Creating an Ethical Accounting Environment

An Honor Thesis (HONRS 499)

By

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Abstract

The recent accounting scandals have highlighted the need for a firm’s management to create an ethical working environment for its accountants. Before management can begin encouraging ethical behavior among its accountants, they must first gain an understanding of what constitutes ethical behavior. Management should also take into consideration the basic philosophical theories and behavioral factors that affect the development of ethics. Management must also consider the professional standards that members of the various accounting societies are bound to uphold.

If management is to create an ethical working environment, they must also understand why these principles are important to today’s business world. Several of the reasons behind this need are discussed. In addition to the issues underlying the creation of an ethical working environment, a variety of tactics that may be used to achieve this goal are discussed.
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Accountants have a very important role to play in the business world. Accountants are responsible for reporting an entity’s financial information. This information is then used by a variety of groups, including investors and creditors, for decision-making purposes. Consequently, the entity’s financial statements must be as accurate, fair, and reliable as possible. When accountants choose to act unethically and present biased, untrue information as an entity’s current financial position, they risk harming their own professional reputation and the reputation of the accounting industry as a whole.

The fallout from the Enron scandal is a prime example of what can happen when accountants lack ethical integrity. Enron was an energy company that used unethical accounting practices. Enron’s Chief Financial Officer, Andrew Fastow, created a variety of partnerships to hide the company’s growing financial problems. The purpose of the transactions between Enron and the partnerships was to keep assets with high debt levels off the firm’s balance sheet without actually losing control of the assets that were “sold” to the partnerships (McGill 27). These deals resulted in Enron’s debt being underreported by billions of dollars.

When Enron’s scheme finally unraveled, many American investors were outraged. The unfair financial reporting cost many people their retirement plans. The public outcry led to a Federal investigation. Enron’s financial situation worsened until it eventually declared bankruptcy. Arthur Andersen, one of the largest and most respected public accounting firms at the time, also went out business because it had audited and certified the financial statements of Enron. After these audits, accountants at Arthur Andersen destroyed many of the documents that pertained to their audit work (Schilit 259-264). Unethical behavior can easily destroy a company. In today’s business world, it is vital to maintain the trust of investors and creditors.
Therefore, a firm’s management must work hard to create a working environment that encourages its accountants to act ethically when reporting the company’s financial position.

**What Are Ethics**

In order for a firm’s management to create an ethical working environment for its accountants, they must first understand ethics. The terms “ethics” and “ethic” were derived from the Greek words *ethikos* and *ethos*. These two Greek terms mean “moral” and “character” respectively. Thus, ethics refers to the values and codes of conduct that are held by a group or an individual (Garner 610). Ethics is a field of study that involves systematizing, defending, and recommending concepts of right and wrong behavior (Fieser). Ethics are also principles that are based on moral truths or premises derived through logic and reasoning (Clarkson et al. 739).

Ethics is concerned with the issues we face in all aspects of our lives. Ethics focuses primarily on “the nature of ultimate value and the standards by which human actions can be judged right or wrong” (“Ethics” 492). Whereas business ethics focuses on how these principles are applied by businesspersons in the workplace, accounting ethics focuses more narrowly on accountants and their application of moral and ethical principles (Clarkson et al. 739).

**Sources for Professional Ethics**

There are several professional associations that have created codes of conduct for their members. One of the most well known accounting associations that has a code of conduct is the American Institute of Certified Public Accountants (AICPA). In addition to the AICPA, accountants can refer to other associations for information about proper professional conduct. Other associations include the Institute of Management Accountants, the Financial Executive Institute, and the Institute of Internal Auditors. Membership in the various societies depends
upon the educational background, work experience, and licenses and position held by the accountant (Windal 5-6).

The American Institute of Certified Public Accountants adopted the Code of Professional Conduct (the Code) to provide guidance and rules for its members. The Code established ethics requirements for Certified Public Accountants (CPAs). The Code is comprised of principles, rules, interpretations, and rulings (Guy, Carmichael, and Lach 6-7).

