The Ethics Of Accounting And Finance: Trust, Responsibility, And Control

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The fiduciary relation results from the manifestation of consent by one person to another that the other shall act in his behalf and subject to his control, and consent by the other so to act.... The law of agency (therefore) is based on the maxim that one acting by another is acting for himself.
Clarkson, Miller, and Jentz (1986)

When Bellah et al (1991) quoted Niebuhr (1978) saying "Trust is never to be taken for granted", they not only agreed with him but also described him as "sociologically realistic and religiously perceptive".

This book presented a fine collection of selected papers from the tenth National Conference of Business Ethics. The conference was sponsored by the Center for Business Ethics at Bentley College with the advice and assistance of the faculty in the Department of Accountancy. Contributors such as academicians, lawyers, government officials, and financial services and accounting professionals offered a multidimensional look at the ethical problems and issues that confront the financial services and accounting industries. The central theme throughout the book, however, was the focus on the importance of ethics and its proper role in the way financial services and accounting are performed. The editors of the book succeeded in assembling a consistent and challenging group of readings that is crucial to both ends of the financial services, the client and business agent. A variety of issues that are of special importance to contemporary business were addressed. These issues included fiduciary responsibility and conflicts of interest in the world of financial services, ethical problems in financial reporting, the ethical implications of new financial instruments such as derivatives, and the expanding ethical role of auditors and audit committees.

The editors chose the best eighteen papers from the conference and organized them in this volume into four parts: Part I, "Ethics, Fiduciary Responsibilities, and Conflicts of Interest" contained five chapters. Chapter 1, "Defining Trust in Fiduciary Responsibilities" analyzed the professional relationship between a fiduciary and a principal as founded on and characterized by trust. Each of the principal and fiduciary has a set of rights and responsibilities. A principal has the right to skillful and diligent performance of contracted services, prompt communication of all relevant information, loyal commitment, obedience to his instructions, and a complete and accurate account of all of his funds. These principal's rights are viewed as the fiduciary's responsibilities. The responsibilities of the principal, however, are viewed as the rights of the fiduciary. They include full compensation for services, reimbursement for expenses and indemnification of liabilities, cooperation, and safe working conditions. This fiduciary relation has, in recent years, become a model that crossed the traditional boundaries of the financial world. The relationships between doctors and patient, lawyer and client, social worker and case subject, and clergy and religious members have all been seen as fiduciary relations. In Chapter 2, "In Defence of Finance: Understanding Fiduciary Responsibility and Conflicts of Interests", the author brings in the view of a consultant. The focus here is on the clients' often misunderstanding or incomplete understanding of the nature of financial markets and services especially when it leads them to conclude a breach of fiduciary duty as they suffer financial losses. The breach of fiduciary relation occurs only in case of fiduciary's incompetence or his failure to act in the client's best interests. It is stated here that financial conflicts of interests are commonly thought to be more frequent and serious than they really are. The author explained that the client's success is, in fact, a precondition for the success of the agent. Consequently, their interests are complementary rather than conflicting. Chapter 3, "Should Mutual Fund Managers Be Banned from Personal Trading?" discusses a report issued by the mutual fund industry's Advisory Council on Personal Investing

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and presented to the Securities and Exchange Commission. The author concluded that the report did not scrutinize the arguments for and against personal trading thoroughly enough, and thereby missed an opportunity to genuinely examine substantive issues and prevent possible future problems in the industry. Chapter 4, "Fiduciary Responsibility and the Duty to Account for Client's Funds" probes the legal and ethical implications of fiduciary relations from the perspective of accounting as it applies to the duties of an attorney handling money for a client. Ethical requirements imposed by the bar such as maintaining separate accounts of a client's funds and providing a complete and accurate reporting on the funds are violated more often than might be expected. The authors argue that it is not enough to cite professional codes unless practitioners are truly convinced they are relevant. The challenge to the profession, therefore, is to make fiduciary responsibility consonant with its roots in ethical and moral behavior, and thus with the tradition of the competent and caring professional. Chapter 5 concludes Part I by "Some Ethical Issues in Financial Markets". After citing examples of activism by institutional investors and municipal bond trading, the author concludes that more inclusive moral frameworks are needed to better serve and resolve the most common ethical dilemmas. Citing the voluntary ban on campaign contributions by a number of Wall Street firms, the author states that only through exercising systematic moral problems can be dealt with effectively, and perhaps even eliminated.

