

Neutrality and Accounting Ethics

Posted on October 16, 2018

In the wake of the recent accounting scandals and the way financial reporting is taking shape these days, accounting has become a tough job (Adhariani et al. 2017, p.44). It is one of the few jobs in the world where one has to make sure that they are following the best interests of the organization while also staying true to the accounting conventions and guidelines.

Thus, it is one of the few professions where moral scrutiny is on the highest side, but it is also difficult to determine what are some of the risks that need to be taken at the level of the organization to make sure that they are following ethical accounting standards (Adhariani et al. 2017, p.44). There are many concepts that are floated to make sure that accounting as a profession becomes a bit more transparent (Adhariani et al. 2017, p.44). One of those concepts is the way neutrality in accounting is considered. In this paper, it will be seen what neutrality in accounting actually means, what sort of value it adds to the accounting analysis, and whether it is the best way to make sure that ethicality and better decision-making in accounting are witnessed (Adhariani et al. 2017, p.44).

What is Neutrality in Accounting

One of the key things that people must be able to understand is that what is meant by the neutrality in the financial statements (Adhariani et al. 2017, p.44). The neutrality in the accounting talks about the fact that how is supposed to be made sure that all the financial reporting that is carried out by the enterprise needs to be free from all the bias. At the same time, it should also reflect a balanced view of how things are supposed to be done and ensure that they are being presented in a favorable light (Adhariani et al. 2017, p.44). When there is a lack of neutrality in the accounting process, there are two reasons why it might be present (Adhariani et al. 2017, p.44). The first reason is the fact that if the neutrality of the information that is presented is compromised in a deliberate manner (Adhariani et al. 2017, p.44). Or there are instances when the systematic bias is witnessed in the way accounting information is being provided. In both the cases, what really happens is that it is the integrity of accounting as a profession that is being compromised (Adhariani et al. 2017, p.44). Now to make sure that the level of neutrality is being taken care off in the conventional accounting process. More or less all the accounting standards make sure that neutrality is observed during the process of accounting. In order to dig deep, it would be seen that how neutrality during the course of the accounting is compromised and what are some of the reasons due to which it is bound to happen (Adhariani et al. 2017, p.44).

Faithful Representation

The other accounting concept that has been used a lot in the accounting discussion and along with the neutrality is that of the faithful representation (Adhariani et al. 2017, p.44). What is meant by faithful representation is that the businesses and the transactions that are carried out by the stakeholders are needed to be presented in a faithful manner (Adhariani et al. 2017, p.44). The concept is based on how close the reliability factor is going to work out in most instances (Adhariani et al. 2017, p.44). What must be made sure that when one talks about faithful representation that it must be made sure that all the information that is presented in the financial statement has to be reliable most of the times (Adhariani et al. 2017, p.44). The idea is to make sure that the user of the financial statement must be making correct decisions that should be based on the financial data that they seem to be getting from the financial statements (Adhariani et al. 2017, p.44). Thus both the neutrality and the faithful representation are being used in synch and the two guiding principles they imply is that how the accounting reports must be free from the bias (Adhariani et al. 2017, p.44). At the same time, all the information that is presented in the financial reports must be solely based on the fact that how reliable it is in order to make the right decisions during the course of the accounting cycle (Adhariani et al. 2017, p.44).

Deliberate Bias

Most of the time, whenever there is a case of deliberate bias, it happens due to conditions that might cause management to state the financial statement incorrectly (Adhariani et al. 2017, p.44). For instance, when the managers of the organization are supposed to be provided benefit for achieving higher profit. When there is a case, there is a huge incentive for the management to make sure that they are adopting accounting policies that are resulting in the higher profit rather than sticking to the conservative estimates (Adhariani et al. 2017, p.44). The adherence to the GAAP principle might not be followed to balloon the financial statement in the wrong manner (Adhariani et al. 2017, p.44). Another practice where deliberate bias might be witnessed by the people is when they tend to hide factual problems about the organizations. For instance if the organizations is facing liquidity problems, they might be willing to window dress the financial statement. The manipulation of the current ratio might be carried out to make sure that they are able to hide the gravity of the situation (Andon et al. 2015, p.986). So these are some of the key aspects that need to be kept in mind when the reporting of the financial statements is done in a manner where facts are twisted in a deliberate manner so that they might portray the results of the organization in a favorable light (Andon et al. 2015, p.986). So there are many ways through which the deliberate bias might be witnessed in the financial statements (Andon et al. 2015, p.986).

