

Volume VI Number 1 2014

**REVIEW OF STRATEGIC AND
INTERNATIONAL STUDIES**

ISSN 2326-8085



EDITOR-IN-CHIEF
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ISIS

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Print ISSN 2326-8085

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Typeset and Graphic Design by Kalina@ISIS, Florida, The United States of America

Published by ISIS, Florida, The United State of America

Printed by ISIS Printing House, Florida, The United State of America

AUDITING FOR CITIZENSHIP: CODES OF ETHICS

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ABSTRACT

This paper is based on the research project that promotes the Auditing for Citizenship which is, particularly, helpful to citizens who are interested in answering investment questions that have a large spatial or temporal scope. Indeed, in the multifaceted environment, this research will be guided by pursuing the challenges and difficulties on the behavior of auditors in order to minimize the auditor failure and attracting talent due to the fact that auditing effectiveness (independence, capability, education background, experience, authority, resources and diligence) as a higher demanding intellectual activity.

Keywords: Auditing, Citizenship, Codes of Ethics

1. INTRODUCTION

All over the world...banking scandals, financial crisis, chronic Deficit State Budget and their negative impacts brings concerns on the sustainable life of the citizen, because it influences the financial stability. These examples illustrate the raising awareness of auditing for citizenship. Auditing has been used extensively by businesses, financial institutions, public entities and organizations. However, it faces illiteracy among the citizen. Indeed, the goal of this research is to struggle it.

Auditing for citizenship will be built on the promotion of strategies and publishing regulations, norms and laws made by several entities. In relation with the theoretical framework was based on literature review of auditing (Ahrens & Loebbecke, 2004; Cosserat & Rodda, 2005; Porter et al., 2008), in general, and codes of ethics, in particular (Thompson, 1958; Benson, 1989; Wood e Rimmer, 2003). The methodology used on the empirical analysis is based on the content analysis (Krippendorff, 2012) of Codes of Ethics from several of International and Portuguese Entities, such as: United Nations Global Compact (UNGC), Organisation for Economic Co-Operation and Development (OECD), International Federation of Accountants (IFAC), International Ethics Standards Board for Accountants (IESBA), International Accounting Education Standards Board (IAESB), International Auditing and Assurance Standards Board (IAASB), Public Interest Oversight Board (PIOB), International Organization of Supreme Audit Institutions (INTOSAI), American Institute of Certified Public Accountants (AICPA), *Ordem dos Técnicos Oficiais de Contas* (OTOC) and *Ordem dos Revisores Oficiais de Contas* (OROC) to answer to the auditing report that is need for the business to disclosure it to stakeholders, in general, and to the citizen, in particular.

Due to the fact that the citizen has high expectations about the accountant and the auditor profession, then ethical principles, professional values and attitudes are essential to regulate the relationships between all. Without a doubt, accountants and auditors must change the persistent discrepancies about auditing and accounting process and their negative shocks that bring concerns on the sustainable life of the citizen, because they are part of the investment decision process of all the economy. In examining this relationship, the arguments presented by Jensen & Meckling (1994: 1) argues that "understanding human behavior is fundamental to understanding how organizations function, whether they be profit-making firms in the private sector, non-profit enterprises or government agencies intended to serve the 'public interest'". Moreover, public interest is not homogeneous and therefore cannot be simply represented.

This research facilitates dialogue between citizens and provides a coherent framework in the context of the agency problems to diminish uncertainty in 21st century. On the one hand, the theoretical framework is based on literature review of auditing and accounting, in general, and codes of ethics, in particular (Patton, 2002). On the other hand, the empirical framework reflects the practices of codes of ethics where the disclosure of information occurs when the company engages ethics issues and then activities that advance a social agenda and goes beyond the Annual Report of the firm (Siegel & Vitaliano, 2007). The structure of the paper is organized as follows. Section 2 gives an overview from statutory auditor and the

auditing context. Section 3 goes from auditing context and the principles on the code of ethics. Finally, the section 4 presents conclusions and limitation to the future research.

