

Section 7. What Are the Advantages of Financial Accounting Ethics?

Accountants use established standards to create financial reports.

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ABSTRACT

Companies rely on the financial reports prepared by their accountants to be true and accurate to make sound business decisions. Inaccurate financial reporting caused by the unethical or deceptive practices of a company's accountants can lead to loss of revenue through an exposed accounting scandal, or worse, corporate collapse.

Purpose

The purpose of financial accounting ethics is to ensure that certified public accountants (CPAs) conduct their duties objectively and with integrity. Financial accounting ethics form the basis for legal and regulatory requirements and include issues related to maintaining public trust. Professional organizations such as the American Institute of Certified Public Accountants (AICPA) and the Institute of Management Accountants (IMA) have codes of ethical conduct to which their members must adhere.

Maintaining Public Faith

In the wake of the numerous accounting scandals in the early 2000s, transparency regarding a company's accounting methods and practices has become increasingly important to the general public. A company that provides a clear explanation of the accounting methods used to prepare its financial statements appears to be more ethical and trustworthy than companies that do not provide such information. Often, the more ethical and trustworthy a company appears, the more likely it is to attract new investors.

Avoiding Regulatory Investigations and Sanctions

If a company's financial reports contain suspicious accounting methods, it can lead to a regulatory investigation such as a Securities and Exchange Commission (SEC) investigation or an IRS audit. If regulatory bodies find any accounting malfeasance on the part of the company and/or on the part of the accountant, they can levy costly fines or sanctions against the company and the CPA could lose his license. An example of corporate malfeasance is if the company failed to report all of its earned income. Accounting malfeasance can include actions such as the accountant knowingly using false information provided by the company or accepting cash or other incentives outside of his regular pay to prepare the company's financial statements; for instance, if the accountant knew the company was not reporting all of its income but prepared the financial statements anyway and accepted cash or other incentives to do so.

Avoiding Stock Price Volatility

When companies are accused of, or under investigation for, unethical accounting practices, investors begin selling off their shares in an attempt to avoid a total loss on the investment. This leads to a decline in the price per share. However, as some investors are selling their shares, market speculators and high-risk investors may be purchasing the shares at the lower price, causing a temporary increase in share price. Constant share price volatility can lead to investor panic and induce a large selloff of the company's shares, driving the share price down. If the price per share drops low enough for a long enough time, the company is delisted from its respective stock exchange, its credit rating can go down and it will have a difficult time obtaining the money it needs to continue operation. Banks and other creditors to which the company owes money may call in their loans. If the company cannot obtain the funding to pay its creditors, bankruptcy and corporate collapse could follow.

<http://smallbusiness.chron.com/advantages-financial-accounting-ethics-32960.html>

Section 8. Sources of Finance and Their Advantages & Disadvantages

Different funding sources come with different advantages and drawbacks for any business.

Related Articles

1. The Advantages & Disadvantages of External Financing
2. Advantages & Disadvantages of Bank Loans
3. Advantages & Disadvantages of Retained Profit
4. What Are Internal Sources of Finance?

ABSTRACT

Whether you're funding a new business or trying to expand an old one, choosing the right source of financing for your unique situation can be challenging. While you can ideally choose from several options, each source of financing comes with its own set of advantages and drawbacks. No one option is better than the others in all cases.

Personal Savings And Assets

Your personal savings and other assets make a great source of capital. Because you already have them, acquisition costs are minimal, and you won't be paying interest on a bank loan or sharing returns with investors. The drawbacks, of course, are that if you plow your personal savings into a business venture, you could lose it all. Some assets, such as retirement accounts, are safe from creditors and bankruptcy courts; placing such assets at risk may not be good for you, especially if you're approaching retirement age and are running out of time to rebuild depleted accounts.

Investors

Corraling a group of investors can help you raise startup or expansion capital for your business without placing all of the risk of loss on you alone. These investors may be active partners in the business, or they may be silent investors who simply provide capital and wait for their returns. The disadvantage to bringing in investors is that you do give up a certain element of control over the company. Even if you retain a majority interest, you'll need to keep your investors happy. Additionally, if you share the risk with others, you'll also have to share the profits.

Bank Loans

Private banks can be another good source of funding. For small ventures, you may be able to secure a personal loan or line of credit; for larger operations, you may have to leverage assets -- real estate, large equipment or inventory -- by using them as collateral to secure the loan. The advantage to borrowing the money is that it enables you to keep your cash on hand to use as operating capital or for personal survival during a down period in your business. Additionally, if business goes bad, you may be able to protect your most important personal assets by declaring bankruptcy. The disadvantages are that you'll have to pay interest on the loan. Furthermore, your payments will be due on time regardless of whether business is bad or good.

Government Grants and Loans

The U.S. Small Business Administration offers several loan and grant programs to help startup companies and assist existing ventures in expansion; your home state may have similar programs on a smaller scale. Grants are basically free money, and government-guaranteed loans come with interest rates that are typically far below what you can get on your own. Unfortunately, they come with a lot of red tape and may not be available for every type of business. Budget issues from year to year may affect the availability of funds. Finally, a government-guaranteed loan is still a loan; you'll have to pay it back regardless of whether business is good.