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# MANAGING AN ENTERPRISE AND ETHICAL DILEMMAS IN ACCOUNTANCY

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Key words: ethics, accounting, financial reporting, management, conflict of interest, ethical dilemmas.

Abstract

The purpose of this article is to present the correlation between management of an economic entity and the development of ethical accounting dilemmas in the era of high-risk business.

In the globalisation era and recurring economic crises, realisation of the objectives of a company takes place under high risk conditions. It is therefore necessary to use a proper management system. The necessary condition for making all decisions is to have relevant information. The value and relevance of these decisions depend on the quality of information which they have been based on. Lack of ethics in accounting has a direct impact on the company's management, which is based on information generated by the accounting system of the company. Ethical dilemmas arising in accounting are also ethical dilemmas arising in the process of business management.

## ZARZĄDZANIE PRZEDSIĘBIORSTWEM A DYLEMATY ETYCZNE W RACHUNKOWOŚCI

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Słowa kluczowe: etyka, rachunkowość, sprawozdawczość finansowa, zarządzanie, konflikt interesów, dylematy etyczne.

Abstrakt

Celem artykułu jest przedstawienie związku między zarządzaniem organizacją gospodarczą a powstawaniem dylematów etycznych w rachunkowości w dobie wysokiego ryzyka prowadzenia działalności gospodarczej.

W dobie globalizacji i powtarzających się kryzysów gospodarczych realizacja celów przez przedsiębiorstwa odbywa się w warunkach wysokiego ryzyka. Konieczne jest zatem stosowanie odpowiedniego systemu zarządzania. Warunkiem koniecznym do podejmowania wszystkich decyzji jest posiadanie odpowiednich informacji. Wartość i trafność tych decyzji zależy od jakości informacji będących ich podstawą. Brak etyki w rachunkowości ma bezpośrednio wpływ na zarządzanie przedsiębiorstwem, którego podstawą są informacje generowane przez system rachunkowości w przedsiębiorstwie. Dylematy etyczne powstałe w rachunkowości są również dylematami etycznymi powstającymi w procesie zarządzania przedsiębiorstwem.

## Introduction

Each entity engaged in economic activity under free market conditions should set goals as well as the means and methods to achieve them. Therefore, it can be assumed that the aim of the company is to maximise its market value determined by the co-necessity of its survival and development (SAWICKI 2009, p. 9). In contrast, economic activity is to continue making a variety of decisions, which result in a choice between certain action variants (NOWAK 2009, p. 28). A prerequisite for making these decisions is to have relevant information. In economic activity, the main source of information is the accounting department of the company. Therefore, accounting is the basic source of obtaining information about the economic and financial situation of the company for its internal and external users.

The purpose of this article is to present the correlation between the management of an economic entity and the development of ethical dilemmas in accounting in the era of high-risk business.

The introduction presents the reason for taking up the subject, the purpose of the article and the applied research methods. The first section, based on the specialist literature, describes the relationship between managing an economic organisation and a conflict of interest as well as its impact on the formation of ethical dilemmas in business. The second section, based on both the subject literature and international research, shows a strong link between the formation of ethical dilemmas in accounting and business management. The ending is a summary of the considerations contained in the article and an evaluation of the implementation of the article's goal.

## Conflicts of interest and the management in the enterprise

Implementation of the basic objectives of the company, i.e. raising its market value and achieving the best financial results, is fraught with difficulties that each company needs to face. According to K. SAWICKI (2009, p. 10) these difficulties include:

– the high risk of doing business in the global economy,
– the rapidly changing pace of ”modern” technologies,
– extending the R&D implementation period,
– shortening the ”product life” period,
– increasing costs related to environmental protection,
– growing costs of acquiring natural resources as a result of their rapid shrinkage,
– significant fluctuations in exchange rates,
– emerging inflation phenomenon,
– increasing competition on the local and international markets,
– speculative takeover of companies,
– difficulties in obtaining credit,
– high fiscal burden on the state budget.

In the globalisation era and recurring economic crises, realisation of the objectives of the company takes place under high risk conditions. It is therefore necessary to use a proper management system. R.W. GRIFFIN (2005, p. 6) defines the management system as a set of activities (embracing planning and making decisions, organising, leading, *i.e*., managing and controlling people), directed at organizational resources (human, financial, material and information) performed with the intention of achieving organizational objectives efficiently and effectively. Conducting economic activity is to continue making decisions as a result of which the managers, on the basis of available information, make a specific choice of – in their opinion – the best option (NOWAK 2009, p. 28).

