

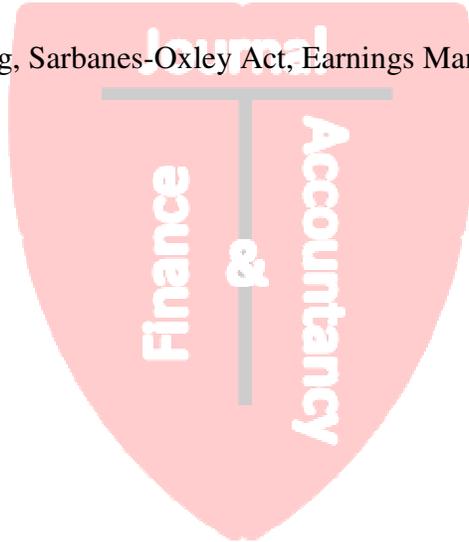
## Ethics in Accounting

Paul Jaijairam  
Bronx Community College

### ABSTRACT

The current information age and business world requires the accounting profession to uphold transparency and provide accurate financial reporting. Accountants therefore, who are responsible for producing accurate, concise, and timely financial reports, must uphold the highest standards of ethical responsibility. However, ethical behavior among accounting professionals is not always assured. The current research examines whether there is a strong mutual interdependence between the accounting profession and the role of the accountant. The study also examines the role of professional accounting bodies' in promoting and enhancing ethics in the global accounting profession. Results indicate that the accountant's role is dependent of the accounting profession ethics.

Keywords: Ethics, Accounting, Sarbanes-Oxley Act, Earnings Management, Ethical Accounting



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## INTRODUCTION

### Background

The Twenty-First Century has witnessed a surprising and disheartening number of accounting scandals, implying a significant failure in the management oversight and reporting process, despite the existence of the professional ethics standards developed by the Institute of Management Accountants (IMA). In response to those failures, it became apparent to organizations that a critical review of the relationship between the accounting role and accounting professional was required. Organizations are now re-examining ethics in the accounting profession with a renewed interest in training and developing individuals to reinforce strong ethical principles and behavior.

Due to the sensitivity around a company's financials, a study of accounting ethics is required as it is an essential aspect of the roles of auditors and accountants in preparation of financial statements. Generally, the term ethics refers to morals or a code system that strongly offers the criteria for distinguishing between wrong and right (Banerjee & Ercetin, 2014). Ethical dilemmas are common occurrence in the workplace and originate from a situation where a group or an individual must make a decision between two options, where the answer is not always black or white. For managers, investors and even small-business owners, it is imperative to learn accounting ethics and their functions to avoid financial and legal dilemmas due to the misrepresentation of financial statements.

Financial statements, created with the element of independence and upholding the required ethical attributes, minimize errors and generate suitable information for the users of financial statements (Stice & Stice, 2012). Users of financial statements rely on the accuracy, fair, and truthful representation of financial statements and auditors' opinions regarding whether the statements represent the fair value of the organization (Ronen, 2008). Even auditors and accountants, who are responsible for the integrity of a company's financials, can utilize their ethics knowledge to overcome the ethical dilemmas that they face as they perform their roles. Ultimately, the role of accountants and their relationship to the production of clean and accurate financial statements enhances the reputation of the company in relation to investors, creditors, and other users (Mukarushem & Kule, 2016).

### Statement of the Problem

Scholars have not been able to make clear assertions regarding the two most important variables that impact ethics amongst accounting professionals: organizational codes of ethics and individual personal values. Currently, a problem exists in establishing whether it is the organizational culture that influences ethical practices among accounting professionals most or whether it is the individual accountants' or auditors' outlook on ethics. It is difficult to ascertain the real determinant of accounting ethics among professionals and to understand what pushes them to practice and uphold ethical behavior in their roles. Further, it is important to note that ethics in the accounting profession is not a mere compliance requirement. It must either be embedded within an organization's culture or in an individual's attitude. The current study seeks to resolve the problem through opinion research in the form of a survey.

## Objectives of the Study

The study explores how ethics entrenched in organizational cultures impacts the conduct of accounting professionals in the execution of their roles. The research also reviews the influence of personal attitudes towards the adherence to ethical codes by accounting professionals. By utilizing the Rest Model or the “Four Component Model of Moral Sensitivity,” the study aims to recognize the influential and significant factors that motivate accountants.