2. THE THEORETICAL FRAMEWORK OF AUDITING FOR CITIZENSHIP

The importance of professional values, ethics and attitudes seek to combat inequality in society while, at the same time, they preserve inequality through their justification of professional privilege (Parker, 1994). In this context, Jensen & Meckling (1976: 6) argues that the company "is not an individual. It is a legal fiction which serves as a focus for a complex process in which the conflicting objectives of individuals are brought into equilibrium within a framework of contractual relations". As a consequence, the Statutory auditors, auditors and accountants must recognize in which country and company their work and then apply the International Standards on Auditing (IFAC, 2014) and the International Accounting Standards (CE, 2008) to increase the level of disclosure of the financial report and then promote the extensive use of standards, policies, procedures and practices. All these experts, in the auditing and accounting area, must have a perfect understanding of the constitutional, legal and institutional principles and standards governing the operations of the audited entity.

In such circumstances, it is very important to promote as *Transparency International (TI)* aims the raise of the internal integrity and transparency to enhanced reputation and on common Information basis for all the accounting information systems of companies (TI, 2010). Without a doubt, the application of publicly stated commitment to work against corruption in all its forms, including bribery and extortion; the commitment to be in compliance with all relevant laws, including anti-corruption laws and the publicly stated formal policy of zero-tolerance of corruption. It is a hard work to fight the opacity of all activities and practices that remain obscure or hidden from outside scrutiny of statutory auditors and review of auditors (Carrol & Buchholtz, 2014).

Before present the empirical framework supported on the codes of ethics is important to understand the definition of the code of ethics. Knowing that is a concept with higher complexity of the phenomenon and with differentiate perceptions. From the literature review, there are several examples of the definition of ethical codes, such as:

Higgins and Olson (1972: 33) is "a main foundation document of the profession. It is the agreement on ethical concepts and adherence to them by an overwhelming majority of practitioners that transforms a vocation into a profession"

Hosmer (1991: 21) as "statements of the norms and beliefs of an organization" and they are the ways that the senior people in the organization want others to think. This is not censorship. Instead, the intent is to encourage ways of thinking and patterns of attitudes that will lead towards the wanted behavior.

Stevens (1994: 64) describes as "professional codes that communicate the goals and beliefs for groups and professionals by which individual practitioners can be guided".

Schwartz (2002: 28) argues that it is "a written, distinct, formal document which consists of moral standards used to guide employee or corporate behaviour."

INTOSAI (2010: 4) is "a comprehensive statement of the values and principles which should guide the daily work of auditors". The independence, powers and responsibilities of the public sector auditor place high ethical demands on the SAI and the staff they employ or engage for audit work. A code of ethics for auditors in the public sector should consider the ethical requirements of civil servants in general and the particular requirements of auditors, including the latter's professional obligations"

These definitions of Code of Ethics help the citizen to accept that business ethics is very divergent, but at the same time very similar. Some of these divergences could be national differences of culture, language, and legal and social systems. Indeed, the final result is that the company must face strong pressures toward transparency and to adopt decisions with more responsibility.

3. FROM AUDITING FOR CITIZENSHIP TO CODES OF ETHICS

The empirical framework reflects good practices from the auditing for citizenship to the code of ethics, which allows to understand the disclosure of the economic and financial information on the Annual Report of the company (Patton, 2002). As van der Linden (2013: 215) point out "seeing principles as rules of thumb is the most obvious way for particulars to make sense of principles, because any understanding of principles as proper codifications of the practical meaning of features would violate the idea of reasons holism". Therefore, principles on the code of ethics play a practical reasoning, because of their ethical violation (Carrol & Buchholtz, 2014: 2). For example, BP spill oil causing the major blow in Spring of 2010.

3.1. United Nations Global Compact (UNGC)

The UNGC advises to "use of independent external assurance of anti-corruption programmers" to "provide the organization with valuable insight into the strengths and weaknesses of its programmers." Also, it has promoted the "Ten Principles of the United Nations Global Compact" and the last principle is anti-corruption which means that a "businesses should work against corruption in all its forms, including extortion and bribery" (OECD, 2010a).

3.2. Organisation for Economic Co-Operation and Development (OECD)

The OECD (2010b) publishes the "Good Practice Guidance on Internal Controls, Ethics and Compliance" adopted by the OECD Council as an integral part of the Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions. It is a central argument for companies that must consider: "ethics and compliance programmers' or measures designed to prevent and detect foreign bribery applicable, where appropriate and subject to contractual arrangements, to third parties" and "a system of financial and accounting procedures, including a system of internal controls, reasonably designed to ensure the maintenance of fair and accurate books, records, and accounts, to ensure that they cannot be used for the purpose of foreign bribery or hiding such bribery". Indeed, between the Good Practices, it is recommended to realize several "periodic reviews of the ethics and compliance programmers' or measures, designed to evaluate and improve their effectiveness in preventing and detecting foreign bribery".

