Ethical values and accounting in business organizations

Nader Naghshbandi and Robert Mosomi Ombati
Department of Accounting, J.N.R. Vidyapeeth University, Udaipur.

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ABSTRACT
The word ethics borrowed from Greek means spirit of culture. According to Oxford dictionary, it is a moral principle that governs or influences a person’s behavior. Ethics are the fundamental principle in any organization and these are the foundations for the survival and success of business concern. Many organizations develop a code of conduct for their employees; such codes are after prescriptive and set out specific guidelines for their employee’s conduct. In India, there are many scripture’s like Vedas, The Gita and The Ramayana. The ideals contained in these scriptures are universally applicable and there are no contradictions to them. Our Vedas and post Vedic concepts have a lot to contribute in management practices. In companies such as Enron, World Com, Satyam Computers and the most of late dotcoms. Now the management has taken steps to enrich the total personality of the employees, who are treated more as associates in the organization rather than mere instruments of production. This paper is an attempt to describe some of the basic principles of ethics, which are mostly concerned in managing accounting in the business world.

Introduction

Regarding managerial ethics, King Manu states, “no one who ignores the principles of philosophy and psychology can bring any human activity to successful issues.”

The ultimate meaning of ethics is industry that is no consumer should be harmed in any way by entering any sort of agreement with the business and industry. This definition can be written in a clear way as: one has to earn wealth only through truthfulness to fulfill the desires, to finally achieve the salvation the ultimate goal. If anybody does anything contrary to this, he/she will have to answer the conscious at the end. The much talked about concept of corporate governance also deals with the ethical aspect of business.

The 21st century promises to be characterized by rapid change in technology and relentless competition spurred by globalization. It is hardly news that, in such an environment, firms will either have the capability to rapidly adapt to change or will suffer the consequences of low performance and ultimately organizational destruction. Failure to perform well relative to profitability and competitiveness not only harms investors, but also creates a multitude of human costs. Organizational leaders are often hurt by their inability to learn and change their organization, their leadership behavior or their employees.

Leadership is about taking the risk of a meaningful management. Pondy (1978) emphasized that a leader’s effectiveness lies in his or her ‘ability to make activity meaningful’ for others by giving ‘others a sense of understanding’ of what is happening. This paper discusses the need for organizational managers, including accountants, to use ethical values to help employees to view change not simply as something to ‘get through’, but as an opportunity to make organizational improvements that will lead to long-term success in the global market place.

What is business ethics?

A business ethics is the application of ethical values to business behavior. It applies to any and all types of business conduct, from boardroom strategies and how companies treat their suppliers to sales techniques and accounting practices. Ethics goes beyond the legal requirements for a company and is, therefore, discretionary. Business ethics applies to the conduct of individuals and to the conduct of the organization as a whole. It is about how a company does its business, how it behaves intrinsically.

What is the difference between ethics and an ethical business?

Business ethics relates to how any company conducts its business in order to make profit. Any company can seek to do business ethically. An ethical business, on the other hand, has a much broader agenda and focuses on making a positive contribution to the community. A mainstream bank, for example, may take ethics seriously by taking responsibility for its negative impacts on society and the environment and seeking to minimize those impacts. An ethical bank, such as the Co-operative Bank, states that it seeks to make the world a better place by taking a different approach to banking. In the case of this type of business, ethics becomes at least as high a priority as profitability.

Ethics and values

The power of employees’ organizational identification as a social adhesive with bottom-line consequences is evident in many studies (such as Altheide et al. 1978; Grant, 1996). Rates of in-house company theft and sabotage – a high eight-figure cost to corporations around the world – are also valid indications of how employee behavior, devoid of organizational identification, can be detrimental to the bottom – line. These crimes generally cannot be dismissed simply as economically motivated efforts to make up for deficient wages: workers at all income levels steal and the amount of the theft might be of little or no consequence to the thief’s overall net income or worth. It is highly possible that such unethical activities can be traced to the fact that employees do not have an intrinsic sense of...
inclusiveness with the organization that it is theirs, that a feeling of ‘us against them’ exists.

