powers to achieve excellence, and human conceptions of the ends and goods involved, are systematically extended. (MacIntyre, 1984, p. 187)

For MacIntyre, a practice is a socially constructed, cooperative enterprise in which people realize intellectual and moral virtues. Individuals within a practice express particular predispositions of character and attitude—distinctive character traits—as they act to fulfill the goals of the practice. As an arena of purposeful activity, a practice supports the intellectual and moral capabilities of practitioners, their capacities to think, evaluate, act, and accomplish the particular purposes of their common endeavor.
A practice, created to fulfill particular social purposes, reveals itself through the actions of its participants in the realization of their intellectual and moral capacities in the particular “internal goods” which they create. Internal goods are the things produced that contribute to the ultimate realization of the community goals, created in order to fulfill the goals of the practice. The members of a practice associate themselves in a cooperative relationship as a contemporary generation of colleagues. These practitioners find themselves linked together by common purposes, by standards of thought and conduct and by supportive institutions. Members of a practice are also linked in historical association with the previous generations of practitioners, earlier members of the enterprise who worked for its common purposes. The members demonstrate their personal virtues through their activity of producing the internal goods of their practice and achieving the purpose of their group. In this manner, the practice as a communal enterprise extends itself through time and establishes itself in a particular society. The practice creates and sustains its own history. Within a practice, there develops a living tradition, consisting of authoritative standards, shared beliefs, and significant institutions that extend from one generation of practitioners to the next.

To adopt MacIntyre’s insight: accounting is a discursive practice. In this practice, the accountants’ specialized texts realize or illustrate what MacIntyre calls “the twofold excellences” (the intellectual and moral virtues) of accounting practice. For our purposes, the “internal goods” of accounting can be understood as the decisions made and the specialized texts created by the competent accountant in producing and diffusing accounting knowledge. The accountant uses technical skills and ethical sensibility – expressed in his or her judgment – to classify financial transactions and record them according to accounting standards. This is the proper activity of the accountant.

The items written into the balance sheet or income statement by the accountant constitute the products of the discourse created by the accountant to communicate
useful knowledge to stakeholders. Guided by accounting standards deemed authoritative, the dutiful accountant has processed financial information and expressed it in the special, systematic forms of the financial statements, thus rendering it as appropriate accounting knowledge. In this process, each part of the financial statement is integral to the overall purpose of the accountant to provide useful knowledge to facilitate stakeholders’ decision making. In MacIntyre’s language: as accountants perform their distinctive tasks related to the preparation of financial statements, they manifest intellectual and moral virtues by creating the internal goods of accounting practice (the specialized texts), and thus they engage in the practice of accounting discourse. By thus doing their job, accountants faithfully pursue the goals of accounting practice.

Each of the accounting standards established by law, regulation, and professional code, as well as the institutions that monitor accounting discourse and the decision processes through which the accountant’s intellectual and moral virtues are embodied in financial statements, is significant for our description of accounting as a discursive practice. In accounting practice, technical proficiency and ethical sensibility are expressed through the accountant’s judgment, and this results in the written accounting texts. The exercise of judgment and the creation of properly written texts (the production of the internal goods of accounting, to use MacIntyre’s terms) are required by accounting standards and the institutions that monitor accounting practice. In this way, the standards and institutions hold the accountant responsible for technical and ethical decision making. In MacIntyre’s language, the intellectual and moral virtues of the accountant are realized as “internal goods” of accounting practice, with institutional standards supporting their expression in financial statements and audit opinions. As internal goods these judgments and the resultant accounting texts represent crucial stages in the discursive practice. In the proper production of the specialized texts of accounting and auditing, the ethical expectations and purposes of the practice itself are achieved. We elaborate on this below.

Because of the great potential of accounting knowledge to influence business decision making – with its capacity to shape society and create opportunities for human development – accountants cannot “do as they please” when representing companies’ activities and status to stakeholders (Schweiker, 1993; Arrington & Francis, 1993). Accounting practice and discourse must conform to the spirit and the letter of accounting standards. In other words, there are “prescriptions” for what is to be represented and how; there are rules to obey and “codes” to follow (Llewellyn & Milne, 2007). In addition, institutions have been created to regulate accountants’ discursive activity. When accountants join their practice, they bind themselves to these accounting standards (principles, rules, codes, exemplary models) and to various mechanisms of legislative, governmental, and professional regulation.