3.3. International Federation of Accountants (IFAC)

The IFAC is a global organization dedicated to the accountancy profession and founded in 1977 and, actually, has 179 members and associates in 130 countries and jurisdictions, representing more than 2.5 million accountants employed in several types of organization. The mission of the IFAC (2014) is "to serve the public interest, strengthen the worldwide accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high-quality professional standards, furthering the international convergence of such standards, and speaking out on public interest issues where the profession's expertise is most relevant." The IFAC has established several boards, such as: IESBA that is an independent standard-setting board that develops and issues, in the public interest, high-quality ethical standards and other pronouncements for professional accountants worldwide.

3.4. International Ethics Standards Board for Accountants (IESBA)

The IESBA mission is "to develop standards, progress projects on inadvertent violations of the *Code of Ethics for Professional Accountants*, conflicts of interest and responding to fraud and illegal acts". The IESBA handbook published in March 2013, that are effective on April 1, 2014 (IESBA, 2013). This handbook contains the entire *Code of Ethics for Professional Accountants* for the use of professional accountants all over the world. Then, the five principles of the code of ethics are (IESBA, 2013: 12): **Integrity** is "to be straightforward and honest in all professional and business relationships". **Objectivity** is "to not allow bias, conflict of interest or undue influence of others to override professional or business judgments". **Professional Competence and Due Care** is "to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards". **Confidentiality** is "to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the

professional accountant or third parties". **Professional Behavior** is "to comply with relevant laws and regulations and avoid any action that discredits the profession."

3.5. International Accounting Education Standards Board (IAESB)

The IFAC has established the IAESB that is an independent standard-setting body board that serves the public interest by "strengthening the worldwide accountancy profession through the development and enhancement of education." It has released an exposure draft which proposes to change to the definition of "those charged with governance" in the "Code of Ethics for Professional Accountants of IESBA" to align it with International Standards on Auditing (ISA). Also, it has published the Framework for International Education Standards for Professional Accountants establishes the concepts that the IAESB where it is details the overall objective of the accounting education to develop competent professional accountants. Following this, the concept to **competence** is "the ability to perform a work role to a defined standard with reference to working environments. To demonstrate competence in a role, a professional accountant must possess the necessary (a) professional knowledge, (b) professional skills, and (c) professional values, ethics, and attitudes": The international education standard (IES) **3 is related with professional skills and general education** details the intellectual skills, technical and functional skills, personal skills, interpersonal and communication skills and the organizational and business management skills. The international education standard (IES) **4 is related describes the professional values, ethics and attitudes** that must be acquire by the Underdegree programmers' and Master degree, which it will lead to be accountants and statutory auditors in the best interests of both society and the profession. For example, to improve of the ethical judgment is possible with sharpening ethical decision-making skills based on case studies (IAESB, 2014).

3.6. International Auditing and Assurance Standards Board (IAASB)

The IAASB is an independent standard-setting body board that serves the public interest by setting high-quality international standards on auditing, assurance, and other related standards, and by facilitating the convergence of international and national auditing and assurance standards. The framework for audit quality: key elements that create an environment for audit quality (IAASB, 2014) details the "Quality audits involve auditors: Exhibiting appropriate values, ethics and attitudes; and Being sufficiently knowledgeable, skilled, and experienced and having sufficient time allocated to them to perform the audit work."

3.7. Public Interest Oversight Board (PIOB)

The PIOB as formally established in 2005 to oversee the auditing and assurance, ethics, and education standard-setting activities of the IFAC, as well as, IFAC Member Body Compliance Program an because it is an international body that it increases the confidence of investors and improves the quality assurance to promote the public interest focus of the IFAC standards in the areas of audit, education, and ethics.