In making any decision, managers should also consider the moral judgement of the situation and decision. Economic activities are dominated by complex practical situations where a moral judgment is rarely a bivalent assessment. Very often – in the course of decision-making – a choice needs to be made between the good of one group and the good of another one, between a benefit now and in the future, between environmental protection and the provision of jobs, etc. (LEWICKA-STRZAŁECKA 2001). This means that in the course of decision-making, boards of business entities face various conflicts of interest. According to A. LEWICKA-STRZAŁECKA (2014), a conflict of interest occurs when a person (or organisation) requires – as a result of external circumstances or own load-bearing activities – dual loyalty, which means it should meet objectives whose simultaneous achievement is not possible in a certain situation. This means that a conflict of interest exists when a person (or organisation) works for their own benefit or the benefit of a certain entity to which it has commitments, while also acting against the interest of another entity to which it should also be loyal (LEWICKA-STRZAŁECKA 2014). It can therefore be concluded that ethical dilemmas in economic activity occur when we are dealing with a conflict of interest, since each decision is a choice between the interests of one entity and a lack of interest in the second entity.

Decision-makers in companies have to deal with different types of ethical dilemmas. Kidder distinguishes four types of dilemmas, calling them paradigms (GASPARSKI 2010):
– truth versus loyalty,
– individual versus society,
– short-term versus long-term,
– justice versus mercy.

It is possible to assign every ethical dilemma occurring in the process of managing a business leads to at least one of the above-described types (paradigms) of ethical dilemmas. Dealing with the conflict of interest, depending on the dilemma, the decision-maker must select, for example, between presenting the actual state of affairs and the loyalty to the employer, or between his personal interest and the company's interest, etc.

## Unethical actions in accounting, their impact on the information derived from the accounting system and the emergence of conflicts of interests in decision-making processes in companies

The necessary condition for making all decisions is to have relevant information. The value and relevance of these decisions depend on the quality of information which they have been based on. The information underlying the decisions come from internal sources, such as accounting records, financial reports for external and internal purposes, internal control reports, as well as from external sources, such as stock exchange quotations, exchange rates, audit reviews and reports, etc. According to K. SAWICKI (2010, p. 12), managing a company is a collection of sequential decision-making sets based on processing the information which lead to decision-making in instable conditions. This means that in an era of continuous crises and growing competition, management boards of enterprises are under constant pressure. Table 1 presents the results of Ernst & Young's (EY) research on the types of pressures exerted on workers and managements of companies in European countries[1].

[1] Department of Fraud Risk Management of Ernst & Young annually conducts research relating to fraud, which then is placed in the form of reports on company websites at <http://www.blog.ey.pl/audytsledczy/>. Research of Economic Abuses is carried out every year. In the even-numbered years, the world research is carried out, in odd-numbered years – in Europe. In the European study, the EY researchers conducted interviews with the staff of about 25 countries – by phone, online or in person. The respondents were employed in listed companies, international companies or in those which employed over 1000 people. Interviews in all countries were conducted in local languages. The research methodology is included in each report.

Table 1

Types of pressure exerted on the management and employees in enterprises

| Types of pressure exerted on businesses | Percentage of answers given* | |
|---|---|---|
| | 2009 | 2011 |
| Increased pressure on cost reduction | 64 | 60 |
| Increased pressure on revenue growth | 31 | 35 |
| Job loss | 40 | 31 |
| Increased pressure on profitability growth | 22 | 26 |
| Increased pressure on compliance with regulations | no answers | 24 |
| None of the above | 9 | 7 |

* The sum of the answers exceeds 100% because respondents could have chosen more than one answer.

Source: own study based on: *European fraud survey 2009 Is integrity a casualty of the downturn?* (2009), *European fraud survey 2011 Recovery, regulation and integrity* (2011).

The data in Table 1 show that most of the types of pressure exerted on the boards of companies can have an impact on the accounting and, more specifically, on the information which will be generated in the form of various reports, which will, in turn, form the basis for decision-making by both internal and external users.

According to the MSRF (See: *Auditing Standards Board ASA 240*... 2010) and SAS (See: *SAS No 99 – Consideration of Fraud*... 2007), fraud in accounting is based on a so-called „fraud triangle", which is shown in Figure 1.