Systematic Bias

As far as the systematic bias is concerned, it is bound to happen when the accounting problems when the systems are developed in the manner that they tend to favour one outcome over the another with the passage of time (Andon et al. 2015, p.986). The systematic bias happens when the accounting systems and the policies are developed in the manner that despite the intention of the people being right, some of the wrong practices are inculcated (Andon et al. 2015, p.986). One of the examples when the accounting neutrality is compromised is when they are setup in the manner that is overtly prudent (Andon et al. 2015, p.986). This might be happening due to some sort of a cultural influence that the management and the regulations have over the accounting practices that are carried out in the organization. So, all these aspects need to be taken into consideration when decision-making has to be made at each of the respective levels, to say the least (Andon et al. 2015, p.986).

Debate on the Desirability of the Neutrality

Now, one of the key things that needs to be understood is how the importance of prudence will stand out and what accounting practitioners say about it. There had been many instances, most notably during the course of the Bulletin on Prudence in 2013 when it was noted that the view are quite diverse as far as the diversity of the prudence is going to be carried out (Andon et al. 2015, p.986). As a matter of fact, one of the raging debates during the course of the forum was the fact that whether the prudence should actually be made the part of the financial reporting or not (Andon et al. 2015, p.986). Most of the accounting experts were on the agreement though that to make sure that the financial integrity during the reporting is being done, it is important that neutrality is followed to an extent. It has to be noted that most of the time, the key thing that seems to be missing from the ideology of neutrality is the fact that how explicitly it is dismissed most of the time (Andon et al. 2015, p.986). The defining role in the whole conflict was being played by IASB, who were of the point of view regarding how the neutrality and the prudence worked as well as making sure that they stay aligned with their earlier position (Andon et al. 2015, p.986).

Argument about Neutrality

The key thing that can be seen here is that how the basis of the conclusion of the ED is setup and what sort of guidelines it setup in terms of the way prudence is supposed to be working (Andon et al. 2015, p.986). One of the key things that is being argued by prudence is how the optimistic bias of the management should not be reflected when the financial reporting and accounting standards are followed. One thing that can be seen there is that how the positioning of the asymmetric standards might go a long way towards making sure that the neutral information is being provided towards the whole organization. IASB to make sure that all these things are inculcated in the accounting processes, have setup following guidelines that are important (Andon et al. 2015, p.986).

- There is no need to recognize all the assets and liabilities at the disposal of the organization.
- No requirement is there for the measurement of all the assets and liabilities to be done on the basis of fair value accounting.
- The impairment of the assets that are measured at the cost is not needed.

Asymmetry in Accounting and Neutrality

This brings us to the conclusion when it comes to the way reconciliation with the neutrality is supposed to be carried out. For example, the way outcomes are determined, they are going to be in synch with the neutrality. For instance, the recognition of the impairment loss might not appear to be the possible gain (Bamber and McMeeking, 2016, p.73). It happens due to the fact that the increase in the economic resource in the above cost is not going to be neutral in this case. Furthermore, it does not appear to be the standard or the outcome (Caglio and Cameran, 2017, p.27). There are some cases when the only downside of the risks is recognized or disclosed in certain instances, like when there is involvement of the contingent liabilities as well as the onerous contracts that are likely to be set up in the given time period. So all these things are needed to be taken into account when determining the asymmetry to be neutral in all the situations most of the times (Caglio and Cameran, 2017, p.27).