Part II, "Ethics and Financial Disclosure" included three chapters. Chapter 6 discusses some ethical issues in financial reporting for nonprofit healthcare organizations. The author calls for federal legislation requiring hospitals to make publicly available and timely audited financial statements. The author also recommends the formation of visible and accounting-literate watchdog groups to represent the public interest at the state or municipal level. Chapter 7 which is entitled "The Ethical Implications of Financial Derivatives" focuses on the accountant's role in the financial reporting of derivatives and other instruments such as junk bonds. Although the Financial Standards Accounting Board (FASB) states that the "ethical imperative for financial reporting of derivatives is the fair presentation of neutral information for economic decision-making", the author argues that the FASB standards lag behind the introduction of new innovative instruments created by financial engineers. In spite of all the regulations and standards, *caveat emptor* is still the way of the financial marketplace. Chapter 8, "Confidentiality in a Professional Context with Especial Reference to the Accounting Profession in Australia" present an interesting view of the ethical dilemma in the financial world, and that is the need to withhold information. The author argues that despite the code of confidentiality in the accounting profession, the normal relationship of trust and disclosure between an informer and a confidant does not hold especially in the public accounting context. The author believes that the accounting profession must stress the primacy of independence over confidentiality as a value of its members to uphold.

Part III, "Trust, Responsibility, and Control: Cases and Analyses", included six chapters. Chapter 9 took us through the details of the crisis of Bank of Credit and Commerce International(BCCI). Entitling his chapter "Accounting for Fraud: Auditors' Ethical Dilemmas in the BCCI Affair", the author, an expert in criminal justice, blamed the professional concern to preserve client confidentiality and the incomplete audit responsibility as reasons, among others, for an international fraud of that magnitude to go undetected for more than ten years. Chapter 10,"Was Maintaining the Executive Payroll at PTL an Example of Auditor Independence?" focus on auditor independence rather than on confidentiality. In explaining the catastrophe of the Praise the Lord organization, the author believes that had the PTL auditors been independent from the organization authority, been more proactive, and less mechanical in their handling of the payroll, PTL would not have gone down the drain the way it did. In Chapter 11, "From Monitor to Master: Ethical Comments on the Regulation of Fraud Notification by Accountants", the author who is professor and director of the European Institute for Accounting and Auditing Research, presents the arguments for and against the Dutch accountants' 1994 decision to tighten their self-regulation by notifying their government about clients' fraud. In this interesting discussion, the author elaborates on three ethical considerations, whistle-blowing, confidentiality and trust, and civil virtues. Chapter 12 "Unique Ethics Challenges in Defence Industry Auditing" tackled with the very sensitive and complex issue of having the U.S. government, specifically the Department of Defense as a client. The author, a manager of operational audit at Bath Iron Work whose business is entirely defense-related, went over the defense contractors' unethical practices, the formation of the 1985 Packard Commission, the 1986 Defense Industry Initiative (DII), and the 1991 Federal Sentencing

Guidelines. As the DII became a textbook of business ethics and conduct in the defense industry, the author states that by 1994 almost half of the firms winning federal defense contracts were DII signatories. Chapter 13, "The Critical Oversight Role of the Audit Committee" defined the Audit Committee and explained why it was essential. While explaining all about the external pressure for corporations to have audit committees, he revealed that the only state to require them was Connecticut, and the only federal level was that of the 1991 FDIC Improvement Act that came after the S&L crisis. The ethical ramifications of the Saving and Loan crisis, the preconditions of the FDIC Improvement Act, and other commercial banks crises are fully analyzed in Chapter 14, "Why Banks Fail".

Part IV was designed to wrap up the book by "Lessons from the Past and a Look toward the Future". Chapter 15 traveled through the history of economic thought as far back as to Aristotle days. The author wanted to prove that such a history provided very little support for those who believe regulation is the best way to manage financial derivatives. The competitive nature of the market, not ill-conceived efforts to regulate it, would be the most effective method of control. In Chapter 16, the author, Rabbi Cohn presented a religious perspective of the moral values, the Talmudic approach, to examine secular problems such as earning misrepresentation. Chapter 17,"The Development of Moral Reasoning and Professional Judgment of Auditors in Public Practice" expose the findings of an empirical study on the same topic using Kohlberg's theory of moral reasoning competence as a framework for analysis. Chapter 18, the last chapter, is entitled "Trust Is Good Business". It focused on the notion that maximizing client welfare is the most reliable long-term source of profits and success for financial firms.

Although I was pleased by the comprehensiveness of the ethical issues discussed in this book, I was bothered by the lack of the discussion of these issues from the perspective of the individual finance. It is no secret that the general tone of the discussion leaned toward the ethics in the realm of corporate finance more than in personal finance. While I consider this book a relevant reference to both faculty and students in our field, I strongly believe that the study of Ethics should not only be an essential component of our curriculum but should also be an integral element of continuing professional education for our graduates as they become financial planners and counselors, consumer specialists, and family business experts.

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