The Code recognizes six principles. The first is the principle of responsibilities, which requires CPAs to use sensitive professional and moral judgments when completing their professional activities. The second principle deals with the public interest; it requires CPAs to conduct themselves in a manner that will serve the public interest, honor the public trust, and demonstrate their commitment to professionalism. The third principle is integrity, which requires CPAs to perform their professional duties with the highest sense of integrity. The fourth principle discusses objectivity and independence; it requires CPAs to be objective, to be free from any potential conflicts of interest, and to be independent in both fact and appearance when completing an audit or another attestation service. The fifth is the principle of due care. CPAs exercise due care by observing the accounting profession's technical and ethical standards, striving to continuously improve their competence and the quality of their services, and discharging their professional duties to the best of their abilities. The sixth principle relates to the scope and nature of services. According the final principle, a CPA, who engages in public practice, must use the principles of the Code to determine the scope and nature of the services to be provided to their clients (Guy, Carmichael, and Lach 7-8).

The Institute of Management Accountants, formerly known as the National Association of Accountants, developed Standards of Ethical Conduct for Management Accountants, which
contains standards on competence, confidentiality, integrity, objectivity, and resolution of ethical conflict. The standard of competence requires management accountants to continuously develop their knowledge and skills, to perform their professional responsibilities in accordance with applicable laws, regulations and technical standards, and to prepare reports and recommendations that are complete and clear based on relevant and reliable information. The standard of confidentiality requires management accountants to refrain from disclosing confidential information unless they are authorized or legally obligated to do so, to inform subordinates about the confidential nature of the information and monitor them to be assured of the continued privacy, and to refrain from using any confidential information for their own advantage. The standard of integrity requires accountants to avoid any potential conflicts of interest in both fact and appearance, convey both favorable and unfavorable judgments and opinions, and to avoid engaging in or supporting any activity that would discredit the accounting profession. The standard of objectivity requires management accountants to convey fair and objective information and to disclose all relevant information that could reasonably be expected to influence the user's understanding of the reports, comments, or recommendations. The standard for the resolution of ethical conflict explains the proper steps for dealing with an ethical conflict if the organization the accountant works for does not have any established policies on how to handle this type of situation. The standard does not permit external whistleblowing unless the accountant is legally obligated to do so (Windal 237-39).

The Financial Executives Institute's members are "internal professionals who hold senior positions in the accounting and finance area" (Windal 6). The Code of Ethics of the Financial Executives Institute requires its members to conduct both their professional and personal affairs with honesty and integrity. Its members must continually develop their knowledge and skills and
complete their professional responsibilities to the best of their ability. Its members must also present complete, relevant information to internal and external users. Its members must adhere to confidentiality standards and refrain from committing any act that would discredit the profession (Windal 240).

The Institute of Internal Auditors Code of Ethics consists of several standards of conduct. One standard requires its members to be honest, objective, and diligent when performing their professional duties. Another standard requires its members to exercise loyalty to those they are rendering services to, but restricts them from becoming a party to any illegal or improper activity. Another standard restricts its members from abusing confidential information. Another standard requires its members to reveal all material facts in their reports that could distort the reports of operations or conceal illegal practices if omitted (Windal 241-42).

Although there are may different sources an accountant can use to determine which behaviors are ethical, it is clear that many of the same ethical principles are expected to be upheld by accountants, regardless of their position. Accountants are clearly expected to provide honest, objective, and relevant information in their reports. Accountants are also expected to act with integrity at all times. Consequently, an accountant should never profit at the expense of others or commit any act that would cause society to question the authority of the profession.

**Philosophical Theories on the Development of Ethics**

Before an organization institutes a code of ethics, it may be helpful to those writing or choosing the code to gain an understanding of some of the basic philosophical theories about the ways in which individuals determine which actions are ethical. There are many philosophical theories about the development of ethics. Although it would be extremely difficult for management to incorporate all of these theories into its code of conduct, it is important for
management to have a basic understanding of the philosophy behind their codes and policies. If management understands the different ways that individuals learn ethics, they can use that knowledge when they are dealing with the ethical dilemmas an individual employee is facing or when attempting to teach the ethical values of the organization to all of its employees.