Developed in 1994 by Narvaez and Rest, the model is comprised of four components of ethical decision-making: moral sensitivity, moral judgement, moral motivation, and moral character (Schwartz, 2013). The first step relates to moral sensitivity and involves ethical evaluation which is determined by a professional’s ethical sensitivity to review a situation at hand based on their perception and interpretation (Jeffrey, 2015). In this case, an accounting professional will have to review a decision to be made in consideration of whom his or her decision affects and how it will affect themselves. It requires a careful evaluation of whether their decision will include fairness. The second step of the model includes the moral judgment component which is influenced by a professional's moral motivation. The third step relates to the moral motivation of an individual and involves the decision-making process. Here, a professional decides the right course of action to take but in consideration of ethics and morals (Cooper, 2001). The decision made however, is influenced by a professional’s intention and moral motivation. Finally, in the last step of the model, a professional must execute or implement their judgment or intention as determined by their moral character. Moral behavior requires proper functioning of all the components of Rest’s Model.

Consequently, in consideration of the model’s components, the research also examines the undeniable role of ethical motivation combined with the emergence of ethical conduct that originates within one’s self. Furthermore, the research re-examines the importance of adherence to professional ethics in the accounting role and its relevance to the well-being of corporate accounting procedures.

## Scope of the Study

The research focuses on the responses and views of accountants in relation to their dependency or independency on the accounting profession’s ethics as embedded in the organizational culture. The study also evaluates the impact of accounting professionals’ attitude towards ethics on their decision making, judgment, and adherence to professional conduct requirements. Other aspects that may influence an accounting professional’s ethical conducts is not included in the study. Further, the study only focuses on the views of financial professionals such as accountants, financial managers, auditors, financial consultants, and other professionals who are directly engage in the accounting role on a frequent basis. Thus, views from other professionals who do not actively and directly play a role in the accounting field are not included in the study. The survey purposely focuses on professionals within the financial services industry, and does not consider those who are working in other industries.

## Significance of the Study

The study supplements the existing literature on ethics in accounting by contributing new information regarding the role of organizational culture in imparting ethical conduct among

accounting professionals. It also provides further information regarding the impact of personal attitudes held by accounting professionals regarding their ethical conduct in making judgments and decisions as they perform their roles. The identification of influential and significant factors that are related to ethical motivation of management accountants is vital in organizational management. The findings of this study can be used by organizational managers and decision makers in determining the best course of action that they can take to ensure compliance with ethical standards in the preparation and presentation of financial information. Additionally, the literature provided by this research can be used by researchers who may want to expand research in this field in future.

## **LITERATURE REVIEW**

### **Introduction**

Significant literature from prior studies on ethics in accounting exists. Therefore, research on this topic has been done before. However, existing studies have focused on other perspectives of the ethics debate in relation to the accounting profession. This section reviews the existing literature, providing theoretical, conceptual, and empirical literature to inform the research process.

### **Background to Ethics in Accounting**

Ethics in accounting is mainly known as applied ethics, which strongly emphasizes human and business ethics, judgments, moral values, and their application in accountancy. Generally, the major ethical drivers of accounting are an appropriate practice and a good standard of professionalism. According to Micewski and Troy (2006), the ethical responsibility within the business world is not holistic, but lies under the particular context of ethical behavior. A majority of the corporations in the world have instituted ethical issues in the accounting processes, which increases the potential for conflict of interest. Breach of ethical rules within the corporate finance practice, through financial misstatements, usually damages an organization's reputation, customer satisfaction levels, and the trust of investors on the company.

According to Johannes Brinkman (2002), ethics is the discipline that exhibits the matters related to evil and good, wrong and right, and vice and virtue. Therefore, ethics are used to examine moral principles, human behavior, and their efforts to distinguish between good and bad. The development of ethical codes within organizations can secure the fidelity of business transactions and financial processes, which in turn, affect employee performance, relationship, and credibility of the company.

The role of accountants in regards to the timely and accurate preparation of financial reports is of significant importance to decision-making by investors, managers, and other senior management officials. Adherence to ethics in accounting also aids in ensuring compliance of internal control systems with standards. Therefore, accountants can identify and measure resource wastage, investigate, and perform roles that can contribute to the improvement of policy formation and fraud identification in an organization (Elias, 2002). Unethical behaviors not only degrade the reputation and credibility of an individual, but the company as well, increasing the likelihood of criminal activities that could result in the decrease in profit levels (Sims, 2003).

