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Ethics in Finance and Accounting: Editorial Introduction

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Abstract In light of the recent crisis and its aftershocks, it becomes crucial to reflect on the relationship between finance and accounting and on how to integrate ethics and efficiency, as well as on how to motivate and empower practitioners in the world of finance to commit to justice, fairness and enhanced understanding, and to improving their personal integrity. This article, written as an editorial introduction to a special issue includes works related to control measurement and ethical behavior, misbehaviors in finances and accounting, professionalism in accounting, ethical investing and corporate reporting. We conclude by suggesting further research for a better integration of technical aspects of accounting and finances into business activity—human activity actually—and an for understanding of ethics not limited to rules, but as a mutual and interdependent system of values (human goods), virtues and principles.

Keywords Capitalism · Ethics in finance · Ethics in accounting · Managerial control systems · The separation thesis · Ethical rules · Goods and virtues

> Today we must regain control of the future before it is too late—reverse the financialization process and ensure that finance once again operates in the interests of human dignity and progress.
>
> Manifesto of Observatoire de la Finance (2008).

Finance and accounting are important functions for the management of any firm. Accounting systems are an essential tool for providing information for decision-making, as well as for the evaluation of decisions previously made, and the finance function must seek resources at a reasonable cost and use them efficiently.

Finances and accounting are not merely technical tools with no connection with ethics. They cannot work without trust and trust is not possible without ethics. Ethics includes action, foreseeable consequences and people, with their virtues or lack of virtues, involved in any human activity.

Let us briefly reflect on the causes of the financial crisis. At the end of May 2015, Mrs. Christine Lagarde, Managing Director of the International Monetary Fund, pointed out that "… recently (…) capitalism has been characterized by 'excess'—in risk-taking, leverage, opacity, complexity, and compensation. It led to massive destruction of value. It has also been associated with high unemployment, rising social tensions, and growing political disillusion—all of this happening in the wake of the Great Recession." (Lagarde 2014) This is contrary to what she calls "inclusive capitalism" the attributes of which are "trust, opportunity, rewards for all within a market economy—allowing everyone's talents to flourish." We could add that such "excess" (perhaps more accurately termed, "greed") erodes both the common good and, connected with this, public trust. Again, it is Mrs. Largarde who recognizes such consequences: "In this age of diminished trust, it is the financial sector that takes last place in opinion surveys. This might not be surprising in light of some of the behavior that triggered the global financial crisis. But it is nevertheless disturbing. As many have pointed out, the

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very word *credit* derives from the Latin word for trust." (Ibidem).

From a different perspective, Pope Francis, in quite severe terms, has warned us about the rejection of ethics and the necessity to recover it: "Ethics has come to be viewed with a certain scornful derision. It is seen as counterproductive, too human, because it makes money and power relative. It is felt to be a threat, since it condemns the manipulation and debasement of the person (…) Ethics—a non-ideological ethics—would make it possible to bring about balance and a more humane social order" (Pope Francis 2013, #57). He advocated a financial reform in which ethics is central and proposed the motto: "Money must serve, not rule!" (Ibidem #58). We do not know if Mrs. Largarde read these comments, but in her above-mentioned speech, she affirms something similar: "Thankfully, the crisis has prompted a major course correction—with the understanding that the true role of the financial sector is to serve, not to rule, the economy. Its real job is to benefit people, especially by financing investment and thus helping with the creation of jobs and growth." (Lagarde 2014).

Behind the previous statements are a great number of well-known scandals which, since the beginning of this century, have prompted the business and academic communities to reflect on the role of ethics in the business world. As the financial industry experiences major transformations, there is wide debate about the role of finance in society and how it can and should contribute to the common good. Similarly, certain auditing and reporting activities have been questioned in a number of notorious cases.

The debate has been particularly nourished by the global financial crisis and its aftermath. Voices from different arenas are questioning certain widespread practices of financial and non-financial companies and their management. Managers, businesspeople, politicians and, of course, academics and researchers should learn from the causes of this crisis and the scandals and deliberate on the proper role and ethical content of finance and accounting.

Aligned with this concern, there emerges the necessity to reflect on the analysis of the causes and consequences of ethical and unethical behavior in the financial sector and in accounting practices. Even more importantly, academics should seek and evaluate new proposals for a solid integration of ethics in finance and accounting. These problems were discussed in the 18th IESE Symposium on Ethics, Business and Society, held in Barcelona, Spain, on June 30–July 31, 2014. This special issue contains a selection of articles presented there. This editorial introduction gives an overview of these articles and proposes some short reflections on the integration of ethics in finance and accounting.

