Statements on Management Accounting

LEADERSHIP, STRATEGIES & ETHICS

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TITLE

Values and Ethics: From Inception to Practice

CREDITS

IMA® would like to acknowledge the work of Nick A. Shepherd, FCMC, FCCA, CGA, of EduVision Inc. on whose work this SMA is based. Thanks also go to Christopher Dowsett, Mike Van Roy, and Curt Verschoor, who served as reviewers, and to Raef Lawson, Ph.D., CMA, CPA, IMA director of research and professor-in-residence, who serves as series editor.

Published by
Institute of Management Accountants
10 Paragon Drive
Montvale, NJ 07645
www.imanet.org

IMA INSTITUTE OF MANAGEMENT ACCOUNTANTS
Advancing the Profession™

LEADERSHIP STRATEGIES & ETHICS

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I. EXECUTIVE SUMMARY

In the business reality of the 21st Century, where knowledge management and intangible assets are key sources of competitive advantage, the individual behavior of employees from top management to front-line workers can make or break an organization's reputation. This has a significant impact on share value, the ability to attract and retain clients, investors, employees, or customers, and the risk of compliance violations. Globalization increases the potential impact of behavioral conflicts. An organization operating in different countries may find that the values and ethical standards of other cultures clash with its own. Each of these issues contributes to the need for every organization to define its own principles of behavior by clearly outlining its organizational values and creating a code of ethics and corporate conduct that provides guidance in decision making internally and in relation to external parties and compliance requirements. Such guidance is a critical element in the creation of a framework for ethical management.

For those in the management accounting profession, the Institute of Management Accountants (IMA®) created *The Statement of Ethical Professional Practice*. Other major global accounting bodies also maintain codes of ethical conduct. The intent of this Statement on Management Accounting (SMA), however, is to make all accounting professionals aware of their responsibility to act as change agents within their organizations, supporting the maintenance of effective internal controls and ensuring that their organizations have considered, adopted, and fully implemented a company-wide ethics and compliance program, including a code of ethics and a confidential hot/helpline.

This SMA identifies the issues that are driving the increased attention to ethical conduct and how they impact risk management and internal controls. It explains the steps required for organizations to clarify, define, and develop their values and create their codes of ethical conduct. More importantly, it shows how to move beyond the creation of words and plaques on the wall to a reality where the commitment to ethical values becomes the way the organization operates on a day-to-day basis. Through this, risk related to the behavior and decision making of individual employees can be linked to the overall management processes of planning, organizing, staffing, directing, and controlling. Issues of ethical decision making can be aligned with leadership behavior, organization processes, relationships between individuals within and without the entity, and systems of measurement and control.

Organizations that succeed in a broad-based deployment of a code of ethics will create a base for enhanced risk assessment, greater transparency for those responsible for organizational governance, and an increased probability that commitments made in words are truly being fulfilled in practice. As a result, CEOs and CFOs who are required to sign commitments of compliance will do so with a greater degree of knowledge and certainty that their words and the actions of the organization are aligned.

II. INTRODUCTION

While ethics is not a new concept in business, it has gained importance and visibility recently as a result of public- and private-sector disclosure and reporting issues and the passage of The Sarbanes-Oxley Act (SOX). The lessons learned from Enron and the other accounting scandals show that the development of an ethics policy does not automatically lead to an ethical organization any more than developing a corporate Vision creates a visionary organization (Collins, 2001).

Ethical behavior is not about abiding by the law. Individuals and organizations can act legally and still be acting unethically. Ethical behavior is driven by compliance with a set of values that acts as the touchstone for situational decisions where rules may not exist to cover every alternative. Ethics is about the integrity of the decision-making process that is used to resolve any number of issues.

Rushworth Kidder, president of the Institute for Global Ethics, explains the link between the driving values of an organization and the behaviors that result: "Ethics, in its broader sense, deals with human conduct in relation to what is morally good and bad, right and wrong. It is the application of values to decision making. These values include honesty, fairness, responsibility, respect, and compassion." In its *Statement of Ethical Professional Practice*, IMA outlines the overarching principles that drive ethical behavior. Members of the organization are expected to abide by the Statement and engage these principles—both at their jobs and in life itself—even if it costs them financially, just as members of other professional organizations are expected to abide by their group's respective code of ethics, such as the American Institute of Certified Public Accountants' (AICPA) "Code of Professional Conduct."

Establishing a code of conduct in smaller, privately owned organizations is usually fairly straightforward: The owner "leads by example." His or her demonstrated behavior becomes the model for other employees—even if it is never documented—and creates the organizational "culture." Challenges arise when these organizations grow and employees become disconnected from direct day-to-day contact with the owner.

In larger organizations, the problem is magnified. If no defined code of conduct and ethical behavior is developed, employees will act on their own beliefs and values, or they will observe and emulate the behavior they see around them on a daily basis.

If the kinds of scandals that plagued the business world in the late 20th and early 21st Century are to be avoided, organizational behavior needs to be defined and deployed in a way that drives the individual behavior of employees in a manner consistent with defined expectations of the wider organization. Many individuals at the center of corporate scandals have professed the belief that they were innocent of any wrongdoing, including Kenneth Lay of Enron or Conrad Black of Hollinger. The problem is that these individuals did not define their behavior by what most of society would see as "reasonable," but rather they followed their own particular code—in some cases, limiting the definition of ethical behavior to require compliance with the law and nothing more. When laws may have been broken, it falls to the courts to decide if an act was illegal and to assess penalties. In situations that may be unethical but are not illegal, however, there is no legal remedy. The only course of action for society is to either pressure the government to enact more rules or to decide not to do business or develop relationships with unethical companies and individuals. This is how SOX came about, and it is how an organization can lose the value of its brand.

Values and Ethics in a Changing World

While the concept of ethics has been around for centuries, the changing conditions of the world today are creating problems never seen before. There has never been a greater level of human mobility in the world. While the majority of the top 500 corporations still come from the United

States and the West, companies from emerging nations such as India, China, and Russia are being added (*Fortune*, July 24, 2007). The practice of outsourcing key activities, such as manufacturing or call center operations, from large developed economies to those where labor costs are significantly lower results in situations where corporate headquarters are based in one society while other portions of the company operate in different countries where values, expectations, and behavioral norms may be vastly different. Added to these changes is the ease of global communications, which enables daily conversations as well as voice, data, and video transmissions from one side of the world to the other.

Mobility has also allowed the massive movement of people from one culture to another. In the U.S., the flow of immigrants from a vast array of countries continues to create a broad range of differing cultural, ethnic, and religious backgrounds. When groups share the same cultural background, they tend to share the same values as well. Consequently, the basis for decision making and actions, including alignment with a code of ethical conduct, will be similar. When immigration combines groups from dissimilar countries or backgrounds, the impact can be significant, and the values and decision making processes may not be the same. It has nothing to do with a person being “good” or “bad,” but rather is a matter of differing “norms” of behavior based on the society in which that person grew up. This situation is also observable when individuals go abroad to receive an education.

Some interesting work has been done in this area by the World Values Survey Association, which found various “blocks” of cultural values that tend to cluster together. (See the website of the World Values Survey Association, www.worldvaluessurvey.org.) The challenge of conflicting values becomes greatest in cases where a society has, for example, a limited separation of “state and religion.” While most of the Western world professes to maintain a barrier between church and state, a number of countries in other parts of the world have a far greater integration of the two. In many cases, this creates national conflict when the two find themselves in disagreement on various issues.

All of these changes lead to a melting pot of personal values within societies and organizations, creating profound challenges for leaders and resulting in a new aspect of risk management for organizations. If organizations fail to make the effort to clearly define their expectations of ethical behavior and provide support and encouragement for complying with them, then the vacuum that is left will lead to unpredictable results.