Therefore, it is essential for accountants to strictly adhere to behavioral accounting profession ethics.

### **Earnings Management and Ethics**

'Financial ethics' is usually regarded as the greatest problem of the accounting profession. The fraudulent activities, in the financial set-up, occur when accountants and managers do not adhere to the standards of earnings management ethics. In such cases, managers and accountants alter financial information. This alteration usually entails the addition of predetermined results in the financial statements, which gives different results than the actual ones. This behavior of earnings manipulation within the accounting profession is usually referred to as earnings management (Ronen & Yaari, 2007). It leads to doubt, especially when fraudulent activities or data infringement take place. The social norms or the organizational culture linking earnings management ethics, play an extensive role in determining the norms observed in an organization. It is believed that the acts, amendments and the articles of Sarbanes-Oxley Act may help in bringing the ethical standards within the financial set-ups (Strohm, 2006). Failure to decrease organizational tolerance, to the levels of earnings management in response to the Sarbanes-Oxley Act, will result in a substantial discrepancy between an organization's culture and societal norms for earnings management behavior. Moreover, the professed control over ethical behavior includes factors related to the direct involvement of managers and accountants in earnings management.

The Sarbanes-Oxley Act was introduced after numerous, high-profile corporate accounting scandals such as Enron, Tyco, and WorldCom shook investor confidence in the United State (Grama, 2015). The Sarbanes-Oxley Act strongly advocates that an organization's management should have accurate and fair financial reporting (Vay, 2006). In addition, the competence levels of an organization's internal control system in disclosing its weaknesses should provide reasonable assurance that there will be accurate and fair reporting. The aforementioned provisions are meant to ensure ethical earnings management practices by organizations. Therefore, the Sarbanes-Oxley Act focuses on preventing organizations from committing misleading or fraudulent acts, specifically in financial information reporting.

### **Case Study: Earnings Management and Inappropriate Accounting in Enron**

Enron and Arthur Andersen faced a very strong infamy that resulted in their bankruptcy (Grasso, et al., 2009). Enron and Arthur Andersen, being the two giants in the utility and accounting industries, respectively, took advantage of public and government bodies and investors to increase their personal wealth through illegal and unethical activities. Investigations by the Securities Exchange Commission (SEC) established that Enron had engaged in unethical activities in regards to fraudulent financial reporting (Jennings, 2009). Essentially, it was the negative effects of fraudulent accounting within Enron that brought the company down. As noted by Grasso, et al. (2009), inappropriate accounting extensively decreased the value of the company's stock in the capital market and posed an indirect impact on its corporate reputation causing a major setback to their brand name. Thereafter, huge penalties were imposed on the company and strict laws regarding accounting standards were introduced to provide more transparency and reliability to company's financials.

There had been distinct safety measures that significantly helped in protecting the public and investors before the fall of Enron. Such measures of safety included the Generally Accepted Auditing Standards (GAAS), Generally Accepted Accounting Principles (GAAP), Statements on Auditing Standards (SAS), and professional ethics (Louwers, 2007). The requirement to use GAAP standards by accountants provides the standard protocol, which provides the dynamic set of both specific and broad guidelines in the preparation of financial statements and documents. However, in addition to these guidelines, there still needs to be auditing of the financial statements, whereby independent and external auditors carry out strict checks to ascertain whether an organization consistently follows GAAPs in financial statement preparation.

In the case of Enron, such regulations were strongly adopted in order to bar investors from raising money from the increased stockholder's investment by dissolving their accountabilities to subsidiaries and by strengthening their balance sheet with the values of inflated assets (Stinson, 2017). Consequently, Enron was unable to incorporate information regarding such organizations in their financial statements, which resulted in substantial misstatements.

GAAP regulations include the setting of standards for the audit cycle and how financial statements are presented under the GAAS regulations. Consequently, auditors should analyze and determine the essential tests to adopt, establish the acceptable audit level, and decide on the extent to which testing can be done. In view of these provisions, Enron's auditors were independent. There was no conflict of interest surrounding the auditors and their clients because if there was, they would have been disqualified. Additionally, it is essential to adopt the SAS standards along with various other standards while supporting and protecting the public interest. Furthermore, the banking information collected from both Enron and Arthur Andersen indicated that standards and regulatory policies would comply appropriately while auditing (Cagle & Baucus, 2006). Strict adherence to GAAS and GAAP regulatory standards is essential in ensuring that ethics in accounting are adopted, as they can aid in the prevention of fraudulent activities within an organization. In cases where GAAP and GAAS principles are practiced appropriately, auditors can determine the exact financial position of the firm for the good of investors and other users of the financial information. As a result, the trust level increases amongst investors, customers, and senior leaders.