Control Measurement and Ethical Behavior

The theory of the firm based on the classical standard economic model proposes value maximization as an objective because, under some assumptions, this decision rule results in a socially efficient outcome. However, in practice, the basic assumptions often do not hold. Apart from other considerations, under the premise that "maximizing value goes first" one could manipulate accounting if necessary. This often leads to poor decisions and to unethical behavior. We suggest that to prevent this from happening, firms must have a strong sense of both internal and external mission, attempting to satisfy the respective real needs of employees and customers while not harming other stakeholders, making decisions in accordance with these two missions and integrating ethics into any management decision.

In the context of management control systems, and more specifically in performance evaluation the establishment of incentive systems typically 'hangs' from performance measures. The root of many misbehaviors is that organizational objectives cannot be entirely quantified; and while it is true that a 'bad' measure is better than nothing (if properly used), a bad measure poorly used may be much worse than nothing. If people are pushed only in the direction of quantifiable goals though 'strong' incentive systems that reward the quantitative results, it is very likely that they will not pursue the 'real' objectives of the firm, but seek to maximize the thing measured instead, which may well be, at the same time, both unprofessional and unethical.

The recent scandal Toshiba is illustrative. Toshiba is one of the ten biggest firms in Japan in terms of revenues, and one which is widely respected. In 2014 Toshiba overstated its profits by more than 1.2 billion dollars, or about one-third of the total figure reported, in order to meet the (otherwise unrealistic) targets that top management had established for the company and its subunits. According to the *New York Times* (Soble 2015), there were problems in "virtually all corners of its business, which encompasses products stretching from refrigerators to nuclear power plants." Therefore, it is easy to conclude that the practice did not have to do with one manager occasionally misbehaving, but with the whole reporting and reward system. The same newspaper also reports that Hisao Tanaka, the serving chief executive, who has subsequently resigned, acknowledged that the company had engaged in "inappropriate accounting," but said this had not been done intentionally, and denied that he had told subordinates to exaggerate the profitability of their divisions. How then, did it come to occur in "all corners of its business"? The answer is quite simple: it was through the

pressure put on the executives by the measurement and reward system. Taking such measures triggered by the control system, they fostered unethical practices (lying to obtain an economic advantage) and damaged the whole company.

Related with control systems is the article co-authored by Cugueró-Escofet and Rosanas (2016), which focuses on the dysfunctional effects of certain current systems of measurement and incentives and the possible ways to overcome these effects and to achieve a stable state of congruence between corporate and individual goals. They develop a model of control systems based on justice.

Misbehaviors in Accounting and Finance

Causes of misbehaviors in finance and accounting can be diverse. The "fraud triangle" theory (Albrecht 1991) is often used to predict the likelihood of fraud within an organization by considering the presence of opportunity, incentive/pressure, and attitude/rationalization. The latter can include lack of awareness, intuition coupled with rationalization, and reasoning (Murphy and Dacin 2011). The model has been questioned, however, since fraud is a multifaceted phenomenon and its contextual factors may not fit into a particular framework (Lokanan 2015). Soltani (2014), by analyzing six well-known corporate frauds—three American (Enron, WorldCom and HealthSouth) and three European (Parmalat, Royal Ahold and Vivendi Universal)—identified possible causes as ineffective boards, inefficient corporate governance and control mechanisms, distorted incentive schemes, accounting irregularities, failure of auditors, dominant CEOs, dysfunctional management behavior and the lack of a sound ethical tone at the top.

Three papers refer to particular aspects of accounting and finance. Vladu et al. (2016) develop a model for detecting earnings manipulators using financial statement ratios from a sample of Spanish listed companies. They suggest that their proposal can be extremely useful in detecting manipulators and can be employed by a wide range of users of accounting information including stock exchange supervisors or investment professionals. Fassin and Drover (2015) highlights the moral dimension inherent in the entry and exit of venture partners and the importance of considering moral judgement, as well as intentions in decision-making. Using twelve vignettes, they look at the asymmetries between entrepreneurs and investors and discusses a set of ethical problems that arise among key actors concerning the dynamics of venture partner entry and exit, applying a multiple-lens ethical perspective to analyze these issues. On their part, Cowton and San-José (2016) identify and explore the ethics of trade credit. Making a distinction between "operating" trade credit and "financial" trade credit, they provide an account of the maximum period for which it is appropriate for one company to delay payment to another from which it has purchased goods or services.

Professionalism in Accounting and Finance

Many unethical decisions and finance scandals have occurred in a context of pressure to obtain short-run results. However, such decisions could have been avoided with good management—in the wide sense of being "good," which involves professional competence, a strong sense of mission and behavior consistent with this by establishing the right priorities.

Accounting and finances need ethical rules, but are rules enough? Rules allow us to answer the question of whether or not a specific practice is acceptable in order to earn money. Rules will say that misrepresentation of the financial situation is not acceptable, nor is the taking of imprudent financial risk nor not acting in good faith in banking operations, to mention a few examples. There are excellent treatises in this line, which can be applauded, but some might question whether it is sufficient to adopt a set of rules added as constraints to economic activities.