Instances of the Asymmetric Prudence in the IFRS

Even if one talks about the standards that were developed after 2010, the key fact that can be seen is how prudence and neutrality were dismissed. There are many arguments and merits for such a decision (Himick and Brivot, 2018, p.4). The key factor that has lured the people in terms of the way they have dismissed prudence is due to the fact that how most of the times, the way financial accounting is carried out, it comes across as somewhat conservative. Now, keeping in mind the broader perspective, whatever the economic consequences of any action are, they are always going to be rather symmetric (Himick and Brivot, 2018, p.4). Thus the key thing that is needed to be taken care of here is that how the neutral financial reporting is needed to be carried out is to make sure that the most relevant and most useful financial information is needed to be sorted out. The more useful the financial information is, the greater is going to be likelihood that it would turn out to be useful when carrying out the final decision making in any process. In some ways, the neutrality becomes very important as far as the way this whole thing is supposed to turn out (Himick and Brivot, 2018, p.4).

Why does not Mean Ethics and Accounting

Methods

If one looks at most of the accounting standards, then it can be seen that more or less all the accounting standards talk about the importance of neutrality in the financial reporting. There is a lot of hue and cry about the fact that neutrality is the only thing that needs to be carried out to make sure that the level of ethics that one gets to see in accounting and financial reporting is going to improve (Himick et al., 2016, p. 22). If that was the case though, in some of the recent accounting scandals, the accounting standards that they were following were complexly complying with the IRFS and GAAP (Himick et al., 2016, p. 22). Thus neutrality was followed but that still did not prevent these accounting scandals. So this mentality is needed to be snubbed that by just bringing about the neutrality in the accounting standards, everything is going to improve at that very instance (Himick et al., 2016, p. 22). The other thing that has to be kept in mind is that how the accounting is merely the representation of any economic activity. Thus there is all the likelihood that the representative function might be neutral in each of the instance, but the faithful representation might not be the neutral one thus time around. So all the factors are needed to be kept in consideration (Himick et al., 2016, p. 22).

Conclusion

Rather than emphasizing about the way neutrality works, the key thing is to make sure that the technical errors such as accounting are needed to be kept in account. The effort and dialogue needs to be there that needs to make sure that the global standard that serves the interest of the broader accounting community is being developed (Kelly and Murphy, 2016, p.23). The notion of general interest also needs to be defined. Faced with the multiple and inevitable risks of instability, there is a need to create security factors. The highest goal of accounting standards setting, like all the other parts of financial regulation, is to contribute to financial security. This is the general interest (Ho et al. 2015, p.351).

References

- Adhariani, D., Sciulli, N. and Clift, R., 2017. An Introduction to the [Ethics of Care](#). In *Financial Management and Corporate Governance from the Feminist Ethics of Care Perspective* (pp. 17-48). Palgrave Macmillan, Cham.
- Andon, P., Baxter, J. and Chua, W.F., 2015. Accounting for stakeholders and making accounting useful. *Journal of Management Studies*, 52(7), pp.986-1002.
- Bamber, M. and McMeeking, K., 2016. An examination of international accounting standard-setting due process and the implications for legitimacy. *The British Accounting Review*, 48(1), pp.59-73.

Caglio, A. and Cameran, M., 2017. Is it shameful to be an accountant? GenMe perception (s) of accountants' ethics. *Abacus*, 53(1), pp.1-27.

Himick, D. and Brivot, M., 2018. Carriers of ideas in accounting standard-setting and financialization: The role of epistemic communities. *Accounting, Organizations and Society*.

Himick, D., Brivot, M. and Henri, J.F., 2016. An ethical perspective on accounting standard setting: Professional and lay-experts' contribution to GASB's Pension Project. *Critical Perspectives on Accounting*, 36, pp.22-38.

Ho, S.S., Li, A.Y., Tam, K. and Zhang, F., 2015. CEO gender, ethical leadership, and accounting conservatism. *Journal of Business Ethics*, 127(2), pp.351-370.

Kelly, K. and Murphy, P., 2016. The Interactive Effects of Ethical Norms and Subordinate Recommendations on Accounting Decisions.