In analysing the information contained in Figure 1 and the results presented in Table 1, it can be concluded that managers are subject to great pressure, both by external and internal factors and also have the greatest opportunity for unethical behaviour due to their position in the company.

Figure 2 presents the results of research conducted in 2009 by EY[2] on the risk of fraud due to the position in the hierarchy of the company.

The presented data show that the risk of fraud in an economic activity is mostly related to senior and middle management (67%). This is also largely affected by the fact that there is tacit approval for activities that – in the name of saving the company – produce better results. They are seen as a justifiable action, as evidenced by the data in Table 2.

[2] These results also confirm the published studies on the risk of fraud in business activity conducted since 1996 by the *Association of Certified Fraud Examiners* (ACFE), which monitors this type of phenomenon around the world and promotes measures to detect and prevent it.

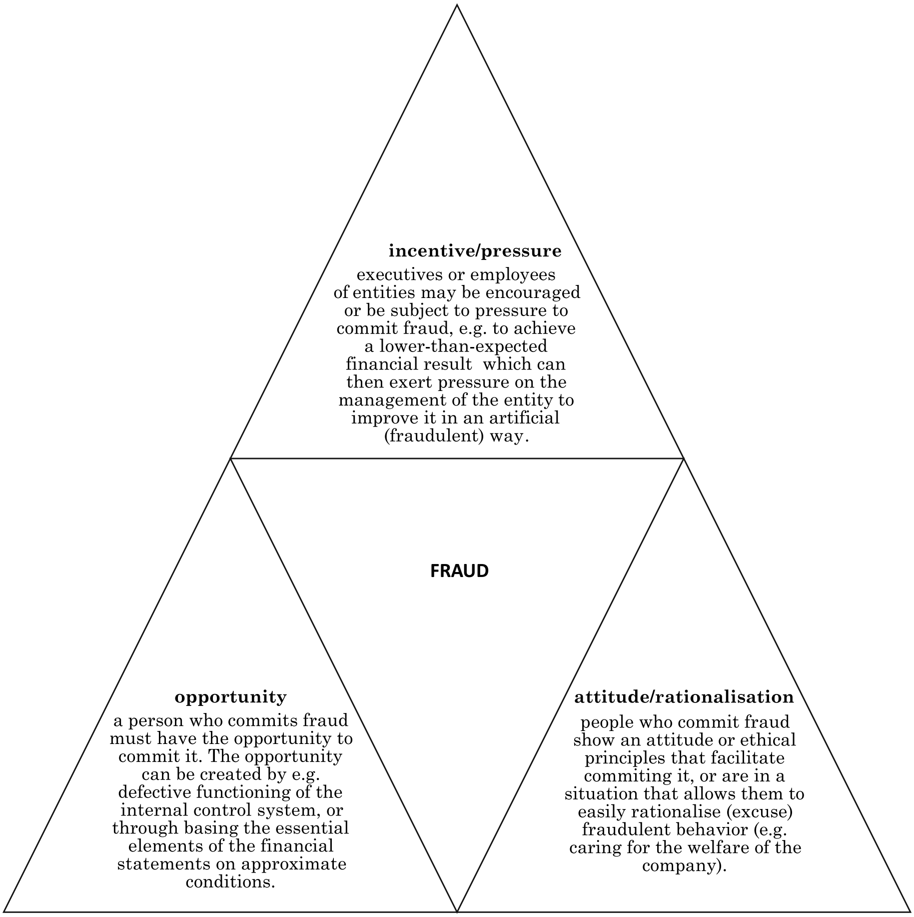


Fig. 1. Fraud triangle
Source: own study based on Hołda, Nowak (2003, p. 126).

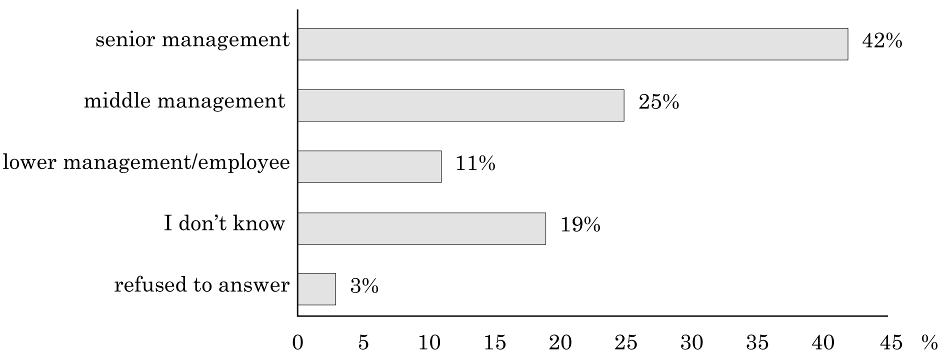


Fig. 2. Risk of fraud due to the position in the hierarchy of the company
Source: own study based on *European fraud survey 2009 Is integrity a casualty of the downturn?* (2009).