Two papers deal with the importance of professionalism in accounting and finance. One of these, authored by Lail et al. (2015), reviews the causes of the recent accounting and financial reporting frauds and shows that regulatory reforms are insufficient. They argue that, although restoring financial reporting systems should begin with reforms, virtuous professionalism is necessary to restore the public-servant identity of the accounting professional. The second paper, by Alzola (2016), critically examines the normative foundations of gatekeeper liability. He posits that gatekeeper liability may be morally objectionable on grounds of both fairness and consequentialism. After systematizing the framing and the moral justification of gatekeeping duties, he questions the normative support for targeting intermediaries instead of primary wrongdoers. He concludes by anticipating some negative (and often overlooked) results of gatekeeping strategies in the accounting profession, specifically in the realm of clientele selection, the expectation gap, and auditor compensation.

Responsible Investment

Responsible investment has been encouraged by a great variety of institutions and voices, including the United Nations, which, since 2006, has backed principles for responsible investment (PRI). Two papers focus on responsible investment. Majoch et al. (2016), by using

empirical research based on an annual survey of signatories carried out by the PRI in a 5-year period, found that pragmatic and organizational legitimacy, normative and utilitarian power, and management values are the attributes that contribute most to the salience of the PRI as a stakeholder. The next paper begins with a reminder that responsible investment provides an opportunity to express and promote ethical values via choice of financial instruments. In practice, however, the majority of retail investors retain a conventional approach to investment. Facing this situation, and based on behavioral economics and nudge theory, Pilaj (2015) develops a conceptual framework to improve the effectiveness of policy-making for sustainable and responsible investment.

Corporate Reporting

A specific field related to accounting, and of course, accountability is corporate reporting. The last two articles of this special issue focus on ethics in corporate reporting. S. Prakash Sethi et al. (2015) discuss the quality of Corporate Social Responsibility reports by some of the world's largest financial institutions. Their evaluation using a novel instrument to measure the quality of reports shows, among other findings, that several factors have a positive influence on the quality of these reports. They find, for instance, more quality in countries based on common law and with higher CSR standards, policies and regulations in place. However firm size has no significant impact. Similarly, integrity quality is higher in countries with a common law regime. They conclude by offering guidelines for companies toward improving the quality of their reports, and several suggestions for further research.

Maniora (2015) focuses on integrated reporting, understood as "a process founded on integrated thinking that results in a periodic integrated report by an organization about value creation over time and related communications regarding aspects of value creation." Through a wide empirical analysis, she examines the impact of such reporting on the integration of environmental, social and governance issues into the business model and the related economic and performance changes. Her results suggest that integrated reporting is a superior mechanism for the integration of environmental, social and governance issues only in some cases.

Conclusion and Future Research

Some papers presented in this special issue posit some current problem regarding the integration of ethics in finance and accounting and present some reflections, but much more research is still necessary; in all fields mentioned here, and others. However, in our opinion, future research should go to the very roots of the problem. In particular, two crucial issues deserve attention. The first is a deep understanding of the so-called "Separation Thesis" and the search for sound alternatives. In accordance with this thesis, "the discourse of business and the discourse of ethics can be separated so that sentences like 'x is a business decision' have no moral content, and 'is a moral decision' have no business content." (Freeman 1994, p. 412) A consequence of applying this thesis is seeing control systems as a business matter exclusively focused on measuring efficiency—remember Toshiba, mentioned above—and accounting and finance are a mere technique. The Separation Thesis, criticized by many, including the solid arguments of Putnam (2002), is contrary to the common sense of ordinary people. Who would say, for instance, that the mortgage securitization of Leman Brothers was a mere technique with no ethical content? Or that Bernard Madoff's behavior was a simple Ponzi scheme? The Ponzi scheme is the technique used but Madoff's behavior was not by any means a bare application of a technique.

The second issue is a broader view of ethics that comes from accepting that it entails not only rules, or vales or virtues, but rules, virtues and ethical values (human goods) which are mutually interdependent (Macintyre 1992; Melé 2005, 2012, pp. 32–3).

It is not our aim here to develop these two big issues, but we would like to suggest that a key for future research could be to go back to the simple idea that business activities are essentially human activities. And, if economic activities are essentially human, they belong to the field of philosophical anthropology and have an intrinsic ethical dimension (Melé and González Canton 2014). This is completely general for business, but in the context of this special issue, we can say that a full integration of ethics in finance and accounting requires seeing finance and accounting not simply as economic tools, or only as mere techniques, but as human activities and therefore intentional.

Being intentional activities, they can be applied to serve the cause of good or, on the contrary, for egoistic interests and to damage others, as happens in what is euphemistically termed "earnings management," when actually there is accounting earnings manipulation or earnings fraud.

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