

Business ethics

Topic Gateway Series No. 46



About Topic Gateways

Topic Gateways are intended as a refresher or introduction to topics of interest to CIMA members. They include a basic definition, a brief overview and a fuller explanation of practical application. Finally they signpost some further resources for detailed understanding and research.

Topic Gateways are available electronically to CIMA Members only in the CPD Centre on the CIMA website, along with a number of electronic resources.

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Definition

'Business ethics' is defined by the IBE as 'the application of ethical values to business behaviour'.

Does business ethics pay? – revisited, IBE 2007

'A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest.'

IFAC Code of Ethics for Professional Accountants, 2006

Context

Ethics runs throughout the CIMA qualification. In the current syllabus it is part of the Certificate level paper, where there is a specific paper on ethics, governance and business law. Ethics is also covered in Paper 3 (Review and Audit of Control Systems), Paper 4 (Managing Human Capital) and Paper 5 (The Basis of Strategic Management). Ethics is also a criterion of TOPCIMA.

Related concepts

Code of conduct; compliance; corporate governance; corporate responsibility.

Overview

In recent years, ethics has risen up the agenda of business and accountancy. As professionals, accountants are required to demonstrate the highest ethical standards. These are integral to being a professional and are set out in CIMA's principles based code of ethics for CIMA members.

As well as being required to uphold their institute's code of ethics, professional accountants working in business are often involved in developing, defining and enforcing ethical values in their employing organisation. As more and more companies adopt codes of ethics to guide employee behaviour, the new challenge is to embed these values.

Application

Ethical standards, along with technical competence, are what defines a professional. They help members of a professional body stand apart from others with similar academic qualifications. Few would dispute that one reason why we trust members of the medical profession such as doctors and nurses to heal us when we are sick is because of their strict ethical code.

Ethics is about more than simple compliance with the law or about choosing between right and wrong. Where an action is clearly right or wrong, the decision about what to do can be relatively easy, but when there are grey areas a decision can just as easily be between 'right and right'. Ethical codes are the tools that help guide people's behaviour when they have to decide between shades of grey.

When ethical failings come to light, the result is a loss of public trust. A number of high profile corporate scandals, including the collapses of Enron and WorldCom, contributed to the decrease in public trust in corporations and the accountancy profession in recent years.

The immediate effect of these failings was an increase in regulation, such as the introduction of the Sarbanes-Oxley legislation in the US, but they also served to push ethics up the agenda of both business and accountancy. This has resulted in increased pressure on companies to be accountable and trustworthy, leading to the adoption and embedding of codes of ethics at both professional and corporate levels.

Codes of ethics are usually either a set of rules that must be complied with (rules based approach) or principles that must be applied (principles based approach). There are advantages and disadvantages to both of these approaches. Principles based codes are usually considered more flexible than rules, and confer a responsibility on the individual to apply them. Principles are also thought to encourage people to act in accordance with the spirit of the guidance.

A rules based code, on the other hand, is usually associated with prohibitions which users are required to comply with. Rules can encourage a check box, compliance based approach and there can be a tendency to look for loopholes to circumvent them. A rules based code must cover every eventuality specifically, so they are sometimes considered less flexible than principles, which can be applied across a range of situations.

Rules based codes are also often longer than principles based ones, and tend to grow over time as new situations arise that need to be covered. Principles based codes do not attempt to cover every eventuality specifically, but can be applied across a wide variety of situations. The framework approach does, however, demand professional judgement to apply it and it can be less clear cut.

CIMA's code of ethics is principles based, and applies to all members and registered students. It is based on the code of ethics of the International Federation of Accountants (IFAC), the umbrella organisation for accountancy institutes. The code sets out a framework of five fundamental principles:

- integrity
- objectivity
- professional competence and due care
- confidentiality
- professional behaviour.

The code describes common potential threats to these and identifies safeguards that can be put in place to mitigate those threats.

The principles approach of CIMA's code means that it can be applied across a wider range of situations than a rules based code. This makes the code more comprehensive and is therefore in the public interest. Members must identify potential threats to the fundamental principles, evaluate the significance of these and decide on a course of action to remove or reduce any threats to an acceptable level.

The code of ethics in practice

The code suggests that when resolving an ethical issue, a professional accountant should consider the relevant facts, ethical issues involved, fundamental principles, established internal procedures and potential courses of action. After thinking about these and weighing up the consequences of each possible course of action, the accountant should decide on a way forward that is consistent with the code.

If the matter cannot be resolved, the code suggests consulting with other people within the employing organisation. Members should also document the substance of any ethical issue they come across and the actions they take to resolve it, for future reference.

The code of ethics can be used as a tool by someone facing an ethical dilemma. If an accountant is under pressure to do something that he or she does not feel is right, he or she can use the code of ethics to explain why the action is not acceptable and to back up their reasons for not doing what has been asked.

The use of the code of ethics in business

It is not only professional bodies who have codes of ethics. Increasingly, employers are putting codes in place. These are sometimes called business principles or codes of conduct, but all are intended to guide employee behaviour and how the organisation does business. Research by the Institute of Business Ethics (IBE) shows that 85 FTSE100 companies now have a code of ethics [*Do business ethics pay? – revisited*, IBE 2007].

According to the IBE, the challenge for companies once they have embraced a code of ethics or a set of values, is to embed those values into their business and reinforce them by training employees. They also need to ensure that the necessary systems and processes are in place to back up the code. The IBE argues that organisations should develop ethical assurance, so they can be confident that they are actually living up to its ethical values and commitments [*Living up to our values*, IBE 2006].

There are other signs of the growing importance of codes of ethics. The Professional Accountants in Business (PAIB) committee of IFAC has issued guidance on the role of accountants in developing an effective organisational code of conduct [*International good practice guidance: defining and developing an effective code of conduct*, PAIB 2007].

According to this, accountants can play a number of roles in driving organisational ethics. Firstly, they can support their employer's code of conduct through their own behaviour. CIMA's code of ethics acknowledges this potential to influence, stating that accountants should:

'... encourage an ethics based culture in an employing organisation that emphasises the importance that senior management places on ethical behaviour.'

CIMA Code of Ethics, section 2005

As well as leading by example, accountants may be directly involved in developing and approving a code of ethics or establishing a compliance programme. Those in relatively senior positions may also be involved in demonstrating compliance with the code to third parties, such as investors. Accountants working in internal audit may be involved in implementing the code and assessing whether it minimises risk effectively, as well as reporting back to the audit committee.

A code of ethics is also a part of the control environment in which a professional accountant may be operating, monitoring, reviewing and reporting on performance. Accountants should be able to:

- recognise potential ethical problems within the organisation
- apply a framework for resolving conflicts and explain their decision
- engage with stakeholders
- monitor and report on adherence to the organisation's code of ethics
- assess whether ethics initiatives adequately manage the risks faced by the organisation.

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Readers can also find electronic articles and other publications at:

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Websites

Institute of Business Ethics (IBE)

The IBE exists to encourage high standards of business behaviour based on ethical values. www.ibe.org.uk

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International Business Ethics Institute (IBEI)

The IBEI is a private, nonprofit, nonpartisan, educational organisation. It was founded in response to the growing need for transnationalism in business ethics. www.business-ethics.org/about.asp

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European Business Ethics Network (EBEN)

EBEN is a non-profit association dedicated to the promotion of business ethics in academia, business, the public sector and civil society. www.eben-net.org

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European Business Ethics Network UK (EBEN-UK)

EBEN-UK is the UK association of the European Business Network. www.ebenuk.org/aboutus.html

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