In consideration of the aforementioned, it is essential to ensure high standards of ethics in accounting to ensure the preparation of valid and reliable financial statements. In the case where changes are required, they should be executed to prevent recurrence of similar fraudulent events in future. In addition, training and counseling sessions should be introduced by organizations to ensure adherence to ethical standards in accounting procedures. In addition, organizations should develop high-quality financial reporting and institute effective quality control frameworks.

### **Impact of Ethics in Accounting on Society**

Ethics in accounting requires that financial statements should be useful for end users in order to ease their financial decision-making process. Business society expects accounting professionals to adhere to ethical standards and ensure the timely, accurate, and transparent information is presented to all end-users. Any attempts to deliberately construct false financial statements could severely damage the reputation of a business and lead to the following:

- a. Increased criminal and fraud activities:** Poor ethical considerations by a company's accountants minimize the level of oversight and control by superiors, which creates

loopholes for auditors to engage in unethical behavior and conceal evidence. It creates opportunities for significant data manipulations, leading to the commitment of serious crimes such as tax evasion and fraud.

- b. Damaged reputation of the business:** Unethical activities by accounting professionals affect an organization's trustworthiness and reputation to its stakeholders. Absence of trust due to unethical activities taints the firm's identity, which makes it difficult to conduct business.
- c. Limited usefulness of financial statements:** Unethical behaviors of accountants are violations of the regulations because they entail financial statement information manipulation. Consequently, such financial statements have a less appropriate legal status, which greatly affects the decision-making process.

### **Responsibilities of the CEO, CFO, and Auditors in Developing Ethics in Accounting**

It is the responsibility of senior management, including the Chief Executive Officer (CEO), Chief Financial Officer (CFO), and Controller to develop ethical standards in an organization. It is essential for the CEO and the CFO to portray truthful and ethical behavior because the responsibilities of handling ethical issues rest on their mandate. They should handle apparent and actual conflicts of interest between their professional and personal relationships appropriately. The CEO and CFO should control the weaknesses and deficiencies in the operation and design of internal controls in regards to the reporting of financial statements. Therefore, they should improve the process of recording, reporting, and summarization of financial information. Also, it is essential to identify and control fraudulent activities by engaging employees and higher management in the development of internal controls for the reporting of financial resources.

The role of the CFO in an organization is to subsequently collect and manage the design and implementation of the internal control system to ensure compliance with the Sarbanes-Oxley Act. Further roles include the development of effective financial reporting in order to improve the organization's internal controls and ethical standards. It is also an essential obligation of the CFO to cultivate an ethically accountable culture within the organization by instituting continuous improvement towards accounting controls and process excellence.

Accountants are required to ensure that the financial statements' opinion is in accordance with the framework of financial reporting in order to develop ethics in accounting. Auditors should ensure a high degree of confidence in managing and controlling the financial statements to aid the users, such as investors and lenders, in their decision-making process. Auditors should also aid in the collection of sufficient and suitable evidence and observe, compare, test, and confirm the validity and fairness of financial reports to enhance reasonable assurance. Auditors help in understanding and evaluating internal control systems and provide support for developing the procedures for performing analytical auditing strategies.

### **Rules and Regulations**

Both the government and the private sector strongly focus on instilling ethical practices within accounting firms. To ensure mitigation or reduction of unethical behaviors within the society, the development of ICAEW's Code of Ethics is strongly emphasized. This code was developed by the Institute of Chartered Accountants in England and Wales to instill moral or

ethical behavior among professionals, scholars, and firms in their professional business activities (ACCA Global, 2016). The code outlines rules that guide professional behavior among accounting professionals in:

1. Improving the financial market and providing assurance for financial information, on which decisions of stakeholders and investors are dependent. It also aids in enhancing equal allocation of resources to all stakeholders.
2. Ensuring that it contributes to individual company growth, and sustains and supports non-profit organizations to assist them in attaining social and economic objectives.

