Ethical and Legal Obligations in Accounting

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The recent and past scandals of major corporations such as Enron, WorldCom, Qwest, Tyco, HealthSouth, Rite Aid, and Global Crossing to name a few of the biggest have brought a new awareness to the ethical and legal obligations of financial reporting. Although fair accounting principles and theories have been around for some time, it has not been so closely analyzed and scrutinized as it has been in the past 10 years.

Generally accepted accounting principles or GAAP are rules which are used to prepare financial documents and statements in publicly traded and privately held companies in the United States. These generally accepted accounting principles are not the same for local and state governments which follow the GASB or Governmental Accounting Standards Board. In the United States as well as some modern countries who operate under the English common law system, the government does not set the standards of generally accepted accounting principles. The GAAP is not considered a written law, although the United States Security and Exchange Commission (SEC) do require it to be followed by all publicly traded companies.

The United States government, through the Securities and Exchange Commission has taken steps to ensure that financial reporting of privately held companies are following the rules of generally accepted accounting principles. The SEC works closely with private organizations that set the generally accepted accounting principles, but it does not set the rules themselves. Several organizations are part of this private group that set the standards of accounting. In 1939, the American Institute of Certified Public Accountants appointed the Committee on Accounting Procedure or CAP. It was during the years of 1939- 1959 that the CAP issued over 50 accounting research bulletins that

dealt with timely accounting problems. This was however not enough to deal with the mounting issues of GAAP. In 1959, the AICPA created the Accounting Principles Board. Their mission was to develop the conceptual framework of the modern GAAP. Their span of control ran from 1950 to 1973 when it was dissolved to form the modern FASB or Federal Accounting Standards Board.

The Sarbanes-Oxley Act of 2002 (SOX) was a step forward by the United States government to help manage and combat the less than forthright accounting practices being used by publicly help companies. As a result of the Sarbanes-Oxley Act of 2002, the Public Company Accounting Oversight Board or PCAOB was created. The PCAOB is a not for profit corporation in the private sector which was created by the Sarbanes-Oxley Act of 2002. The PCAOB's primary function is to oversee the auditors of public companies. The PCAOB helps to shore up confidence of investors and further the public interest in preparation of informative, fair and independent audit reports. The board was created primarily in response to the many accounting scandals that were occurring during this time. The most notable scandals at this time were WorldCom and Enron. The Sarbanes-Oxley act is an extension of power to the SEC giving the government more control and inputs on generally accepted accounting practices and principles.

The generally accepted accounting principles and practices are important to consumers and investors of publicly traded companies. Without some reform and repair or the current practices, the public will loose confidence in American companies and start looking abroad to invest capital. Financial reporting in order to be useful and trusted should be useful to investors and creditors by presenting them with information that is relevant, reliable, comparable and consistent. These are the four basic qualities of

financial accounting. (Wikipedia.com) In order for financial reporting to achieve these qualities, some basic assumptions must happen. First there is the economic entity assumption which assumes a separation between business finances and personal finances. Investors and creditors need to know that the company is standing alone and the owner's personal finances are not part of the overall view of the company. Next there is the going concern assumption which assumes the business will be around for the time of the financial reporting. Then there is the monetary unit assumption which simply assumes that the unit of currency will be a stable unit of record, most commonly the United States dollar adjusted for inflation. Last, there is the periodic reporting assumption which assumes that the operation of a business can be monitored and recorded into different, separate and equal periods of time such as months, quarters and years. This is a necessity if you are going to compare past to present figures. (Wikipedia.com)

The principles of accounting are the foundations of generally accepted accounting practices. The first of the four principles is the historical cost principle. This principle looks at the acquisition cost as the most objective and verifiable figures in order to account for assets and liabilities in a business entity. The next principle is the revenue recognition principle which looks at the revenue recognized when the earning process is complete and an exchange transaction has occurred. This usually takes place when a sale is made to another individual or entity and it has been confirmed. The matching principle is the attempt to match revenues earned during a fiscal period with the expense incurred in earning those revenues. Finally, the full disclosure principle is the reporting of enough information for a creditor or investor to make best possible judgments while still managing to keep the costs of such reporting reasonable and fair. This information is

typically presented in the main body of financial statements where it is most notable and easy to pick up on.

These guidelines and generally accepted accounting practices are the foundation of the modern day accounting systems. The overall goal of the auditing companies, accountants and government organizations is to bring back trust to the accounting profession and publicly traded organizations. In order to keep American investors and financiers in the US, we need to establish the trust again. Dishonest accounting practices not only hurt the immediate investors, creditors, business owners and employees, but it hurts our economy overall.

Resources

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