Employee commitment to an organization cannot be legislated or purchased. It’s management’s responsibility to create an environment in which employees can identify with the organization by establishing means and ways to develop and nurture the human capital and to affirm the attitude of the whole employee – as a contributor to the firm’s operations, as a worker who is part of the community’s job market, as a member of groups outside the firm that make legitimate demands, (e.g., families, religious institutions, and civic associations), and as an individual with physical and psychological needs (Horstein, 2003). These affirming arrangements frame the perspectives of both managers and subordinates by sending genuine messages of inclusion saying that the organization regards all employees as part of ‘we’. As a result, employees are invited to identify with the organization and managers are inhibited from treating employees as ‘different’… as ‘they’ rather than ‘we’.

Introducing ethical values into accounting

The design of organizations naturally evolves over time. Work systems (firm structure), management processes, human resource systems, organizational principles and values, and leadership behavior must be flexible enough to integrate a company’s strategy and culture into the current business environment as well as adapt to changes within that environment. When the operating environment shifts to require new business habits, the strengths that led to organizational success cannot be rigidly maintained, allowing no modifications. To do so may mean that previous strengths may disintegrate into weakness and that success becomes failure.

The inability of corporations to survive and prosper in the long term is generally not caused by lack of innovative ideas, but rather that existing (and possibly, new) leaders often fail to redesign their organization to enable the innovations to emerge and alter the we’re succeeding , keep doing what we’re doing attitude. Such an attitude is common in accounting functions, in part because accounting is historical in nature, relies on consistency of operation, and emphasizes verifiability and lack of bias. But even in accounting, change occurs. The focus here is not on changes in how things are accounted for (generally accepted accounting principles) but rather the influx of new accounting ideas being introduced into an organization. Few functioning may improve the performance and profitability is discussed here.

Budgeting

One area of accounting change might be in the process of budgeting, which is the financial statement of the organization’s goals and objectives for the future. Many people in organizations treat budgeting as a burdensome yearly activity that is often effected through some level of game playing. It is common place for managers to adopt an ‘us verses them’ mentality by either not asking for employee participation in the budget process or asking for participation and then totally denigrating or dismissing the information provided. Employees who are allowed to participate always take their own ‘us verses them’ attitude by introducing budget slack into the process by understating revenue and overstating expense estimates so that, when actual figures are generated, the employees appear to be performing more effectively and efficiently than was originally expected. In the Guillermo Furniture Store Scenario, Guillermo, the owner of a local furniture manufacturing business, in Sonora, Mexico, saw the impact of a local economy growing, overseas competitors, and modern technology producing the same quality furniture while maintaining ethical values. This will analyze the risks associated with unethical budget forecasts and the Ethical considerations in the preparation and subsequent use of the budget. Through this will show that ethics might influence his accounting decisions. Enron's complex financial statements were confusing to shareholders and analysts. In addition, its complex performance according to McLean and Elkind in their book The Smartest Guys in the Room, "The Enron scandal grew out of a steady accumulation of habits and values and actions that began years before and finally spiraled out of control." In a model and unethical practices required that the company use accounting limitations to misrepresent earnings and modify the balance sheet to indicate favorable performance. Change would be introduced by adopting an open-book management philosophy that emphasizes involving all employees and providing them with full access to operating and financial information so that performance can be enhanced (Stack, 1992; Davis, 1997). Budgeting goals must be communicated throughout the organization and ethics can be used to create mental models to direct focus on critical versus noncritical items. Each dimension or linkage of mental model is essential to help employees understand the what, why, and how of the budgeting process. Ethics can help employees visualize the company’s financial picture for the future, what will occur (or not occur) if financial goals are met (or not met), why is it necessary to prepare forecasts as accurately as possible, and how personnel, production equipment, facilities space and supplier negotiations, among other things, are influenced by budgets.