Table 2

Accepted unethical actions to rescue the company from a crisis or help to achieve growth

| Unethical actions | Percentage of answers given* | |
|---|---|---|
| | 2009 | 2011 |
| Financial benefits in order to gain/retain customers | 25 | 18 |
| Gifts to gain/retain customers | 24 | 24 |
| Entertainment to gain/retain customers | 19 | 21 |
| Giving false financial results | 8 | 4 |
| None of the above | 41 | 53 |
| I do not know | 12 | 6 |

* The sum of the answers exceeds 100% because respondents could have chosen more than one answer.

Source: owns study based on: *European fraud survey 2009 Is integrity a casualty of the downturn?* (2009), *European fraud survey 2011 Recovery, regulation and integrity* (2011).

The data show that consent to give false financial results decreased in 2011 compared to 2009 by half and was 4%, which is a very positive development. However, the fact that there is an acceptance of the falsification of financial data can be dangerous for users of financial reports and security of business transactions. The data resulting from accounting is necessary for decision-making in business. Thus, in the hands of dishonest accounting management it can be a very dangerous tool for fraud. This is because such information does not show economic events or the financial situation of the company as they are, but shows them according to the wishes of the company management (BROOKS 1988).

If the management of an entity wants to give a „false positive" image of the company, it may use different practices, such as (SCHNEIDER 1988, PIŁAT 2008, WIŚNIEWSKA 2005):

– count undelivered services or unsold products as income,
– demonstrate the highest possible profit,
– do not create reserves or write-downs,
– reduce the depreciation of fixed assets,
– reduce the value of accruals.

Achieving a „positive" company image may have an impact on the following (KUHLMANN 1994, p. 47):

– creditors will be inclined to maintain or increase the standby credit,
– shareholders encouraged by the results will acquire new shares,
– employees will have the impression that their salaries are assured by the company,
– customers will acquire the belief that the company ensures uninterrupted implementation of services and contracts.

By contrast, the aim of „deterioration of the image" of the company, i.e. presenting the financial status and performance of the company in a way that seems worse than it actually may be include avoiding or reducing tax liability, not disclosing the actual profits or losses, lowering the price of shares in order to discourage small shareholders and encouraging them to dispose of the shares at low prices for the larger shareholders, or – in the case of closing the company and distributing its assets – paying the outgoing shareholders the smallest amounts of liquidated shares possible (KUHLMANN 1994, p. 47).

A „seemingly negative" image of the company's situation can be represented by (SCHNEIDER 1988):

– demonstrating the lowest possible profit,

– maintaining write-down or profit-sharing payments as low as possible,

– maintaining a fixed percentage dividend in the long run despite achieving relatively higher profits,

– demonstrating losses,

– demonstrating lack of financial liquidity,

– increasing the depreciation of assets,

– creating high provisions for doubtful debtors, unreasonable according to real risk.

Besides presenting a better or worse image of a company than it is in reality, we also encounter a situation called „neutral adulteration", which involves demonstrating abnormal individual assets and capital or a profit and loss account. A characteristic feature of such fraud is a correct overall balance of assets and liabilities as well as the profit and loss balance (ŚNIEŻEK, WIATR 2004).

The practice of „neutral adulteration" of the company's image consists of (SCHNEIDER 1988):

– offsetting positions uncorrelated as to the subject matter,

– transferring non-liquid elements to liquid elements,

– not entering a separate item for settlements with questionable debtors, but putting it as the total amount of receivable accounts,

– artificial liquefaction of assets, e.g. by obtaining cheques or bills of exchange from dubious debtors with no intention of releasing them into circulation, in order to provide in this way a higher value in the balance sheet under „other funds" instead of under the „dubious debtors".