Expectations Change when Society Changes

The approaches to governance, accountability, and management control that exist in the U.S. today came about largely from the stock market crash of the 1930s, which gave us the Securities & Exchange Commission (SEC) and many of the labor laws still on the books today. Events showed that the traditional frameworks were no longer adequate for a rapidly developing industrial society, and new rules were needed.

The 1980s and 1990s saw the savings and loan scandal, the Orange County investment fiasco, the invention of Junk bonds, and global problems such as the collapse of Barings Bank. In response, the focus of management has turned to a better approach to risk management. Efforts such as the Committee of Sponsoring Organizations of the Treadway Commission (COSO) sought to identify the causes of fraudulent financial reporting and make recommendations to reduce its occurrence, but the problems did not go away. The beginning of the 21st century was marred by even greater financial scandals, such as Enron, WorldCom, Global Crossing, and others. This was not just a U.S. problem—similar issues were seen across the globe.

As manufacturing undergoes radical changes, including outsourcing to less developed countries (LDCs), and traditional industrial societies move more and more into a service- and knowledge-based economy, the behavior of individuals becomes a much more critical, yet harder to control, aspect of organizational activity. Some of the more established, traditional knowledge-based businesses recognized these issues long ago and have had ethics programs or policies in place for many years. Johnson & Johnson still uses a corporate "credo" developed by General Robert Wood Johnson in 1943. To this day, those principles guide the destiny of the company no matter where it operates in the world.

Most observers agree that ethics cannot be merely a compliance requirement, but that it must be embedded within the culture of an organization. Section 406 of the Sarbanes-Oxley Act requires that a positive culture be created "at the top" of a company. When prosecuting companies, the Department of Justice considers the environment within which business decisions are made, and the revised Federal Sentencing Guidelines issued in 2004 now recognize the criticality of ethics training at every level for every individual within an organization. Creation of a code of ethics and organizational corporate conduct, supported by verified statements of the CEO and CFO, is no longer enough to ensure that an organization is actually behaving ethically in its daily operations.

Research has shown that ethical organizations have higher levels of productivity, improved interpersonal dynamics and group cohesion and involvement, and lower risks of fraud. Those moving beyond compliance generally see improvements in business process streamlining and higher quality of products and services. All these benefits lead to better financial performance. Some areas are clearly measurable, some are partly measurable, and some are assessable as a lower-risk potential. If financial and other risks are to be recognized and reduced within an organization, an ethical culture must be imparted into every single aspect of the organization's activities. Management accountants can have a significant impact on the allocation of corporate resources to ensure that ethics become embedded within an organization's culture, and they can identify areas of internal control risk associated with behavioral issues that need to be addressed through a focus on ethical conduct.

III. SCOPE

This SMA is addressed to financial and management accounting professionals who want to achieve improved assurance of ethical compliance and are seeking ways to create an ethical culture within their organization that delivers enhanced performance and permeates every aspect of the organization's activities. Many of the concepts are designed to address and align with Enterprise Risk Management (ERM) initiatives, where individual behavior becomes a key aspect of exposure to risk and must be considered when evaluating and implementing internal control. The concepts and approaches outlined in this SMA are universal and apply to:

- Financial and management accounting professionals;
- Public and private organizations;

- Profit and not-for-profit organizations;
- Large and small organizations;
- Service, knowledge-based, and manufacturing organizations; and
- Organizations around the world.

This SMA covers the logical building blocks of creating an effective, ethical organization. It only briefly addresses the philosophy behind the theoretical concepts of ethics and the various schools of ethical development and thinking. It does not address several aspects of ethical drivers, such as religious belief systems and other specific areas that may be considered unique to a limited group.

This SMA discusses the stages required in developing and implementing a values-based ethics system within an organization in order to meet compliance requirements and create ethical sustainability as the organization grows and develops. To provide a context for overall risk and control assessment, the application of a framework such as COSO's *Internal Control—Integrated Framework* as a basis for internal control assessment under SOX Section 404 requires an assessment of the organization's culture. This SMA casts light on the ways in which an ethical culture can be developed, fostered, and improved so as to reap benefits beyond compliance. As human behavior is increasingly recognized as a driving aspect of the integrity of control systems, this SMA shows how an ethical environment can be created only by a complete and integrated approach to all aspects of the work-life and decision making of every individual within an organization. While this responsibility rests primarily with the management accountant in terms of developing internal processes, systems, and controls, the approach will assist those in assurance roles, such as internal and external auditing, to broaden their understanding of the complexity of ethical assurance. This will enable them to move beyond meeting the requirements of an ethical checklist and enter a state in which the COSO environmental assessment can truly demonstrate the level to which an ethical culture exists and is mature in its application and scope.

Each section of the SMA addresses an important step in the process of developing an ethical culture:

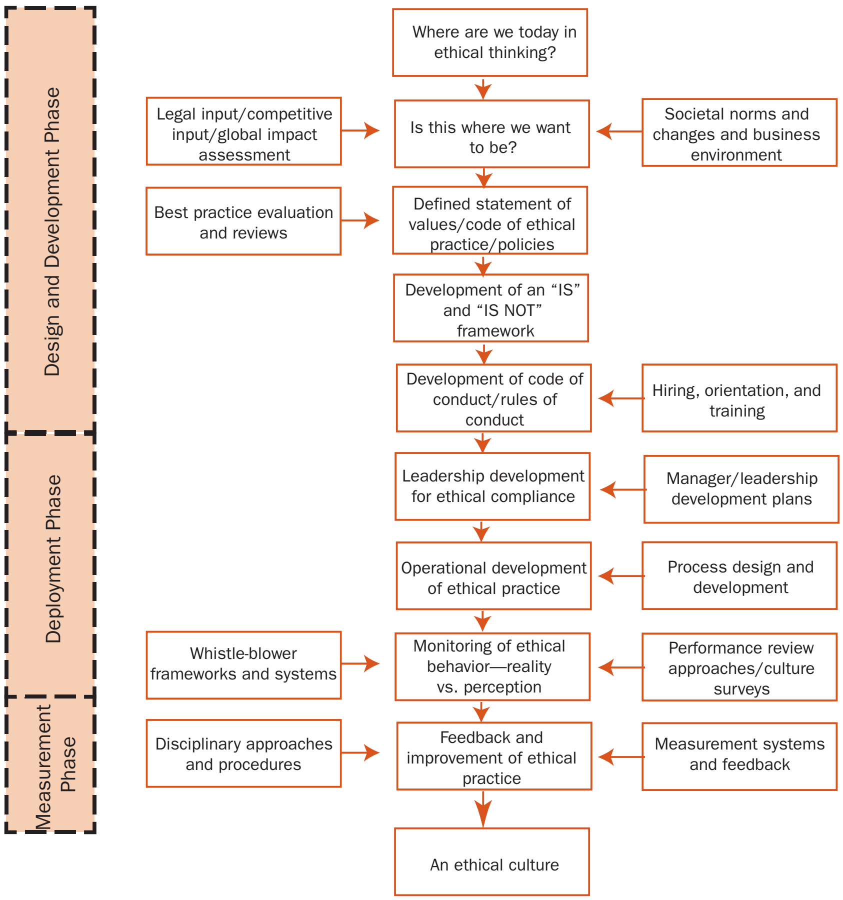
- **Values, Ethics, and Accounting** outlines why financial and management accounting professionals must move beyond traditional approaches to control systems and focus on the softer skill areas for a behavioral understanding of their human capital.

- **Defining and Developing the Organization's Behavioral Values** shows how to 1) assess the existing ethical cultural reality in an organization, 2) compare it to the expectations of the owners and key shareholders, and 3) complete an analysis of any existing gap between the two.

- **Leadership by Example** deals with the primary critical success factor of building an ethically-based organization. The alignment of organizational values and beliefs is not only expressed in what those in leadership roles say, but also in how they manage and act on a daily basis.