Some philosophers believe in voluntarism, a theory that maintains that moral principles are willed by God. God informs people of these principles by giving individuals moral intuitions or by revealing these principles in scripture (Fieser). According to this view, an accountant could learn that it is unethical to sign a financial statement that is obviously filled with inaccuracies because the Bible states in Exodus 23:7 that you should “distance yourself from a false matter” (qtd. in Gellis, Giladi, and Friedman).

Moral relativism, on the other hand, claims that ethical values are invented by humans. Moral relativism can take two forms. The first form is individual relativism; those who believe in this form think that individuals create their own moral principles. The second form is cultural relativism, which holds that moral principles are decided by one’s society (Fieser). Thus, an accountant, a group of accountants, or the community could determine which ethical principles accountants should abide by while completing or auditing a firm’s financial statements.

Deontological, or duty-based, theories focus on specific, foundational principles of obligation when determining which behaviors are right. There are four main deontological theories. The first theory was developed by Samuel Pufendorf. According to Pufendorf, there are three classifications of duties: duties to God, duties to oneself, and duties to others. Duties to oneself include the development of one’s skills and talents. Duties to others include the avoidance of committing any action that would wrong another person (Fieser). Therefore,
followers of Pufendorf would easily agree with the Code’s principles of due care and public interest.

The second deontological theory is known as the rights theory. According to this theory, the duties of one person are implicit in the rights of another. Moral rights are comprised of four features: natural, universal, equal, and inalienable. A right is natural when it is not invented or created by a government. Rights are universal when they transcend cultural and geographic boundaries. Equality is achieved when rights are the same for all people. A right is inalienable when it cannot be given up or “sold” to another person (Fieser). Thus, an investor’s right to reliable information is an accountant’s duty to provide reliable information.

The third deontological theory was developed by Immanuel Kant. Kant’s theory emphasizes only one principle of duty. Kant believed in the categorical imperative (Fieser). “The categorical imperative has no conditions; it is a command or law of morality” (“Kant” 272). According to Kant, an action is moral when the underlying motivation to commit the act is good and the individual believes that all of society should be able to commit the same act without serious consequences (McCormick). For example, if every accountant presented false information, no one would ever be able to trust any financial statement when deciding whether to invest in a certain company. Therefore, accountants should not present false information in the financial statements.

The fourth deontological theory was developed by W.D. Ross. Ross’ theory focuses on seven prima facie duties. The first duty is fidelity, which obligates us to keep our promises. The second duty is reparation, which requires us to compensate others when we harm them. The third duty is gratitude, which compels us to thank those who help us. The fourth duty is justice, which is the obligation to recognize merit. The fifth duty is beneficence, which is the
requirement to improve the conditions of others. The sixth duty is self-improvement, which is our duty to improve our own virtue and intelligence. The final duty that Ross recognized was nonmaleficence, which makes it our duty to avoid injuring people (Fieser). The duties recognized by Ross, especially those of fidelity, self-improvement, and nonmaleficence, should be seen as part of an accountant’s duty since the public wants accountants who are trustworthy and knowledgeable.

Philosophers have also developed three types of consequentialist theories. Consequentialist theories determine the morality of certain actions by doing a cost-benefit analysis of the action’s consequences. The first type of consequentialism is ethical egoism, which holds that an action is ethical if the cost-benefit analysis shows that the consequences of the action would be more favorable than unfavorable for the individual performing the action (Fieser). Thus, the consequences that will befall the rest of society are not seen as a deterrent as long as the individual will benefit from the action. This clearly is not a good theory for accountants to use when developing their own ethical standards because ethical egoism results in an individual choosing actions based on his or her self-interests (Kaptein and Wempe 27). The profession needs to focus more on the needs of others than on those of the individual accountant to be successful at keeping the public trust.

The second type of consequentialism is ethical altruism. According to ethical altruism, an action is deemed to be ethical if the cost-benefit analysis shows that the consequences of the action would be more favorable than unfavorable for the rest of society without regard to the individual who is performing the action (Fieser). An altruistic accountant would choose to use his or her knowledge and skills to present an accurate picture of the company’s financial situation because it would be beneficial to investors. The accountant’s decision would not be
swayed by any benefits, or harm in some instances, that he or she would face as a result of this action.