Enron's stock price (former NYSE ticker symbol: ENE) from August 23, 2000 ($90) to January 11, 2002 ($0.12). As a result of the decrease of the stock price, shareholders lost nearly $11 billion. Ethics gain in complexity when each idea is fitted to the actual circumstances and when the interrelationships between the ideas can be clearly seen by those whom the ideas are being presented. Thus, it is essential that everyone in the organization be ‘on the same page’ and, as such, part of the ‘we’ mentality. Employees must be reassured that their budget participation will be real rather than pretense – a fact that can be seen if open-book management is in place.

Ideal Standards

Another change in accounting process could be the introduction of ideal rather than expected or practical standards in the workplace. Both total quality management (TQM) and Just-in-Time (JIT) production systems have evolved as a result of an upsurge in Japanese productivity, which deems waste and inefficiency unacceptable. Unlike traditional standards which not only build waste and inefficiency into the standard and then expect more of the same under a management by exception
principle, both TQM and JIT begin with the premises of zero defects, zero inefficiency and zero downtime. Under TQM and JIT, ideal standards become expected standards and no (or only a minimal allowable) level of acceptable deviation from standards.

When a standard is set at a less-than-ideal level, companies allow and even encourage inefficient resource utilization. Ideal standards result in the most useful information for decision making as well as the highest quality products and services at lowest possible cost. However, without proper ethics introducing such a system may create worker resentment. Thus, establishment of the proper ethics should help communicate the need for and appropriateness of the new standards. Employees should be presented with a view of the ‘perfection’ standards not as a punishment to make them work harder but rather as a means to eliminate no-value-added activities such as waste, idle time, and rework and therefore, generate lower costs and higher organizational profitability. Employees should be encouraged to identify the causes of unfavorable variances and suggest ways to eliminate those causes. If variances are related to external sources such as poor quality material) management must be willing to change suppliers and/or pay higher prices for higher-grade input. Additionally, ideal standards assign the majority of responsibility for quality to employers and therefore, management must give those employees the authority to react to problems. Lastly, requiring employees to work at their maximum potential demands recognition, which means that management must provide appropriate rewards for achievement. Ethical values, the introduction of ideal standards as a means to make the organization better reiterates the all-important ‘we’ perspective

Activity Based costing

Managers in many companies are concerned about the product costing information being provided by traditional cost accounting systems. Although such product cost are reasonable for use in preparing financial statements they often have limited value for management decision making and cost control. As such, accountants may want to implement activity based costing (ABC) in an attempt to develop more useful product costs. ABC focuses on attaching costs to products and services based on the activities conducted to produce, perform, distribute and support those products and services.

Instituting an ABC system requires significant organizational change. Before making a change to ABC, process maps must be developed to indicate every step in every area that goes into making or doing something and then each step in the process must be identified as value – added or non-value added. These tasks must be framed in a manner that reiterates the inclusiveness of all organizational members while simultaneously seeks to eliminate (or, at a minimum, reduces to the extent possible) non-value added activities, which oftentimes generates the elimination of employee jobs.

If employees believe that their employing organization’s loyalty to them depends largely on how the organization answers the question ‘what did you do for us today?’, employees ‘boundaries of “we” shrink until only “I” and self-serving behavior remain. The remedy is substantial organizational effort communicating that every employees’ tomorrow is on the organization’s list of today’s responsibilities. This attitude does not mean that organizations are obliged to commit financial suicide by guaranteeing employment. The alternative to choosing between selfishly instrumental organizational decisions and guaranteed employment requires affirming employees as workers who have lives that go beyond their immediate employment. One way to do that is by introducing efforts that result in employees’ enhanced employability. An example of ‘we’ mentality is Intel Corporation’s redeployment procedure, which has helped the firm diminish layoffs by successfully relocating between 80% and 90% of Intel employees who needed to find new jobs because their old ones disappeared (Cascio, 2000). The procedure provides Intel workers with opportunities for assessment, guidance, training and job listings. If all these opportunities fail to produce an internal placement, then Intel provides outplacement assistance. Such attention to employees not only reduces hiring and training costs, it also enhances organizational memory and learning.