3.8. International Organization of Supreme Audit Institutions (INTOSAI)

The INTOSAI is an autonomous, independent, non-political and non-governmental organization with special consultative status among the Supreme Audit Institutions on government auditing and the Economic and Social Council of the United Nations Organization and founded in 1955. The INTOSAI mission is "provided an institutionalized framework for supreme audit institutions to promote development and transfer of knowledge, improve government auditing worldwide and enhance professional capacities, standing and influence of member SAIs in their respective countries". The International Standards of Supreme Audit Institutions published by INTOSAI (INTOSAI, 2014) starts on level 1 with the Lima Declaration of Guidelines on Auditing Precepts. The level 2 includes the Code of Ethics and Auditing Standards which focus four principles, such as: **Integrity** is "the core value of a Code of Ethics. Auditors have a duty to adhere to high standards of behavior (e.g. honesty and candidness) in the course of their work and in their relationships with the staff of audited entities. In order to sustain public confidence, the conduct of auditors should be above suspicion and reproach." **Independence, objectivity and impartiality** is when "auditors, particularly in their reports, should be accurate and objective. Conclusions in opinions and reports should, therefore, be based exclusively on evidence obtained and assembled in accordance with the SAI auditing standards." **Professional secrecy** is when "auditors should not disclose information obtained in the auditing process to third parties, either orally or in writing, except for the

purposes of meeting the SAI's statutory or other identified responsibilities as part of the SAI's normal procedures or in accordance with relevant laws." **Competence** is when "auditors have a duty to conduct themselves in a professional manner at all times and to apply high professional standards in carrying out their work to enable them to perform their duties competently and with impartiality."

3.9. American Institute of Certified Public Accountants (AICPA)

The AICPA and its predecessors have a history dating back to 1887, when the American Association of Public Accountants was formed. Since 2008, it has been published the Code of Professional Conduct (AICPA, 2013) has two parts: Principles and Rules. The Principles provide the framework for the Rules, which govern the performance of professional services by members, such as: **Public Interest** is "the collective well-being of the community of people and institutions the profession serves." **Integrity** is "an element of character fundamental to professional recognition and it is the quality from which the public trust derives and the benchmark against which a member must ultimately test all decisions." **Objectivity** is "state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Independence precludes relationships that may appear to impair a member's objectivity in rendering attestation services." **Independence** precludes "relationships that may appear to impair a member's objectivity in rendering attestation services". **Due care** requires a "to discharge professional responsibilities with competence and diligence. It imposes the obligation to perform professional services to the best of a member's ability with concern for the best interest of those for whom the services are performed and consistent with the profession's responsibility to the public".

3.10. Ordem dos Técnicos Oficiais de Contas (OTOC)

The OTOC is a Portuguese Statutory Body dedicated to the accountancy profession, founded in 1999 and, actually, it has near 73.000 active Chartered Accountants that work with all organizations and citizens. The Law nº 310-2009, of October 26, publish the Statute of the Chamber of Chartered Accountants, approved by Decree-Law nº 452/99, of November 5, changing from Chamber to Order of Chartered Accountant (OTOC, 2014). In performing its functions, the Chartered Accountants should guide their actions by the following principles: **Integrity** implies that "the profession will be guided by standards of honesty and good faith". **Attitude** implies that "the chartered accountant accepts only jobs that will feel well enough to work". **Independence** implies that "the chartered accountant remains equidistant from any resulting pressure of their own interests or external influences, so as not to compromise its independence". **Responsibility** implies that "the chartered accountant assumes responsibility for acts done in the exercise of their functions". **Competence** implies that "the chartered accountant performs their duties diligently and responsibly, using the knowledge and techniques disclosed, respecting the law, accounting principles and ethical criteria". **Confidentiality** means that "the chartered accountant and their employees must keep confidential the facts and the documents they obtain, directly or indirectly, in the exercise of their functions". **Equity** implies that "the chartered accountant ensure equal treatment and attention to all entities to whom they provide services, except as provided in agreed contractual standards". **Fairness** implies that "the chartered accountants, in their mutual relations, act with propriety and civility, refrain from any personal attacks or derogatory allusion, guiding their conduct that the rules of fair competition and rules legal force, in order to dignify the profession."