- **Ethics and Internal Controls** deals with the critical integration of ethical thinking into the core aspects of business process management. The key aspects of ERM, process development and improvement (BPR), quality management, "mistake proofing" (Poka-Yoke concepts), and the development of a learning

EXHIBIT 1: A SCHEMATIC FRAMEWORK FOR THE CREATION OF A SYSTEM FOR ETHICAL CONDUCT



organization can all be aligned and integrated, leading to an internal control structure that integrates human resource strategy with the organization's objectives.

- **Practical Application: Converting Intent to Operational Reality** deals with practical issues that must be taken to ensure that ethical expectations—and the values they represent—are present in a number of required aspects of organizational management. This includes an ethics-based HR management regime that develops position requirements and addresses employee attraction, motivation, assessment, review, training/development, and retention as well as a situational-based understanding of ethical behavior based on employee orientation approaches and work-level task discussions. It also aligns ethical expectations with other third-party relationships, such as the way an organization involves and communicates with suppliers, partners, clients, and others; and considers ethical and value-based aspects of business direction as part of the planning process.

- **Measuring and Improving Ethical Compliance** deals with development of the "glue" that holds an ethical organization together: how the commitment to ethics is verified, validated, and assessed through various feedback metrics. This is a key aspect of effective corporate governance. The board of directors, board committees (such as the audit committee), and others tasked with the overall responsibility for ensuring ethical compliance need to be aware of the "facts" related to deployment results of ethics policies. This section addresses the core issue that many responsible for ethical compliance "don't know what they don't know" and, as a result, can only rely on signed statements and attestations that "all is well."

Readers should recognize that effective implementation of an ethical culture requires a consistent management philosophy and that it is not a short-term program to "fix the ethics issue."

Exhibit 1 provides a detailed schematic of the steps generally involved in the development and deployment of a framework for ethical management, including the supplemental tools, inputs, and supports that should be considered. The final phase of implementation must result in an approach and framework for ongoing assessment and evaluation of the degree to which ethical management is practiced within the organization. The results of such a tool can be combined with ongoing training and individual sign off by employees on an annual basis to provide a solid base for assurance of ethical behavior.

IV. VALUES, ETHICS, AND ACCOUNTING

Whether minimizing the costs of operations in a nonprofit organization or optimizing profitability and return on investment in a commercial venture, management accountants working within organizations have an important responsibility to protect the organization's assets and ensure they are being used to their fullest extent.

In most organizations today, labor costs constitute the majority of operating expenses. Efforts to reduce overhead have led to decentralization of operating decisions and the slimming down of supervision. The result is that employees cannot be watched and controlled in every aspect of their work, and an organization must, to a great degree, trust that its employees are acting in its best interests. Human "capital" is a critical asset. Humans create the innovation that generates new products or services and finds unique ways to undertake work in more cost-effective ways. They bring knowledge to the workplace and share it with coworkers. People develop relationships with each other and with suppliers, clients, and others on whom the organization depends. Top leadership in particular creates a climate and culture in which such productive applications of human skills can be optimized to the highest level. So how can an organization be sure that the behavior of its employees is consistent with its desired principles in a way that perpetuates and grows the human "asset" instead of impeding its effectiveness?

In the past, quality compliance and industrially-engineered output expectations helped exert a high level of control over direct-production employees, but managers still realized that effective quality management only occurred when employees were "engaged and involved." In particular, quality problems were not reported or acknowledged as quickly or frequently if workers expected to be penalized personally for the problems.

In today's service economy, control often involves developing management systems that include the flowcharting, mapping, and documentation of processes, activities, and tasks so that individuals know what to do "on the job." This works well when everything proceeds as anticipated, but what does an employee do when unplanned events occur? What reference does an individual look to for help in making decisions? To take a phrase from the pioneering work done in process management by Geary Rummler and Alan Brache (1995), what does one do "in the white spaces"? In most cases, an organization relies on the judgment of the individual and/or direct supervisor to develop a course of action that they feel represents the "policy" of the organization. This is why it is important to have a defined set of organizational values and code of ethics—they create the "touchstone" against which every unanticipated decision must be judged. Failure to have every individual in the organization know and understand these values and ethical code leads to inconsistency and, in the worst cases, unethical or fraudulent behavior. No financial manager, management accountant, or any other manager can afford to allow that risk to exist in their business. Rules can be developed for predefined situations (such as most "rule-based" accounting standards that are the traditional approach of the Financial Accounting Standards Board, or FASB). In undefined or unpredictable situations, however, principles-based standards work more effectively. Approaches to values and ethics management should therefore be based on a set of principles rather than a set of rules.

In organizations where capital investment is a key component of activity, financial managers and management accountants spend considerable time trying to predict the future performance of capital assets in order to ensure that they will work as anticipated and produce the desired results. It is not unusual for the planning aspects of a $500,000 capital purchase to comprise at least 5% of the capital cost. If the asset was expected to last five years, this planning cost would be incurred at the beginning and probably amortized over the five years. Accountants would think little of carrying out detailed DCF/ROI calculations and developing models, spreadsheets, and simulations to verify the asset's potential performance. The goal of this planning and analysis is to optimize the investment and reduce the risk of a poor decision. If hiring decisions and employee orientation and training fail to address the alignment of individual values and ethics with organizational expectations, the result can be an equal, if not greater, negative impact on an organization's performance. Unmotivated employees can poison the atmosphere and reduce the teamwork and cooperation required for knowledge transfer and innovation, and they can have a significant negative impact on relationships with suppliers and customers. In any position of leadership—senior management, managers, supervisors, team leaders, and "influencers"—they can create confusion and conflict toward the desired culture an organization wishes to create.

Understanding and acting on this aspect of human behavior has potential far beyond compliance with legal or regulatory requirements. Effective development and deployment of a values-based ethical culture becomes the cornerstone of an optimized and productive knowledge-based organization. The challenge is that an ethical culture deals with the performance of intangible assets that in most cases do not appear on the balance sheet. Yet as surely as property, plant, and equipment are assets whose effective use can make or break a business, an organization's human assets can have the same effect.

Even if accounting standards and statutory reporting treat these intangible assets as unquantifiable, management accountants must find ways to help ensure these assets are used as effectively as possible. By following the approach outlined in this SMA, management accountants will be able to:

- Identify the gaps between the ethical behavior expected from employees and their actual behavior;
- Address these gaps through various plans, programs, and interventions;
- Have the desired ethical behaviors permeate every aspect of the organization's operations; and
- Develop indicators to ensure there is no degradation in ethical behavior, depleting the value of human capital with its negative impact on the organization.

This approach will enhance the operational effectiveness of the organization and significantly improve its risk profile in regard to fraud and other individual infractions.

V. DEFINING AND DEVELOPING THE ORGANIZATION'S BEHAVIORAL VALUES

Every organization already has a culture. In smaller companies—particularly family-owned businesses—the culture reflects the personal values and business methods of the owners and primary operators. In larger companies, it is more difficult to convey the proper culture from the top. One of the most significant risks in very large organizations, in fact, is that the culture (and, by definition, the values and ethics) that the board of directors and senior management believe to exist within the company may be different from the actual culture experienced by employees, clients, and suppliers. In other words, upper management's perception of the culture is not reality.

Many of the business scandals of the last 30 years stem from this issue—not because the board or senior management were "bad people," but because they "did not know what they did not know" about the activities going on within their businesses and made major assumptions that turned out to be erroneous.

Step one in establishing an ethical culture must be an assessment of the existing organizational values and culture and the development of a set of statements that define the principles the organization believes in and should act upon. These statements and principles can be developed by the shareholders, the board, or a governing body within the organization. The cultural assessment will ask employees at all levels, suppliers, customers, and others who deal with the organization about their views of what drives the organization.