Accountants’ judgments and actions are answerable to these institutions that constrain their knowledge production and its diffusion. Institutions – by their standard-setting and the monitoring of accountants’ texts – support accounting discourse and shape its practice. Accounting standards and institutions set the appropriate forms of textual expression for accountants’ communication. In essence, accounting standards are the authoritative principles and rules that guide accounting discourse in its communication about financial transactions. In brief: accounting standards mark
the technical limits and the ethical expectations of accounting practice. The standards set the ethical restraints and moral patterns for proper discourse, so that accountants may fulfill their responsibilities to stakeholders – be they management, investors, creditors, or the general public. In following the standards, making technical and ethical judgments, and creating financial statements, accountants achieve the goals of their practice.

CHAPTER REVIEW QUESTIONS

1. (LO1) Briefly explain how and why ethics has come on the agenda in accounting.

2. (LO2) Describe some key issues related to the integration of ethics in accounting curricula, and why these are important for how and why ethics should be taught to accountants.

3. (LO3) The chapter states that accountants need a dual competency – technical proficiency and ethical sensibility. Write a couple of paragraphs to explain what this means.

4. (LO3) The chapter claims that accounting has both a technical orientation and an ethics-oriented practice. Write a couple of paragraphs to explain what this means.

5. (LO6) Accounting is a discourse that communicates financial information to stakeholders and speaks of the financial status of business entities. Why is ethics important for this discourse?

6. (LO1) Accounting has standards – principles, rules, and standardized decision procedures – for making financial reporting decisions. Why are ethics important for its practice? (Aren’t accounting standards adequate, in and of themselves?)


8. (LO3) The chapter suggests that the twofold competency of the accountant (technical proficiency and ethical sensibility) implies that there are four types of accountants. Briefly account for each type and explain how these four are different from each other.

9. (LO3) Consider the four types of accountants, the destructive accountant, the good-hearted accountant, the opportunistic accountant, and the virtuous accountant. Explain which accountant made the following decisions and describe how these accountants might become a virtuous accountant if they are not.

   a. Cedric is an auditor for Stuart LLP working on the audit of Pedersen Enterprises. He knows that Pedersen Enterprises needs a bank loan to continue in operations the following year. Pedersen Enterprises is a small landscape company and he knows how hard the employees have
worked to build the business. If they do not get a loan, they will have to close. This means that he will lose an audit client. Cedric decides to allow the company to recognize revenue early for contracts that will be done after year-end, so the company appears to be more profitable. The early recognition of revenue should allow Pedersen Enterprises to receive the loan they need to stay in business.

b. Dominyka is an accountant for Scott Company. She receives stock options from the company as part of her salary. She benefits from the stock options when the stock price increases, because she can then sell the options for more than they cost at the grant date. She knows that the company should include an estimate of bad debt expense on the financial statements, but, if they do so, net income will decline, and the price of company stock is likely to fall. If this happens her stock options are worthless. She decides to prepare the financial statements without the reduction for bad debt expense, to report net income higher than the previous year. This should increase the stock price and then she can exercise her options.

c. Fumika is an accountant for BCS Inc. She is one of the executives who receives a bonus if net income increases by 6%. She does not understand the accounting rules for recognizing revenue related to leased office space, but she believes that all revenue recognized during the life of the lease should be recognized in the current year, even though the length of each lease is five years. She knows the accounting rules permit the company to recognize revenue when the service is provided and her company allowed the clients leasing the office space to begin using it immediately.

10. (LO3) Consider the four types of accountants, the destructive accountant, the good-hearted accountant, the opportunistic accountant, and the virtuous accountant. Describe what is missing from each accountant’s experience. How can you transform the destructive accountant, the good-hearted accountant, and the opportunistic accountant into a virtuous accountant?

11. (LO4) Explain why accounting is so important to societies and why there is a need to make sure that accountants “play by the rules”.

REFERENCES


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