3.11. Ordem dos Revisores Oficiais de Contas (OROC)

The OROC is a Portuguese Statutory Body dedicated to the Statutory Auditor profession. It has been founded in 1974 and, actually, has near 1.300 Active Statutory Auditors. The legal regime of Portuguese Statutory Auditors has been approved by the Decree-Law nº 487/99 of 16 November that suffered several changes stemming from the transposition into the national law of Directive nº 2006/43/EC of the European Parliament and of the Council, of 17 May, relating to the statutory audit of annual and consolidated accounts (OROC, 2014). For one side, the Decree-Law nº 224/2009, of 20 November, implements into the national legislative system of the drive towards the high-level harmonization of statutory audit requirements through both the obligation to apply international auditing standards and the revision of requirements relating to professional training, as well as the reinforcement of duties of a deontological nature, such as: **Independence** is must act free of any pressure, influence or interest and must avoid facts or circumstances which are capable of compromising his/her independence, integrity or

objectivity, in accordance with the standards of an objective, reasonable and informed third party. **Impartiality** is "incompatible with any other that might imply the diminution of the independence, prestige or dignity of the profession, or which is contrary to the principles of ethics and professional conduct. **Confidentiality** is "may not furnish to companies or to other public or private entities any information relating to facts, documents or other matters which they learnt about during the course of their work, except when the law so dictates, or when this is authorized in writing by the entity to which such information refers". **Prevention of conflicts of interest** is "affect by threats, such as self-revision, self-interest, advocacy, familiarity or trust or intimidation, the statutory auditor or audit firm must adopt the necessary measures to ensure the respective independence, failing which the audit engagement should be declined". For the other side, the Code of Ethics and Deontology of the Statutory Auditor must comply with the following fundamental principles: **Integrity** is "be fair and honest in all professional and business relationships". **Objectivity** is "not allow ambiguities, conflicts of interest or undue influence of others to offset the professional judgments". **Competence and professional care** is "maintaining professional knowledge and skills at the level required to ensure that the customer receives quality professional services as a result of the development of current practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards". **Confidentiality** is "respect the confidentiality of information collected as a result of business relationships and, consequently, does not disclose any information to third parties without permission, unless there is a law or a legal or professional duty to disclose or use the information for personal advantage or third parties". **Professional behavior** is "comply with relevant laws and regulations and avoid any action that discredits the profession".

As conclusion, the emergence of different international and national entities centered on concerns related to ethics and deontology professional during the last century plays a major role. There are probably many reasons for the attention given to this phenomenon, see for example, the Union Carbide Corporation, Bank of Credit and Commerce International, Parmalat, Enron, as well as, the collapse of Arthur Andersen. So, all these principles cannot be ignored and therefore they represent part of the problem with code of ethics – not only concerned to the present and immediate future, but also to prepare the long term strategy to better fight for the future with sustainability.

4. CONCLUSIONS

During long time, the auditing for citizenship has become subordinated to financial performance of the companies and the possibility that statutory auditors can detect mistakes, fraud and corruption has been limited, because they generally do not have this explicit goal. However, statutory auditors are competent to study failures of the internal control system, then companies could change their behavior and the main objective of managers to create value for shareholder above all else could be enhance. But, there is a first limitation, companies must adopt a philosophy of continuous improvement of ethical principles, because the rapid and dynamic growth of the economy, increase the competition of these companies and the behavior of markets, stakeholders and citizens change also. This can be contrasted with the behavior of companies which are truly located in their communities and which consequently have no need for the concept of ethics, because they fully understand the obligations imposed by citizenship; for them public image does not exist. The other limitation is that the code of ethics requires, almost, mandatory behaviors and then increases the concerns of the outcome from the economic and financial image to be transparent and clear to communicate outside the company to stakeholders and citizens. The changes clarify the subgroup of those charged with governance of an entity, such as an audit committee, that may assist the manager body in meeting its responsibilities with ethical recognition. In those cases, if the professional accountant or auditor communicates with such stakeholders, then code of ethics requires from them specific behavior to limited and prevent all kinds of conducts which are with compliance with ethics principles and then determine whether communication with all of those charged with governance is also necessary so that they are adequately informed. The last accepted limitation is that companies do not completely understand the corporate risks and classify them as potential problems. These risks are attitudes, behaviors, values of the accountant, statutory auditors and auditors and then to solve these problems, appear the codes of ethics as a general accepted formula.

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ACKNOWLEDGEMENTS

The author wishes to thank José Ángel López Pérez of Universidad de Seville (Spain). Also, the current version is a publication supported by the Project PESt-OE/EGE/UI4056/2014 UDI/IPG, finance by the Fundação para a Ciência e Tecnologia, and the author is member of the Centro de Investigação de Contabilidade e Fiscalidade.

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