### **The Sarbanes-Oxley Act of 2002**

The Sarbanes-Oxley Act, was introduced with the aim of protecting investors from fraud through improving the accuracy and reliability of corporate disclosures and was designed to adhere to existing securities laws (Leonard, 2011; Strohm, 2006). There should be ways of preventing and detecting fraud in financial statements (Vay, 2006). Therefore, the Act requires management to assess and provide reports regarding the effectiveness of internal control over financial reporting (Leonard, 2011). Additionally, The Institute of Internal Auditors (2008) indicates that auditors should evaluate whether management's assessment of the effectiveness of the internal controls is appropriate. The Act is meant to enhance ethics in accounting by preventing financial statement's fraud, through the manipulation of earnings management (Ronen & Yaari, 2007). Therefore, the Sarbanes-Oxley Act was introduced to prevent criminal and unethical activities by accounting firms through the issuance of criminal penalties for misconduct relating to fraudulent financial statements.

## **RESEARCH METHODOLOGY**

### **Research Design**

The study adopted a qualitative descriptive research design. A survey method was used to collect primary data. A descriptive survey was ideal for this study due to its ability to consolidate qualitative and quantitative data. In addition, both structured and semi-structured data is easily collected (Blumberg, Cooper, & Schindler, 2014). A qualitative descriptive research design provides a valid and accurate representation of the factors and variables under study. For instance, in this case, a qualitative descriptive research design appropriately found out how ethics embedded in organizational culture impact the conduct of accounting professionals in executing their roles. It also aids in finding out the influence of personal attitudes towards the adherence of ethical codes by accounting professionals.

### **Data Collection Methods and Tools**

Primary data was collected by Augustine, et al. (Management Sciences faculty member, University of Benin) in order to find out the ethical role of accountants. The primary data collected by Augustine entailed an assessment of the responses from accountants in relation to their dependence on or independence from, the accountant's role in accounting profession ethics. Data was collected using questionnaires, presented to employees at various financial institutions. Personnel from the finance, accounting, and management departments were requested to respond

to the questionnaires with answers that depicted their views. There were ten questions in each questionnaire. Predetermined multiple choice responses were provided for each of the ten questions. The participants chose from five alternative responses that had been designed using the Likert Scale. To each question, the respondent was to choose one of the following responses;

- 1 = Strongly Disagree
- 2 = Disagree
- 3 = Undecided
- 4 = Agree
- 5 = Strongly Agree

### Sample and Sampling Methods

The research sample was picked using the simple random sampling method. This approach was ideal because it eliminated researcher bias and created an equal opportunity for each prospective contributor to be chosen. A sample of 500 people were selected. The chosen respondents were contacted and questionnaires were presented to them to ensure 100% response rate. Given that the study focused on the views of financial professionals such as accountants, financial managers, auditors, financial consultants, and other professionals who were directly engaged in the accounting role on a frequent basis, participants were randomly chosen from this group only.

### Data Analysis and Presentation

The study analyzed the primary data collected from the responses provided by accounting professionals in order to assess the effectiveness of the null hypothesis. In this case, the null hypothesis was; the accountant role is dependent on the accounting professional ethics. Data was collected from the sample participants' response, assessed, coded into themes, and then analyzed using the Chi-Square statistic technique, by use of Microsoft Excel. The Chi-Square statistic was utilized for data computation because it appropriately analyzes the dependence or independence of accountants' role on accounting profession ethics. The null hypothesis was tested at the significance level of  $p \leq 0.05$  with a maximum acceptance error chance of 5%, which provides the Type 1 error to the statisticians for their maximum acceptable level. The research intended to provide the 95% confidence level, which is effectively utilized for hypothesis testing in management and social sciences. The statistical measurement formula based on Chi-Square is:

$$\chi^2 = \sum \frac{(o - e)^2}{e}$$

Where, the term ' $\chi^2$ ' is the Chi-Square statistical factor, 'e' is the expected value, 'o' is observed value. The rejection or acceptance decision policy is based on the factors related to whether the computed value of Chi-Square statistics is greater to the theoretical value or not. If it is greater, then the null hypothesis cannot be validated due to the significance of the results.

### RESULTS AND DISCUSSION

Collected data was categorized into two themes, "Ethics" and "Accountants' Role". The "Ethics" theme required information to ascertain whether accounting professionals are dependent on the ethics embedded in the organization's culture, in observing and exhibiting ethics in their

accounting or professional practice. Conversely, the "Accountants' Role" theme aimed to determine whether accountants are independent of the ethics embedded in organizational culture, but rather exhibit standard ethics in accounting, dependent on their accounting role or attitudes.