The third type of consequentialism is utilitarianism. According to utilitarianism, an action is ethical if the cost-benefit analysis produces results that are more favorable than unfavorable for everyone (Fieser). A utilitarian approach to ethics "produces the greatest good for the greatest number. When an action affects the greatest number adversely, it is morally wrong" (Clarkson et al. 741). If an accountant was in a situation where he or she could easily embezzle money from a corporation with little or no chance of being caught, the individual should not choose to commit the crime since it would only benefit one person while many others would be harmed by the loss of the corporate funds.

There are many ways in which individuals learn which behaviors are right and which ones are wrong. Once management has acknowledged this fact, they will be able to begin to find the best ways to teach their employees how to be ethical. Management may have to use multiple programs to teach their employees or they may be able to combine certain aspects of the different ethical theories to teach all of their employees in one program.

Behavioral Factors Affecting the Accounting Function

In addition to understanding the effects of an individual’s philosophical viewpoint on his or her conduct in the workplace, management must understand that human behavior also influences the choices made by accountants. As illustrated in Appendix 1, an organization’s accounting function is influenced by the individual’s needs and attitudes, group pressures and control, organizational structures and control strategies, and the social and economic environment (Hopwood 4-5).
An accountant's needs and attitudes can greatly affect his or her performance. An accountant who is motivated and driven to succeed will work very hard to impress his or her superiors. Although a firm wants its employees to be motivated to do their jobs, this type of individual could become a liability if he or she believes that the only way to impress management enough to receive the desired promotion is to manipulate the company’s financial information to increase its profits.

Consequently, the firm's management must be careful to avoid sending the wrong message to its accountants. Many companies choose to reward their managers with bonuses that are tied to the company’s sales and profits. While this practice is intended to encourage better performance, it can have the undesired effect of motivating management to make their financial results look more favorable. This type of compensation structure typically causes management to pressure the accountants for better results and often leads to unethical accounting practices. The accountants can make the results look better by using creative interpretations of generally accepted accounting principles (Schilit 28-30).

An entity that has weak internal controls has a greater risk of employees engaging in unethical behaviors than entities with strong internal controls. If there is little chance of the accounting system detecting an error, the temptation to create fictitious records or modify the current records is great. In general, people are willing to bend or break the rules when they believe that they will benefit and that the chances of being caught are very low or nonexistent (Schilit 31-32).

The current economic environment can also lead to unethical accounting practices. When an entity is under an extreme amount of competitive pressure, management may believe that unfair financial reporting is necessary to make it more appealing to investors or to hide its
financial distress from the investors and creditors (Schilit 32-33). When a business is struggling to survive, its accountants may find it difficult to maintain their integrity because of the pressures to report favorable information.

If management is to succeed at creating an entity with ethical accountants, they must avoid sending the message that the bottom line is more important than the methods used to calculate it. A firm’s management must work to create an environment that does not demand too much of its accountants. Management should realize that an accountant’s duty is to report the entity’s information, not create the information that management desires.

**Consequences of Unethical Accounting**

Although the perceived benefits of unethical conduct can be very tempting, it is important to realize that there are risks associated with these activities. There are serious consequences for those who are caught. These consequences range from legal ramifications to the loss of the public trust to the tarnishing of the profession’s reputation.

Those practicing in today’s business world believe that compliance with applicable legal standards is the moral minimum, or the minimal acceptable standard for ethical behavior (Clarkson et al. 742). Several laws have been passed that deal directly with accounting practices, especially those of publicly traded companies. Management should be familiar with these laws and make sure the firm’s accountants meet these standards.

The Securities Act of 1933 was created to ensure that publicly traded corporations would be more transparent. This law requires public companies to provide their investors with all relevant information concerning securities that are being publicly traded and it prohibits deceit, misrepresentations, and other fraudulent activity in regards to the sale of securities. The Securities Exchange Act of 1934 created the Securities and Exchange Commission (SEC) to
enforce the Securities Act of 1933 and empowered the SEC to require periodic financial reporting for all public companies ("The Laws"). Thus, accountants are legally required to report an accurate picture of a public company’s financial situation.