One of the most effective ways to conduct the cultural assessment is a combination of focus groups and a broad survey. The focus groups act as a "pilot" to extract the major categories of values. Once that data has been collected, it can be merged with input from senior management and shareholders regarding their perception of the organization's values. Then a survey can be conducted using a broad range of employees and other key contacts. The following is a list of sample questions that can be asked during this process:

- What values does this organization believe in?
- What principles drive this organization's decision making?
- By what ethical standards does this organization live?
- What principles/beliefs do managers and leaders demonstrate?

The input from this activity provides a series of "is" answers—the reality within the organization as seen by people on an everyday basis. Nothing makes these answers right or wrong; they provide a snapshot of the current thinking and behavior driving the organization's daily operations.

The same approach should be used with the organizational leadership to create a series of "should" answers—the business leaders' perception of what the culture should be. The gap between the "is" answers and "should" answers defines the areas that the organization needs to address in order to create a credible and aligned set of values that form the basis of an organizational code of ethics.

From this information, organizational leaders should develop a defined set of ethical principles (or values) that will form the foundation of the framework for ethical management and leadership. These short statements will still be capable of unique interpretation by many individuals, so the next step is to have senior management develop a behavioral profile based on each principle. This profile would be structured in a way that respondents are asked what types of behavior would support this ethical statement (i.e., what sorts of activity would demonstrate consistency with the statement). They would also be asked what sort of action would be considered inconsistent with this statement. In this way a general statement can be operationalized into examples related to day-to-day decision making and activities.

One of the major challenges at this stage is ensuring that the values adopted for the code of ethics are more than bite-sized platitudes. Senior management must understand what each statement means in terms of operational implementation. If the statements do not clearly convey the type of everyday environment that is expected from an ethical commitment, they will lead to misunderstanding, conflict, and confusion.

An ethical culture requires the ability to link the decisions being made on a daily basis to a particular aspect of ethical commitment. For example, staff layoffs may appear to be inconsistent with statements related to an ethical commitment of people management. Handling the process of reducing the workforce with consideration, empathy, and understanding, however, is actually an example of ethics applied in practice.

If ethical behavior is negotiable, then the values it represents mean very little. Senior management must be sure that the company can live with any ethical commitments it makes. Examining the actual behaviors that support or detract from the stated ethical principles becomes a vital step in ensuring that key managers have thoroughly considered the dangers inherent in making a values-based statement of intent and evaluated the consequences of real-life situations that might occur. Developing an ethics policy that allows deviations for exceptional circumstances is worse than having no stated policy at all.

Once a code of ethics has been developed, it should then be deployed throughout the organization. This is best achieved by a cascading deployment, where each level of management and supervision presents and explains the expectations to their subordinates. This should be supported by online training along with pre- and post-testing to ensure that all employees have read, internalized, and understood the fundamental aspects of the code.

VI. LEADERSHIP BY EXAMPLE

Ethical behavior is not something that applies to someone else—every single individual is responsible for behaving ethically. Nowhere is this more important than the demonstration of ethical behavior that managers and supervisors exhibit in the way they execute their day-to-day work, including:

- Communication with others all levels—internally and externally;
- Involving others in decision-making processes;
- How they coach and support others;
- Dealing with staff development, performance issues, and reviews; and
- Their personal behavior at the office.

Many of us in today's workforce have seen organizations operating with a lack of ethical commitment. As a result, there often is a high level of skepticism toward what is said by those in management and leadership positions: People tend to believe what they see rather than what they are told in the company "pep talk." In order for a code of ethics to be effective, its application must be demonstrated by those in positions of power and leadership. Leaders must be seen living and managing by the code of ethics.

Ethical Leadership by Managers and Supervisors

The 2005 National Business Ethics Survey identified three key ethics-related actions that support the effective deployment of a code of ethics (Ethics Resource Center, 2005):

- Setting a good example
- Keeping promises and commitments, and
- Supporting others in adhering to ethics standards.

All three rely heavily on the leadership skills of managers and supervisors within an organization. An ethics code ensures that every manager and supervisor has a set of basic practices to fall back on when making ethical judgments. "Management is ultimately responsible for the firm's moral maturity level, and therefore needs to be held to a higher ethical standard than regular employees, not the lower standard we too often see among corporate leaders" (Bottorff, 2006). It is impossible for any organization's ethics policy to retain credibility unless employees see the principles demonstrated on a day-to-day basis by the company leaders.

SOX 404 compliance begins with an internal controls assessment that examines the reality of the control environment within which the work of the organization takes place. Leaders—especially those in the most senior positions—are expected to set the "tone at the top," demonstrating through their actions a commitment to the organization's ethical framework and other controls. Senior managers must avoid creating the perception that they are "above the rules."

The 2004 updates to the Federal Sentencing Guidelines identify the importance of an organization's "effective compliance and ethics program" as a mitigating factor for potential penalties should criminal conduct be proven. The intent is that leadership comes not just from the "administrators" who establish the systems and controls, but from the board of directors and most senior management. CEOs, COOs, and CFOs add credibility to the systems and controls by demonstrating their own personal compliance.

Internal controls—especially in knowledge-based organizations—rely on the integrity and behavior of the people within the organization. Having a credible, communicated, understood, and reinforced ethics policy becomes an essential element of addressing compliance. More than this, however, the ability of both the CEO and CFO to sign their declaration of ethical compliance becomes less of a risk when such a framework is in place and operating. "Leadership must know how the myriad human behaviors and interactions fit together like puzzle pieces to create a whole picture. An organization moves towards an ethical culture only if it understands the full range of values and behaviors needed to meet its ethical goals" (Gebler, 2006).

This role is further reinforced in the third inner ring of the model of "Five Levees for Improving Ethical Performance" that support the first two steps of hiring "ethical" employees and ensuring a code of ethics is in place (Collins, 2006). Denis Collins refers to this factor as the "manager as moral role model."

An organizational code of ethics must therefore be used as a benchmark for hiring decisions. This ensures candidates have a personal code that aligns with the organizational expectations. The code must also form the basis of orientation and training for managers and supervisors, as well as be a key factor in performance evaluations, coaching, and career-progression decisions. An excellent example of putting such a tool into practice is the four-square matrix of managerial performance used by GE. This tool divides behavior into two axes of "task" and "relationships," and seeks to assess each manager against both criteria. Managers who rate as low relationship/high task—those that typically get the job done but fail to behave in a way "consistent with GE Values"–are identified as a major problem. Making the call on these managers is the most difficult of all. They deliver results, but they do it while ignoring values. They are a destructive force because they poison the environment, wear people down, stifle creativity, and cause valuable talent down the line to flee an organization.

This might sound strong and potentially unreasonable—these managers do deliver results, after all—but it goes to the heart of ethical leadership. If an organization seeks to move beyond words, it must be prepared to demand performance that balances *both* the delivery of results (task) as well as the building and development of "relationships" that reflect its stated values. An excellent tool to assist management and individuals in recognizing and dealing with this issue is the "Insights Self Assessment" program developed after extensive studies by the Insights Learning and Development Ltd.

Many organizations have attempted to strengthen their ethical leadership by appointing an "ethics officer." There are several key factors that are needed for an ethics officer to be effective, including the mandate, accountability, and responsibility of the position. In order for the position to remain truly independent, the ethics officer should have unfettered ability to identify issues at all levels of the organization. To do so, the position should report directly to the audit committee and/or a special committee of the board of directors (such as the committee on corporate governance). In addition, organizations can demonstrate their understanding of legal obligations vs. moral obligations by ensuring that the position is not seen as being a legal compliance mandate but is instead part of a broad mandate to prevent unethical acts—regardless of their legality.