As a result of these actions, a conflict of interest is created among market participants regarding the data provided by the accounting department, which is the basis for the formation of ethical dilemmas in accounting. The effects of such a conflict of interest tend to be far-reaching, as confirmed by numerous examples (ENRON, Parmalat, World Com, etc.) (SURDYKOWSKA 2012, pp. 186–192, 207). A conflict of interest manifests itself in different forms and

Table 3

Examples of unethical accounting

| Examples of unethical/fraud actions in accounting | Impact of unethical actions on information from the accounting system | Examples of emerging conflicts of interest | | Dilemma type |
|---|---|---|---|---|
| | | interest for one entity | no interest for the second entity | |
| Assigning fixed assets as expenditures<br>Lack of liquidating totally used assets<br>Unjustified change of inventory valuation methods<br>Retention of redundant or obsolete inventory – no writedowns<br>Not creating reserves<br>Using the *per saldo* method in the statement balances<br>Records of deposits and withdrawals of cash on hand<br>Wrong inclusion of unpaid contributions in equity<br>No adjustment of equity from the revaluation of the sale/liquidation of fixed assets subject to revaluation<br>Recognition of revenues/ expenses in the fiscal year, which do not apply<br>Not posting of wages for a given year, the payment of which was made in the following year | unreliable data in the financial statements:<br>– underestimated/ overestimated revenue state,<br>– underestimated/ overestimated level of costs,<br>– better/worse financial result<br>– incorrect value of fixed assets<br>– incorrect inventory in the unit<br>– lack of provisions for anticipated losses<br>– demonstrating overdue receivables in the financial statements<br>– demonstrating erroneous cash flow<br>budgets based on incorrect data<br>implementation of budgets inconsistent with reality<br>unreal financial plans<br>financial analysis of the company based on incorrect information<br>calculation of prices of products/services based on erroneous financial data | obtaining a loan by the entity<br>reduced tax burden | losses of the bank due to misguided loans, which may cause e.g. tightening the rules in acquiring loans by other businesses for financing development and operations<br>no inflow of funds to the state budget, which may affect, e.g. a decrease of unemployment benefits or health care expenditures, etc. | individual versus society |
| | | obtaining a bonus by the management for achieving high performance/execution of existing plans<br>maintaining a high level of employment | additional costs deepening the plight of enterprises<br>rewarding unsuitable people<br>loss of jobs of the workforce<br>high labour costs<br>deepening financial difficulties – lack of liquidity | truth versus loyalty |
| | | extension of employment contracts<br>acquiring high salaries for the board | overemployment<br>continuation of hiring the wrong people | justice versus mercy |
| | | attracting new investors<br>obtaining funds for the current survival<br>signing new contracts<br>signing a contract for the supply of materials/ commodities/services for production | loss of the invested capital<br>saving the liquidity in the short term – bankruptcy in the future<br>lack of orders<br>loss of customers<br>no payment for delivery<br>financial difficulties of suppliers<br>losing jobs by employees at suppliers – lack of financial liquidity | short-term versus long-term |

Source: own study. The examples presented in Table 3 are only a small part of the situations encountered in practice by the author of the article in the years 2000 to 2013 in her experience of working as an auditor.

occurs at all levels of economic, political, administrative, scientific and other activities (LEWICKA-STRZAŁECKA 2010).

Table 3 presents examples of unethical actions in accounting, their impact on information from the accounting system and the emergence of conflicts of interests in decision-making.

The presented data show that the unethical actions in accounting of a single company, through decisions of its management, have a great impact, not only on the entity to which they relate, but also the security of business transactions. What seems to be beneficial for one entity does not necessarily bring positive effects to the other entity.

## Summary

Companies are forced to operate under difficult economic conditions. In the face of constant change and market instability it is essential to support the decisions taken by the management with reliable information. Accounting is considered to be the most important part of the enterprise's information system. S. SKRZYWAN (1948, p. 11) defines accounting as „[...] all accounting methods and procedures, systematic and casual, used in the enterprise in order to create a basis for management decisions". It follows that accounting provides economic information necessary for decision-making at every level of management. According to E. BURZYM (2005, p. 22) regulations and reporting of financial accounting oriented to rational decision making needs to be included in the so-called „ethical infrastructure", which has an impact on reducing pathological and anti-social phenomena in the company. Lack of ethics in accounting has a direct impact on the company's management, which is based on information generated by the accounting system of the company. Ethical dilemmas arising in accounting are also ethical dilemmas arising in the process of business management.

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