Accountants should also be familiar with the Foreign Corrupt Practices Act (FCPA) that was passed by Congress in 1977. The FCPA prohibits American businesspersons from using bribes to secure contracts with foreign officials. In addition to this prohibition, the FCPA also requires that all companies keep detailed records that are an accurate and fair representation of the company’s financial activities. If a company is found to have violated the FCPA, it may have to pay fines of up to $2 million. An officer or director who violates the act may receive a fine of up to $100,000, which cannot be paid by the company. The officer or director may also face a prison sentence of up to five years for the violation (Clarkson et al. 748).

The most recent law that directly affects the accounting profession was signed by President George W. Bush on July 30, 2002. This law is known as the Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act is designed to increase corporate accountability, to make financial disclosures more transparent, and to help prevent corporate and accounting frauds. This Act also established the Public Company Accounting Oversight Board to oversee the accountants who are involved in the auditing profession ("The Laws"). The Sarbanes-Oxley Act has also made it illegal to retaliate against any employee in a publicly traded company who blows the whistle on the entity’s unethical practices. Any executive who chooses to retaliate against a whistleblower may end up serving a maximum of ten years in prison (Ravishankar).

In addition to the potential fines and imprisonment, unethical accounting may result in an entity losing the public’s trust. An accountant’s public may consist of clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely
on the information when making decisions (Windal 165). If any of these groups begin to doubt the integrity of an entity’s financial statements, the consequences may be disastrous for both the entity and its auditors. As previously mentioned, the accounting scandal at Enron caused both the company and the firm that audited it to go out of business. The public clearly will not tolerate deceitful accounting practices. Although fraudulent reporting may temporarily increase an entity’s stock price, it could completely destroy the company’s reputation in the long run as well as the reputation of the accountants involved in the deception.

The consequences of unethical accounting can be devastating. Unethical behavior may lead to fines, imprisonment, and bankruptcy. The short-term benefits gained by unethical conduct in the accounting profession are clearly outweighed by the potential loss of freedom or funding. Therefore, management’s focus should be on ethical accounting and reporting, instead of short-term gain to ensure the survival of the entity.

*The Development of an Ethical Working Environment*

Although professional codes of conduct are an important means of communicating the ethical values of the accounting profession, there are other factors that contribute to the development of an ethical working environment. The responsibility to create an ethical working environment lies with a firm’s management. Management can create an ethical environment by creating its own code of conduct, choosing to hire employees who have a strong sense of integrity, training their employees to behave ethically, imposing certain human resource policies, and establishing an open line of communication between management and employees.

In addition to the ethical codes created by professional societies, accounting firms and businesses develop their own codes to provide guidance to their employees. All organizations have a code of business ethics. Some entities express their moral norms and values in a formal
written document. Other entities have an informal code that develops and regulates the behavior of their employees without being written down; it is a shared sense of how the entity should operate (Kaptein and Wempe 271). Formal codes, however, are preferred because a written document usually provides adequate guidance that cannot be disputed later (Brooks 131).

When an accounting firm or business begins to write its own code, it may choose to focus on the stakeholders’ interests, the organization’s responsibilities, the organization’s strategic policies, the organization’s mission, or several key issues the organization is currently facing. The entity may even choose to use a combination of these areas to deal with in the code of conduct (Brooks 132). However, there are several important issues that most codes do choose to address. These issues include conflicts of interest, compliance with applicable laws, political contributions, and gifts (Brooks 134).

Appendix 2 presents a ranking of important topics often found in corporate codes of conduct. It is important to note that by 1987, most corporations did not consider false entries in their accounting systems or undisclosed assets to be an important topic that needed to be dealt with in their codes of conduct (Brooks 134). This shift of focus may be one of the most important factors that led to the recent rash of accounting scandals.

If organizations were not insisting that their accounting records accurately reflected their financial situations, some of their accountants may have thought they were doing the right thing by making the numbers look good to meet the company’s objectives. This lack of guidance on proper conduct could have triggered a lack of professionalism in some accountants although they were still required to meet professional standards, such as the AICPA’s Code of Professional Conduct. Accountants obviously do not want to lose their membership in certain professional societies, but they also want to keep their jobs. The pressure exerted by their colleagues and
members of management is going to be stronger since contact with these groups is much more frequent than with the administration of their professional society. Consequently, it is very important for all organizations to include topics about proper conduct for its accountants in its code.