Finally, the ultimate ethical example is displayed by the CEO or equivalent position. Boards of directors are responsible for ensuring that such leadership behavior is displayed, but there still remains an excessive focus on organizational "outcomes" and results. According to a survey by Booz Allen Hamilton (2005), the primary reason CEOs are fired is because of underperformance and not a lack of ethical behavior. Boards must ensure that an ethics policy is in place; that their chosen representative agrees with and abides by such a policy; and that adequate feedback is obtained from the organization regarding the CEO's performance and demonstration of ethical principles, using 360° surveys and other similar tools.

Ethical Leadership by Finance and Accounting Professionals

Demonstrating commitment to a code of ethics is equally important to management accountants and other finance professionals. Members of IMA are expected to abide by the *Statement of Ethical Professional Practice* and apply it to situations in their workplace. The Statement outlines IMA's four overarching principles: honesty, fairness, objectivity, and responsibility. It also states the four ethical standards that form the foundation to guide the ethical professional practice of management accountants: competence, confidentiality, integrity, and credibility.

According to the Statement, "Members shall act in accordance with these principles and shall encourage others within their organizations to adhere to them." This emphasizes the responsibility of management accountants to act as leaders within their organization. This is done not only by demonstrating appropriate ethical behavior, but also by helping the organization develop and put into practice its own set of ethical principles, values, and code.

IMA members must always ensure that they are maintaining their commitment to the Statement. For example, if a member's employer decided to withhold information that "…could reasonably be expected to influence an intended user's understanding of reports, analyses, or recommendations," it is the duty of the member to identify the "unethical" situation and strive to resolve it. Such conduct might lead to challenging circumstances. As in all ethical situations, an effort must be made to collect all the facts before taking action, and professional guidance should be sought where possible.

In June 2005, the International Federation of Accountants (IFAC) issued T*he Code of Ethics for Professional Accountants*. Developed by the IFAC International Standards Board for Accountants, it established a baseline for ethical behavior for accountants: "A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Therefore, a professional accountant's responsibility is not exclusively to satisfy the needs of an individual client or employer. In acting in the public interest, a professional accountant should observe and comply with the ethical requirements of this code." Many other organizations have adapted this Code to help guide the actions of its own members. As a member of IFAC, the IMA Statement is consistent with the IFAC Code.

As globalization of the profession continues, its members must continue to take a leadership role in addressing the need for effective ethical frameworks within the workplace. IMA and IFAC are only two examples of the accounting profession holding itself to high ethical standards. Members of these and other accounting organizations must fully understand and act in accordance with the ethical codes that apply. This includes acting as a professional within their place of work to ensure that they are never in a position of noncompliance personally and to encourage the development, adoption, deployment, and sustainment of an effective organizational code.

VII. ETHICS AND INTERNAL CONTROLS

Human behavior is amazing. Individuals are able to rationalize any decision they make to align with what they personally accept as a given value. A criminal who has determined that society owes him or her something will have no trouble rationalizing theft. Individuals who believe that the ends justify the means will have no compunction about cheating.

The COSO model used by the Public Company Accounting Oversight Board (PCAOB) as one of the bases for conducting the internal controls assessment under SOX 404 provides a framework for determining what risks exist within an organization and how to best manage them. Although compliance with SOX has become an incredibly burdensome initiative for many organizations, and the application of COSO might be considered an excessive requirement, the approach of assessing risk within an organization is valid. Much of the work leading to the creation of the initial COSO framework took place as a result of the scandals and organizational failures of the 1980s. The ability of any organization to determine what risks existed and what controls needed to be in place to address them became an important issue, leading to the emergence of ERM initiatives in the 1990s. A number of excellent case studies outlining the adoption of risk frameworks and practical implementations were published by Keith Wade and Andy Wynne in their book *Control Self Assessment*.

Risk exists in every facet of an organization's activity, as does the need for controls. While SOX defines the breadth and depth of a risk assessment, there is a variety of tools that can be used to determine what actually needs to be assessed.

At the heart of most organizations are the core processes that involve the central, key work performed by the organization. This can include manufacturing a product, processing a health care claim, hiring an employee, or paying a vendor. In almost all cases, process management provides the basis of determining what work is being done and, therefore, what risks might exist. Process management and process thinking become an essential aspect of determining risk and internal controls. The following three tools can be used to combine aspects of process development, risk assessment, and internal controls.

Business Process Reengineering (BPR), which became popular in the 1990s, provides a structured view of organizational processes and reveals the existence of tasks and activities that are carried out in order to transform inputs into outputs. At each task and activity level, there are potential risks that the management accountant will want to consider. In *all* cases, however, the behavioral aspects must provide a context for the risk and its control. The typical question to ask is, "What would a reasonable person do in this situation?" In many cases, any controls implemented would be based on such behavior, but other questions will remain: Is the management accountant assured that a reasonable person is performing this task? How were individuals selected to perform the task? What competencies are possessed by the individual assigned to this task? Are these competencies adequate (and have they been tested and verified) for the "normal" execution of this task? The existence of an ethics policy and assurance that staff are selected and employed based on that policy will establish a baseline against which these contextual assessments can be made.

Quality Management provides another view of process management that can provide management accountants with an excellent variety of options that assist in creating greater visibility on process performance and risk. In fact, quality management and management accounting have much in common. The quality manager seeks to ensure that a process achieves "zero defects" by avoiding unplanned mistakes and costly rework. This includes ensuring that any potential risks that can lead to mistakes occurring or not being identified are assessed and evaluated—goals shared by management accountants.

Quality management tools include Failure Mode and Effects Analysis (FMEA), Poka Yoke assessment (understanding the process and "mistake proofing" the work to ensure no failures), and Six Sigma process analysis techniques (when considered financially viable based on process cost or impact of the process outcome).

A simplified system can involve taking elements of both process management and risk management to create an Excel-based worksheet for analyzing every process under review using the following headings:

- Process activity
  - ✓ Tasks within the activity
- Potential errors or risks at each task level
- Risk assessment of the impact of a failure (Using either a simplified "High, Medium, or Low," or the more traditional "Impact" and "Occurrence" scales of 1-3)
- Assessment of probability of detection using current controls
- Identified action to be taken based on assessment (if any)

Using this tool and considering risk from a behavioral aspect can assist in identifying what types of controls should be in place and where they would be best provided. Rather than relying on traditional accounting approaches such as control batch totals, authorization and security levels, etc., this approach uses the perspective of behavioral deviation from an anticipated norm.

Continual Process Improvement (CPI) is the third area that can significantly contribute to identifying process controls related to ethical and behavioral issues. This concept relates to the development of a "learning organization"—where continual monitoring and assessment of process performance leads to the identification of potential process management and control issues and the ongoing development of modified work and control structures that reduce cost, increase process cycles times, and, from the ethics perspective, identify unanticipated behaviors that render existing controls (including how work is assigned and how staff are hired and deployed) excessive or inadequate. Because traditional controls in most organizations evolve from the reality and experience of staff that may have been in place for some considerable time, CPI is an area that management accountants should pay particular attention to. As an organization progresses—hiring new employees or adapting itself to competitive pressures—the business environment changes. These changes have the potential to make current internal controls ineffective or unacceptable. For example, as the workforce changes, the traditional reliance on the behavior of experienced staff may no longer be sufficient; new staff may not behave in a way that achieves the desired outcomes—especially if there is an inadequate approach to ethical hiring, leadership, and compliance.

Creating an ethical working environment is part of the foundation of any system of internal controls; there is no defined predictability of human behavior unless a baseline of expectations is established and used as a framework for determining what a "reasonable person" would do in a defined situation. This situation is further impacted as employee turnover increases and as the organization operates in different societies and is exposed to the different values and "norms" of ethical behavior that may exist. For internal control purposes, a management accountant can no longer assume that a particular behavior will be consistent or predictable—whether based on a generic societal norm or past experience.