The shift from control to values

Two closely related perspectives have dominated organizations over the years and both are accounting related: efficient performance and control. The first of these is a direct-expression of the concept of shareholder accountability and agency theory, which underlies and dominates most traditional business thinking. A result is the emphasis on fiscal responsibility and on money as the common denominator for expression and synthesizing corporate activities. Another result is the development of financial accounting as the primary means of expressing corporate success and efficiency in terms of profitability, return on investment and related key figures i.e. the emphasis is on financial measures.

Closely related to the concept of efficient performance is the notion of control and the need to build systems to control limited resource utilization. Traditionally, control has often been exerted via the management accounting system to motivate compliance and through external rules and regulations to enforce compliance. The more complex the organization and the more uncertain their environments the greater the demands that have been placed upon developing and implementing control systems with the capability monitor, analyze and adapt to that complexity. The Sarbanes – Oxley Act of 2002 (SOX) Section 404 on internal controls is a perfect example of this type of regulatory environment. There is however, evidence that a continued dominance of these perspectives (efficient performance and control) in more complex business environments can be counterproductive; consider the frauds that have occurred in the recent past because organizational management attempted to force earnings levels that existed only in managements’ (or analysts) minds. In companies such as Enron, World Com, Satym and the most of late dotcoms, the accounting information used by the Finance Department was false and manipulative. What was the role of finance and accounting professionals in all these high profile failures? Of course there were a few professionals who were directly involved in fraudulent activities, however, the majority, at most of the times, refused to challenge what they had already known. Additionally, reacting to higher levels of complexity and uncertainty by attempting to simplify business reality through the establishment of new rules and regulations may lead to inefficiency and a decreased ability to describe, understand, motivate and coordinate, consider the issuance and reevaluation of the SOX mandate that auditors report on managements’ assessments of internal controls. It is unwise to attempt to plan and control that which cannot be controlled without destroying vital qualities of the people for whom the planning and controlling are performed. People are one of the most important assets that an organization, especially people who seek responsibility, personal development, a sense of identity and pride, and the motivation to use their creativity and multiple
talents. People who must feel they share the same values of their organization and are integrated part of that organization.

Business can benefit greatly from pursuing organizational alignment. An important part of aligning self and self-perception of the organization is to understand the organizations values. Like Enron exist in plenty, example World Com, Satym India and Global Crossing and many companies have been known to create accounting entries with the sole purpose of making their financial statements from unsuspecting individuals and organizations. Many organizations talk about their values but fail to realize that discussing values in a management retreat does not make them reality. Values cannot be created; they must be uncovered or discovered. Every company has value drivers-authentic company strengths that lead to the behaviors, which power its results. Value drivers are the strategies that provide consistency behind the different goals for which a company aims and, whether management realizes or not, value drivers define how the organization acts and reacts to people, problems, and opportunities. Exhibit 1 illustrates these relationships.

Conclusion

During the last three decades, a series of articles published in psychology journals underscored the importance of ethical values by demonstrating that it affects whether ordinary people, going about their daily chores, choose to set aside self – interest to assist strangers who need help (Horstein et al. 1971, Horstein, 1982). Evidence showed that people who anonymously helped strangers – as low as 20% in some cases to as high as 80% in others – depended on whether the potential helpers viewed the needy stranger as one of ‘us’ or as one of ‘them’. That sense of connectivity is equally important in the workplace.

Managers (of which accountants are a unique information providing subset) must use ethical values as a way to enhance employees’ loyalty and commitment to their organizations. All organizational participants must be made to accept, understand, and embrace company goals and believe that those goals are contingent with those of the participants, aligned with their personal ethics, and that they are integral to organizational success.

Developing ethics for organizational changes helps managers to formulate clear and consistent communication and thereby, allow goals to be articulated and buy-in to take place. Mental models influence what people pay attention to and what they ignore. Shared visions transform individuals in organizations from passive followers to creative and purposeful leaders. As a business changes and adapts to new circumstances, the accounting processes within that business must also change to improve the business’ chance of long-run profitability and viability. Management must be able to discover how existing organizational capabilities can be augmented with new competencies to meet contemporary challenges – and often, such discoveries relies on having accurate and useful accounting information for decision making, a process that is enhanced when change is framed in a manner that indicates underlying need and future benefit to all concerned.

References