The results on the "Ethics" theme indicated that 57.6% of the surveyed participants strongly agreed that they depended on organizational ethics to exhibit ethics in accounting, while another 27.2% agreed that they depended on organizational ethics to exhibit ethics in accounting (Table 1). Approximately 5.6% of the participants were unsure whether they were dependent on organizational ethics or not. Of the remaining population, 6.8% of the participants disagreed that they were dependent on organizational ethics to exhibit ethics in accounting, while 2.8% of the participants strongly disagreed with the claim that they were dependent on organizational ethics to exhibit ethics in accounting.

Regarding the "Accountants' Role" theme, 41.2% of the interviewed participants strongly agreed that they depended on their roles to exhibit ethics in accounting, while 31.6% agreed that they depended on their roles to exhibit ethics in accounting. Roughly, 10.4% of the participants were undecided about this issue. Lastly, 10.8% disagreed that they were dependent on their role in exhibiting ethics in accounting, while 6% strongly disagreed that they were dependent on their role in exhibiting ethics in accounting.

Results from the Chi-Square statistical analysis (Table 2) exhibited that the computed Chi-Square value of the samples is 16.4 for the sample population of 500 total participants, with the degree of freedom of  $(5 - 1)(2 - 1) = 4$ . Thus, a 95% level of confidence exists. The results equate to an approximate 9.49 Chi-Square statistical value of  $\chi^2_{4, 0.05}$ . These results indicate that the theoretical value is much smaller than what was calculated from the organization's response. This further indicates that the proposed hypothesis related to the dependence of an accountant's role in the accounting profession ethics is valid. Simply stated, the accountant's role is dependent on organizational accounting profession ethics.

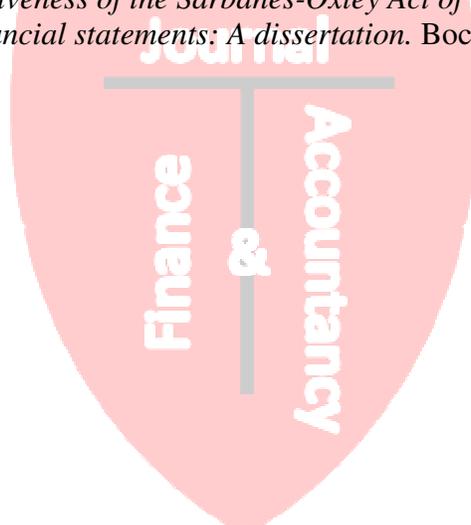
## CONCLUSION

The research established that ethics dimensioning for the accounting profession is essential for national professional bodies in increasing business reputation, and usefulness of financial statements, while decreasing criminal activities and fraud. The research hypothesis also proved that the accountants' role is dependent on an organization's emphasis on culture and accountability. Therefore, it is essential for the government and public governing bodies to advocate and develop ethical practices in accounting firms.

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## APPENDIX

Table 1

*Collected data*

Collected Data						
	SA	A	U	D	SD	Total
Ethics	144	68	14	17	7	250
Accountants' Role	103	79	26	27	15	250
Total Population	247	147	40	44	22	500

SA = Strongly Agree

A = Agree

U = Undecided

D = Disagree

SD = Strongly Disagree

Table 2

*Chi-Square values presented by Enofe, et al (2014)*

Cell	e	O	o-e	(o-e) <sup>2</sup>	$\frac{(o - e)^2}{e}$
1.1	123.5	144.0	20.5	420.3	3.4
1.2	73.5	68.0	(-5.5)	30.3	0.4
1.3	20.0	14.0	(-6.0)	36.0	1.8
1.4	22.0	17.0	(-5.0)	25.0	1.1
1.5	11.0	7.0	(-4.0)	16.0	1.5
2.1	123.5	103.0	(-20.5)	420.3	3.4
2.2	73.5	79.0	5.5	30.3	0.4
2.3	20.0	26.0	6.0	36.0	1.8
2.4	22.0	27.0	5.0	25.0	1.1
2.5	11.0	15.0	4.0	16.0	1.5
<b>Total</b>					<b>16.4</b>

e = the expected value

o = observed value