The question that must be answered when developing a set of management controls to protect shareholder worth is simple: "Do I really know what values individuals within this organization will use to make decisions?" A system of internal control cannot be expected to function with a high degree of confidence until a comprehensive framework for corporate ethical behavior is in place.

VIII. PRACTICAL APPLICATION: CONVERTING INTENT INTO OPERATIONAL REALITY

Creating a meaningful ethics policy is important, but additional work is needed to convert that policy from a piece of paper into something that lives and breathes throughout the organization. It is not enough to communicate a policy and then expect managers to make certain that ethical conduct permeates every aspect of the business. This section identifies the steps that are needed to ensure alignment and consistency between "intent" and action.

Management accountants are concerned with balancing an adequate level of control with a level of investment that can allow the organization to remain profitable and constrain expense growth. Auditors also have to balance the issue of assessing an adequate level of control. Some level of risk will always be inherent in any enterprise—the challenge is determining exactly where to place the investments required for effective control.

No system of enterprise-wide controls can be developed and implemented effectively without conducting an enterprise risk assessment, and this should be the starting point. One aspect of risk is the impact of employee behavior, and one area of investment includes initiatives required to minimize the risk of unplanned and unacceptable behavior.

The Right People

An organization's ethics policy must be applied in the hiring stage. This requires some level of questioning or testing to assess a candidate's alignment with the organization's code of ethical behavior. This could include:

- Interview questions that encourage candidates to define how they would respond to specific circumstances
- Asking individuals what their own personal code of ethics (or values) might be
- Asking candidates to comment about what workplace behaviors would be unethical
- Creating a multiple choice test where candidates state their level of agreement or disagreement with various ethical statements (Gale, 2002)

- Team-based interviews where one interviewer poses an ethical question, other members offer alternatives, and the candidate is asked to add his or her personal view.

Management accountants should work with HR professionals to ensure that the approaches used to reinforce "ethical hiring" meet legal (such as EEO) and other policy requirements. Although still much in their infancy, pre-employment testing tools are being developed that will aid in assessing the behavioral expectations of candidates. While the area of ethical assessment is fraught with challenge, results from applying such testing in other areas of behavior have been successful (such as client services orientation, sales capacity, etc.). Management accountants should ensure that part of the HR budget is allocated for conducting thorough behavioral analysis and that in-depth assessment is mandatory in the case of sensitive positions (revealed through the enterprise risk assessment).

The Critical Role of Employee Training

Although orientation must be provided to every employee at the time of hiring, it is not enough to maintain awareness and commitment to the application of a code of ethics in the workplace. Every existing member of staff should receive ongoing training, starting at the board level and cascading down throughout the organization. Surveys conducted by the Conference Board appear to indicate that organizations are taking this requirement seriously, especially since the revisions to the 2004 Sentencing Guidelines, which recommend that ethics training take place throughout the organization as an effective approach to lessening the penalty if an organization is convicted of improper conduct (The Conference Board, 2006).

Ethics training for employees should focus on covering ethical concepts, the organization's code, and compliance. To achieve this, training should include:

- Ethical concepts and thinking: What is "behind" the issue of ethical action?
- The organization's code of ethics and any supporting "rules"

Expectations of compliance with the code should cover:

- General employee behavior and personal conduct
- How ethics are built into work management methods
- How ethics affects specific jobs, processes, activities, and relationships
- How the organization monitors compliance with the code
- What routes are open to employees who have compliance issues (personal guidance, advice, and "whistleblowing" frameworks)
- What action is taken when a complaint or issue is identified
- The actions and penalties once noncompliance is proven.

Management accountants concerned about effective implementation of their organization's code of ethics should make certain that training programs are in place and that the training is comprehensive, specific to "real world" situations employees will face, and is based on repetition and consistency (i.e., the same message is being delivered repeatedly across the organization—essential to avoid the defense of "I didn't know…"). Finally, as with other areas of competency development, training in ethics and ethical behavior should reflect "career bands"—

ethical training should be customized to the employee's scope, seniority, and position. No position should be immune from training requirements, including senior management.

Building Ethics into Work Behavior

While leadership has been identified as a key component of effective ethical policy implementation and maintenance, most employees will see ethical issues in terms of their own jobs and positions. Failure often occurs when employees are expected to create their own linkage between high-level statements such as "We will treat all customers with dignity and respect" and their own job. This often leads employees to misinterpret the exact level and extent of behavior that is required from them. High-level ethical statements must be cascaded down through the organization so that employees can understand the ethical principles in terms of their day-to-day responsibilities.

Managers and leaders can use this step as a valuable way of communicating specific expectations at the employee level. For example, the manager of a trucking section can meet with drivers and discuss what the statement "We will treat all customers with dignity and respect" means in terms of their specific jobs. The group can then start to develop their own specific "is" and "is not" statements that reflect the reality of this ethical practice at their job level, focusing on how the drivers would convert this high-level statement into practice. This discussion also helps identify issues and problems at the work level that might not have been discussed or anticipated when the organization-level statement was developed. A key issue for ethical behavior is that employees often do not have the opportunity to assess ethical issues—this process would allow it to take place (Bowen, 2006).

The outcome of these discussions can be used as training for new candidates and recruits, helping establish specific job-related behaviors that can be incorporated into competencies, job descriptions, and performance review processes. Such a framework can also help identify areas where specific training might be required or situations where existing processes or tools make it impossible for employees to actually behave in accordance with the ethics statement. (Employees are usually incredibly creative in finding ways around roadblocks to achieve a desired outcome, even if that means compromising an internal control based on a certain type of anticipated behavior.)

Adequate funding should be directed into job-specific training in order to maximize its value. Generic ethics training might be of some value in creating overall awareness and context, but most employees see the world and behavior issues from their own specific position and responsibilities. The ethical aspects of internal controls only work at the work level, so training must be directed at that level to be effective.

Building Ethics into the Approach to Work Management

A typical example of how an organization can fail to commit to a code of ethics is the organization that prides itself on the claim "Our people are our most important asset" yet fails to engage its employees in the design, development, or improvement of their daily work. Apparent conflicts between what an organization says and what it does lead to a lack of credibility for the whole code.

In order for the intent of an ethics code to become a reality in practice, every aspect of an organization's activity should be impacted by the code's deployment. Exhibit 2 provides a simpli-

EXHIBIT 2: AREAS OF ETHICAL BEHAVIORS FOCUS

Areas of Ethical Behaviors focus	Design and Development	Execution of Work Activity	Post-sales Support and Service
Client based	• Needs of client • Fair value	• Cycle time • Quality specification	• Client focus • Support resolution
Employee based	• Involvement • Adequate controls	• Involvement • Training/safety	• Work-life planning • Flexibility of solution
Society based	• Environment • Impact on users	• Noise/other impact • Resource usage	• Outage impact • Waste/disposal
Shareholder based	• Reputation/brand • Risk/cost-benefit	• Lowest cost/no waste • Reputation	• Reputation • Value-stream return
Supplier based	• Involvement • Negotiations	• Planning/delivery • Problem resolution	• Involvement • Learning/support

fied schematic of how such a deployment might be considered. The horizontal axis shows three high-level categories of organizational processes: the design and development of products and services, the actual manufacturing or delivery of products and services and post-sale client support. The vertical axis shows what might be a typical series of groupings of major ethical topics areas. Within the matrix are the considerations of how and where certain linkages between the ethics and values stated within the code and their deployment might occur. While this schematic is illustrative, the only purpose is to show how alignment between intent and actual practice must be created.