After the organization has decided which issues it wants to confront in its code of conduct, it should then begin the writing process. An organization’s code usually establishes its core values at the beginning of the document. These values are the principles that employees should use when making decisions. Consequently, the values need to be clearly defined so that the employees know what is expected of them. An organization should also include specific examples of how the values should be applied to guide its employees (Navran).

Those involved in writing the code also need to realize that it is impossible to foresee every possible ethical dilemma an employee may face. Consequently, the code needs to provide information on how to seek guidance when dealing with an ambiguous or uncertain situation. The code should also list ways to clarify the situation so that the employee can determine how it should be handled in conjunction with the organization’s ethical values (Navran). Thus, a code that focuses more on general principles than on specific rules may be more effective. It may be beneficial to explain the reasoning behind the principles to give employees a better understanding of the entity’s values. This understanding may make the principles more useful when the accountant needs to use them for decision-making purposes (Brooks 136).

Management must also make sure that every employee receives a copy of the code of conduct. If every employee has a copy, an individual can not claim that he or she did not know about a certain principle or rule (Brooks 137). This can be accomplished by passing them out to all new employees when they are hired. If new hires are required to sign a statement that they
have received a copy of the code and that they agree to follow it, the code may be more effective since this requirement may increase the chance of the new employees thoroughly reading it.

In addition to creating a code that all employees must follow, management should also try to hire ethical employees. All potential employees have a system of values ingrained in them. Although there are ways to teach people values, it is better to hire individuals who have many of the ethical values that management desires to see in its employees. Management can begin the process of hiring ethical employees by designing human resources policies that require reference checks and background checks on all individuals who are being considered for a position with the organization. These checks will alert the screeners to any past unethical behavior. However, not every person who will commit an unethical act has done so in the past. Therefore, it is very important that interviewers utilize other tools when attempting to predict the future behavior of a potential employee, especially an accountant who will have access to sensitive information (Arnold and Jones).

Integrity tests are an excellent tool for the interviewer to use to gain insight into a potential employee's mind. Integrity tests are psychological tests that screen job candidates for traits, such as honesty and violent tendencies. Although these tests are surrounded with controversy, a study by the American Psychological Association concluded that there is a need in the business world for this type of testing and that the tests have demonstrated predictive value. The American Psychological Association, however, also warned that there is no such thing as a perfect test so employers should use the results to supplement other information, such as the interviews, reference checks, and background checks on the candidate (Bent).

Integrity testing may take several forms. Some companies use a paper and pencil test or a computer survey. Other companies use a telephonic interactive voice response or an
interactive Web page. A firm that specializes in integrity testing will score the results once the candidate has completed the test and report the findings of the test to the company. Integrity tests can also be customized to test for the traits the employer believes to be important (Arnold and Jones).

After a candidate, who appears to have values that are aligned with those of the company, has been hired, management must begin to teach the new employee the organization’s values. Management can teach their employees the values of the company in numerous ways. In today’s business world, it is very important that all accountants, not just new hires, learn and maintain a firm’s ethical values. As previously discussed, codes of conduct are one means of communicating management’s values. Other methods of instilling ethical values in an organization’s accountants include leading by example and having mandatory ethics classes or workshops.

The attitudes of top management toward ethics can determine whether an entity’s employees will carry out their duties in an ethical manner. Consequently, top management must provide strong, visible support for the entity’s ethics program if it is to have any chance of success. With proper support, an ethics training program can easily instill the organization’s ethical values in its accountants. The training program should explain the firm’s code of conduct. The training program will be more effective if it uses cases of actual accounting dilemmas because accountants will relate better to examples of situations they actually face and will receive guidance that will be useful in dealing with these issues. The program should also give detailed information about where accountants can turn to for advice when they are facing an ethical dilemma. Accountants should also be advised on how they can report unethical conduct in the workplace (White).
Management must also develop human resources policies to punish those who act unethically. If the accountants believe the organization is making rules to govern behavior in the office without instituting punishments for those who disobey, the firm’s code of conduct and training programs are useless (White). When ethical violations are not punished, accountants will not believe that upholding the organization’s norms and values are a top priority of the entity (Kaptein and Wempe 254).

If management is going to punish those who disobey, they must be able to find sufficient evidence of the wrongdoing. Independent audits and the company’s own internal controls may detect many of the errors and irregularities that exist. If the accountant is in a position where he or she can override the controls or is able to work with another individual to commit the crime, management’s best source of information about the plot may come from another employee. Consequently, management must create a working environment that encourages its employees to talk openly about problems within the company to their superiors. If management does not create such an environment, the organization may face a scandal because an environment that does not encourage open communication is an ideal place for an executive or an accountant to engage in creative accounting practices and steal from both the company and its investors. An entity without open communication may also threaten those who would come forward with information into silence (Kaptein and Wempe 254).

Although many people have negative attitudes toward whistleblowers, internal whistleblowers are a very important part of an organization. An internal whistleblower is an individual who informs his or her superiors about unethical conduct in the organization. If the superiors listen to the whistleblower and decide to stop the unethical actions, the organization
will change for the better and may avoid a scandal that could have completely destroyed the business if management had not acted to put an end to the problems (Ravishankar).

There are five basic steps that should be followed to create a culture that encourages open communication. The first step involves creating a policy that employees should follow when they want to report unethical practices. Employees could voice their concerns via a telephone hotline, special mailbox, or even a face-to-face meeting with a superior. The organization also needs to inform employees about the proper chain of command to follow if they do not believe their concerns were being taken seriously. The policy should make it clear that the organization will not tolerate any retaliation against a whistleblower (Ravishankar).

The second step involves getting the support of top management. The executives need to endorse the policy and encourage open-door communication. All levels of management need to be trained to create an open-door policy to hear employee complaints (Ravishankar).

The third step is to publicize the organization’s commitment to the policy. Employees need to hear about the policy regularly for it to be effective (Ravishankar). The leaders of an organization need to discuss their own ethical dilemmas and the ways they resolved these issues with their employees. In doing so, the leaders can show the connections between the organization’s values and the decisions made by management. Management should then encourage other employees to behave ethically. This could be accomplished by asking an accountant for the reasons behind his or her decision. This technique serves two purposes. The first purpose is to show accountants that the reasoning behind a decision is just as important as the end result. The second purpose is to show employees that it is acceptable to discuss the ethical considerations that factor into one’s decision (Navran).
The fourth step is to investigate and follow up on any allegations of misconduct. All employee complaints need to be investigated thoroughly in a timely manner. The origins of the complaint and the results of the investigation should be reported to a higher authority within the organization. If the organization does not investigate its complaints in a timely manner, employees may not believe that the organization is serious about its open-door policy and may choose not to participate in the future (Ravishankar). The investigation process is also important because it helps protect innocent employees from being punished for an act they did not commit.

The final step necessary to create a culture that encourages open communication is to assess the organization’s internal whistleblowing system. Management needs to know how its employees feel about the organization’s culture. This can be accomplished by doing an annual survey of its employees to learn about their opinions of the organization’s commitment to ethics and values. If the employees do not believe that the organization will not tolerate unethical behavior, the current policy is not working and action needs to be taken to correct the problems with the policy. The survey should also make sure that employees know how to report unethical conduct (Ravishankar).

In today’s business world, members of management need to make the creation of an ethical working environment for their accountants a top priority to ensure the survival of the business or accounting firm. If management is to be successful in achieving this goal, they must have an understanding of the philosophical theories behind ethics and of the behavioral factors that affect the profession. Once this foundation exists, management can build upon it to create an ethical working environment for its accountants by instituting a code of business ethics, hiring ethical employees, punishing those who engage in unethical activities, and encouraging open-
door communication. An ethical accounting system will greatly reduce the possibility of scandal and the consequences associated with it.
Appendix 1

The social and economic environment

Organizational structures and control strategies

Group pressures and control

Individual needs and attitudes

The Accounting Function

## Appendix 2

### MOST IMPORTANT TOPICS IN CORPORATE CODES OF CONDUCT

<table>
<thead>
<tr>
<th>TOPIC/RANK</th>
<th>1980</th>
<th>1987</th>
</tr>
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<tbody>
<tr>
<td>General statement of ethics and philosophy</td>
<td>1</td>
<td>2</td>
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Works Cited