Design and Development Processes

In many cases, an organization demonstrates its code of ethics through the manner in which it brings products and services to the marketplace. For example, organizations that produce products that harm the environment, use excessive natural resources, or cannot be disposed of without a significant negative impact on the environment would find it hard to convince employees that it has a high concern with the environment. Management accountants should ensure that processes are in place where issues are addressed within the design and development methodology of the organization. This is when the key decisions regarding materials usage, processing methodology, and requirements for product support and disposal are made. Dealing with these issues later in the design process might result in significant cost increases and a failure of a product to meet its stated market objectives for price and volume. The adoption of a tool such as Life-Cycle Costing can assist in developing a planning process that considers such issues as part of the product design phase.

Work Planning and Execution

Once a product or service has moved beyond the design phase and into production/delivery, ethical behavior and internal controls need to be considered in areas such as:

- Selection of materials suppliers and contract negotiations
- Selection of and negotiations with subcontractors and distributors
- Traditional controls on all areas of processing, such as theft of materials and byproducts
- Fraudulent creation of customers or customer relationships
- Potential for illegal or unethical negotiations with potential clients
- Fraudulent transactions within both the buying and selling processes
- Creation or use of fraudulent or unethical entities to conduct business
- Illegal or unethical approaches to handling waste and/or scrap
- Illegal or unethical uses of organizational assets for noncorporate use
- Misappropriation of funds designated for organizational purposes
- Creation of work processes and their impact on employees (safety, etc.)
- Creation of work processes and their impact on third parties
- Ensuring processes are "designed" in a way that minimizes cost and ensures quality

Ethical practice occurs when daily business decisions and work processes reinforce ethical expectations. In the ISO 9000 standards, the International Standards Organization states, "The organization shall plan and carry out production and service provision under controlled conditions" (ISO 9001, 2000, paragraph 7.5.1). In addition, the guidelines for implementation state, "Management should ensure that the organization has knowledge of the statutory and regulatory requirements that apply to its products, processes, and activities and should include such requirements as part of the quality management system. Consideration should also be given to: the promotion of ethical, effective, and efficient compliant compliance with current and prospective requirements…" (ISO 9004, 2000, paragraph 5.2.3). It is clear that controlled conditions include consideration of the ethical aspects of behavior when developing all levels of compliant process management.

Post-Sales Support and Client Service

In many cases, organizations have an obligation to continue to support their products and services after a sale is completed. This is another key area where the manner in which an organization designs its processes and conducts business can demonstrate compliance with its stated organizational ethics. A well-known example would be Johnson & Johnson's (J&J) recall of Tylenol following the deaths of several people who had taken cyanide-laced capsules of Extra-Strength Tylenol. While outsiders might not be able to determine exactly which aspect of the company's code called for a complete and unquestioned recall of the product, that was the result. No debate. No question. One can imagine the internal discussions regarding the impact a recall would have on quarterly earnings and the probability that most product in the marketplace had not been tampered with. If the company was going to continue living by its overall credo, however, it had to do "what was right under the circumstances." This can be contrasted with other situations where failure to act on growing evidence of product problems or defects led to further deaths or other negative impacts. While J&J was able to avoid long-term effects of the recall—introducing tamper-proof packaging as a response to the crisis—many companies that fail to act promptly never recover in the marketplace.

When a crisis occurs, management accountants face the challenge of balancing what the organization's ethics code states in regard to the need to protect the interests of shareholders against what it states about the quality of products, the importance and impact of customers, and the organization's place in society—all of which contribute to an organization's reputation. It is important in this instance to consider the long-term impact on the shareholders' overall investment instead of focusing on the short-term impact on earnings. In today's economic environment, where intangible assets make up a growing portion of an organization's value, unethical actions that impact an organization's brand or reputation might have a considerable, longer-term impact than would a short-term earnings hit.

Third-Party Ethical Impacts

Ethical issues can arise even when the actions are not controlled directly by the organization. One example would be the impact of using subcontractors in less developed countries (LDCs), where work practices may differ from those deemed acceptable in the parent organization's country. For instance, the public has long held companies such as Nike accountable when news became public that a subcontractor in a different country employed child labor. As the use of outsourcing continues to grow, organizations need to remember that work practices, social conditions, and values can differ greatly from country to country. Areas where the risks involved with potential unethical behavior of third parties include:

- Call Centers and other client services support activities (including technical support)
- Provision of third-party after-sales support by distant suppliers
- Installation organizations employed as subcontractors or "partners"
- Distributors and agents for the organization's products and services
- Advertising and communications agencies that prepare presentations on behalf of the organization
- Service delivery agencies—especially in government, where ASD (Alternative Service Delivery) is being or has been implemented
- Associated organizations operating beyond the reach of regular, routine monitoring by the parent organization

In all cases, ethical violations by any of these third parties will reflect poorly on the primary organization—especially in the eyes of the public. In these times of outsourcing, decentralization, and increased focus on core competencies, organizations must ensure that their governance structures have processes in place to deal with the behavior of their "partners" in the marketplace.

One concern is the process by which third parties are selected. Criteria for selection should include traditional approaches such as organizational credibility, financial stability, compliance with specifications, and pricing, but they should also extend to include assessments of the potential partner's reputation and its ability and commitment to abide by the behavioral expectations of the buying organization. Making selections solely on price significantly increases risk and may create downstream problems when the effects on customers, the marketplace, or society at large are inconsistent with expectations.

Integrating a Code of Ethics into Business Planning

When developing a business plan, decisions on resource allocation consider a series of key business priorities typically focused on the optimization or even maximization of profitability and minimization of costs. If employees within any organization perceive that decision making at the planning level fails to consider aspects of ethical behavior, however, the efforts to maintain the relevancy of the ethics code will suffer and possibly fail. Areas that need to include ethical considerations as well as business priorities include employee testing at the hiring stage, providing ethics training to new and existing employees, and, particularly important, the approaches used toward business expansion and contraction.

Business expansion can come from mergers and acquisitions, self-managed geographic growth (both national and international), and product or service expansion.

In mergers and acquisitions, management accountants must ensure that behavioral aspects of the organizational cultures are part of the due diligence investigation. History has shown that many mergers fail to deliver the desired results—especially in service companies. In many cases, problems arise because the different organizational cultures are very difficult to blend, resulting in lower-than-anticipated benefits, higher costs of integration, higher staff turnover, loss of clients, and, ultimately, the need to write off a significant portion of the cost of the acquisition. Added to this is the negative impact that trying to merge differing cultures will have on engaging new employees.

Among the greatest issues that can arise from the expansion into new markets are the challenges posed by entering new markets with different business cultures. In spite of legislation such as the Foreign Corrupt Practices Act, organizations still face the real problem of obtaining business or getting work done where the expectation of a "commission" is commonplace. When do commissions become bribes? In this area, it is necessary to ensure that expenditure approvals are controlled and transparent and that the organization has fully considered the implications that statements within their code of ethics could conflict with operational practices in various business cultures. In order for employees to see an ethics code as real and robust, they expect to see consistent application across the whole organization—even if it means that opportunities at the business-planning level must be passed up when they require the organization to "bend" or disregard its stated ethical values.

When There Are No Procedures to Follow

One of the greatest challenges in any system of controls is knowing what to do when there are no specific procedures to follow. Forced to make decisions without a predefined framework to follow, an employee must use his or her knowledge of the organization's ethical principles to help formulate a thinking process that will lead to the correct, ethical decision. A failure to effectively deploy an ethics policy and provide employees with proper ethics training will force employees to rely on their personal values, increasing the risk of an inconsistent ethical response. It is these "white spaces"—where only about 5% of the individual's daily work takes place—that create the greatest potential ethical challenges and risks (Rummler and Brache, 1995).

IX. MEASURING AND IMPROVING ETHICAL COMPLIANCE

One of the greatest problems in achieving ethical compliance is the ability of any organization to actually be aware of what is happening on a day-to-day basis and making ethical compliance a core element of its mainstream governance and accountability framework. Passing legislation for tougher audits and stiffer penalties for individuals who act improperly can be a deterrent, but it is internal controls and operational transparency that will ultimately provide management with the required level of comfort. The difficulty is that "You cannot manage what you cannot measure," so it can be argued that ethical compliance still rests largely on the CEO's and CFO's certifications that adequate internal controls are in place. Is this enough? The approach to corporate governance developed in the wake of the stock market crash of the 1920s is now becoming outdated in a society where key corporate assets are intangible and knowledge based—yet the majority of governance compliance remains rooted in purely financial reporting (Shepherd, 2005). Should organizations be assessing ethical compliance in other ways such as the U.S. Sentencing Guidelines and Stock Exchange requirements that are much broader than financial reporting?

While attestation of internal control effectiveness and external audits remain critical components, there are other methods of compliance that an organization can adopt as part of its internal controls. The following approaches, using the COSO framework, contribute to the "monitoring" requirement under SOX 404.

Human Performance Feedback Loop

Performance review and development systems must be fully aligned with the requirements for ethical conduct. Competencies, job descriptions, and objectives should include ethical expectations, and the regular employee review systems (conducted on an annual basis at minimum) must assess employees against the same criteria. If the code of ethics dictates that employees treat all others with dignity and respect, then the review process must include 360° input—including both internal and external responses—in order to assess whether that is truly happening. Key Performance Indicators (KPIs) must include tracking of employees against ethical training requirements. Examples include:

- The number of new hires and percentage who completed orientation within required time frame
- Percentage of employees who completed annual refresher training on ethical conduct
- Number of employees scoring "achieved" and "exceeded" on annual reviews in ethics criteria
- Number of employees given an award for noted ethical conduct

Survey Tools

Ongoing surveys are very valuable tools for assessing ethical performance, especially in areas such as management and leadership. Surveys can be created using the organization's code of ethics and asking employees to rate how well the organization is following the contents. For example, an organization that states "We respect the dignity of each individual employee and recognize their merit" can ask employees the degree to which they agree with statements such as:

- "This organization respects the dignity of all individuals"
- "My dignity is respected within this organization"
- "My manager respects my dignity"
- "My coworkers respect my dignity"
- "My manager recognizes the merit of actions that I take"
- "Merit is rewarded in this organization"

Respondents can be asked to rate each statement on a scale of 1 through 5 or from "Strongly Disagree" to "Strongly Agree." The results become the basis for developing ongoing compliance indicators and can be used to stimulate dialogue with employees about their concerns and the possible courses of action that could be taken to improve ethical compliance. This turns the company into learning and developing organization. At the organizational level, surveys provide the board of directors and other top management with information showing how well the organization's code of ethics is being implemented and followed.

Management accountants should ensure that the survey data is at an adequate level of granularity so that it can be linked to focused attention and action. An inadequate level of detail leads to aggregation, which makes it impossible to identify the pertinent issues that need to be targeted for improvement. Not only does this waste time and resources, but any solutions and actions developed may not be targeted at the correct issue.

Importance of an Outlet: A Whistleblowing Framework

An effective feedback system includes having a confidential framework for employees to report possible violations of the organization's code of ethics and to receive advice on the ethical aspects of challenging decisions. Statistics show that a large number of occupational fraud cases are detected through an employee "hotline" or other reporting method. In the 2006 Report to the Nation on Occupational Fraud and Abuse, the Association of Certified Fraud Examiners (ACFE) notes that 44% of discovered frauds over $1 million were reported through confidential hotlines (ACFE, 2006). According to David Gebler of Working Values, creating a culture where "employees freely raise issues and concerns without fear of retaliation" is one of six key aspects that make up the attributes of creating an integrity-based organization. American Standard, for example, has 65 "ethics advisors" that are, according to Rose Shyman, director of security, the "go-to folks in the field who provide guidance to employees dealing with ethical situations" (Datz, 2005). The advisors meet on a regular basis to identify and discuss common issues that the organization should be aware of and may possibly need to address.

Whichever approach an organization chooses, the collection, analysis, and summarization of ethics issues can provide insight into the operation of its code of ethics and the degree to which employees are following it. In addition, tracking and monitoring issues raised through a whistleblowing framework creates opportunities to enhance and improve internal controls. Management accountants need to ensure that such processes are in place, that they operate on a fully confidential basis, and that they are capable of generating statistical or event-based reporting through which insight into ethical practice can be created.

CEOs and CFOs have to place their own integrity on the line by attesting to compliance with an adequate level of internal controls (as well as all other certifications). Creating a thorough, integrated system for developing, implementing, sustaining, and monitoring ethical performance within the organization will allow executives to make such declarations with confidence that a code of ethics is the foundation of the organization's culture and is fully integrated into the thinking process of every employee and business partner.

X. GLOSSARY

Accountable—Being answerable for one's actions.

Bias—An inclination that influences judgment.

Bribe—Something that is given or offered to a person or organization in a position of trust to induce that agent to behave in a manner inconsistent with that trust.

Code of Ethics—The codified and published ethical principles of an organization, that are intended to dictate how the entity and its representatives will conduct business.

Complainant—Anyone who raises a concern inside or outside an organization about something they believe to be amiss.

Confidential—Something that is done or communicated to another in trust; the implication is that it is information that for some reason (from personal privacy to competitive advantage) the person entrusting the information does not wish at least some others to know.

Conflict of Interest—Circumstances in which a public official, business executive, or other individual in a position of trust might receive personal gain from his or her official/professional actions.

Ethics—a system of moral principles; the standards for behavior of a particular group; any code of behavior (even if it does not claim to have moral justification).

Fabrication—a lie; falsified or created data, experiments, or other significant information, including records, transactions, and audits.

Falsification—Changing or misrepresenting data or other significant matters.

Fraud—An intentional deception conducted to secure an unfair gain.

Management Accountants—Strategic financial management professionals who integrate accounting expertise with advanced management skills to drive business performance inside organizations. They serve as trusted partners to executives in all areas of an organization, offering the expertise and analysis necessary for sound business decisions, planning, and support. Management accountants monitor, interpret, and communicate operating results, evaluate performance, control operations, and make decisions about the strategic direction of the organization. They understand the business formula for delivering value to the customer, arriving at strategies for identifying, developing, marketing, and evaluating a product or service throughout its entire life cycle.

Negligence—The failure to be sufficiently careful in a matter in which one has a moral or legal responsibility to exercise care.

Reasonable Person—Usually used where the question is asked, "Would a professional acting under the same circumstances, with the knowledge available to the field at the time the decision was made, have arrived at the same conclusion?"

Responsibility—The sense in which one is accountable for achieving and/or maintaining positive results. The idea is that one who is entrusted with achieving or maintaining this outcome is expected to have relevant knowledge and skills and to make a conscientious effort to achieve it, whether or not the effort is successful.

Stakeholder—A person or group who can affect or is affected by an action. Responsible decision making requires consideration of the effects on all stakeholders even though not all stakeholders may be equal.

Standard of Care—The degree of care that a reasonably prudent person would exercise in managing their own affairs. In negligence law, an individual may be liable for injuries or damages if his or her conduct falls below such standards.

Trust—Having confidence and faith in the reliability, integrity, honesty, or certainty of a person or thing.

Values—The beliefs of a group or individual on which behavior and decisions are based.

Value Judgment—A decision that requires a subjective opinion on what is right or wrong, good or bad. Moral or ethical values are only one type of value, and moral evaluation is only one type of value judgment.

Whistle-Blower—A person who reports wrongdoing or corruption. This includes concerns about safety, financial fraud, mistreatment of employees, or other improper actions. The report might be made to an entity either internal or external to the organization and is typically done anonymously or confidentially.

XI. REFERENCES AND RESOURCES

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