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Management Control-Related Ethical Issues

Chapter 15

MANAGEMENT CONTROL SYSTEM

Brief Content

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Chapter 15

INTRODUCTION

Ethics seeks to address questions about morality;

- that is, about concepts like good and bad, right and wrong.

- Ethics is important for managers involved with MCSs

  - because ethical principles can provide a useful guide

  - for defining how employees should behave

INTRODUCTION

Managers involved in designing and using management control systems (MCSs) must have a basic understanding of ethics.

- Ethics is a field of study used to prescribe morally acceptable behavior.
  - provides a method for distinguishing between "true" and "false"

INTRODUCTION

Ethics is a difficult subject for managers to understand:

- most managers' basic discipline training is in economics.
- Rational people should act to maximize their own self-interest
    - and the primary purpose of employees in for-profit organizations is to maximize shareholder value

INTRODUCTION

Ethics are important to understand for managers involved with MCSs.

- Ethical principles provide useful guidance for determining how employees should behave.

- Employee ethics is an important component of personnel and cultural control (discussed in Chapter 3).

- If good ethics can be encouraged in organizations, they can replace, or add, control actions (Chapter 3) or control outcomes (Chapter 2).

- In aggregate, the ethical principles that employees follow, help to define the core values of the organization and, therefore, its corporate culture and work atmosphere.

INTRODUCTION

This chapter provides an introduction to the complex subject of ethics.

- discuss how to conduct good ethical analyses and why they are important,

- the reasons why people behave unethically, and

- where MCS-related ethical issues are commonly found.

- This chapter concludes with some suggestions for encouraging ethical behavior in organizations.

THE IMPORTANCE OF GOOD ETHICAL ANALYSIS

- Unethical behaviors are costly to:
  - individuals,
  - organizations,
  - markets and societies.
- Good Ethical Analysis also create a need for
  - extra laws and standards from governments and regulatory agencies, and
  - extra rules, reviews, or supervision within organizations

THE IMPORTANCE OF GOOD ETHICAL ANALYSIS (CONT'D)

- To control unethical behaviors within an organization, managers need
  - well developed ethical reasoning skills.
  - moral expertise to make good ethical judgments.
- Training sessions, codes of conduct, and credos help employees identify and think through ethical issues.
  - Managers should serve as moral exemplars: role models

ETHICAL MODEL

Four ethical models:

1. Utilitarianism

2. Rights and duties

3. Justice/fairness

4. Virtues

Four commonly cited ethical models - 1. Utilitarianism

- The rightness of actions is judged solely on the basis of their consequences.

- An action is morally right if it maximizes the total of good in the world;
  - that is, if it produces at least as much net good as any other action that could have been performed

ETHICAL MODEL (CONT'D)

Four commonly cited ethical models - 1. Utilitarianism

- Limitations:
  - Quantifying net good is difficult because the benefits of some actions or decisions are difficult to measure, aggregate, and compare across individuals.
  - Using utilitarian-type thinking makes it easy to sacrifice the welfare of a few individuals for the good of a larger number.

Four commonly cited ethical models - 1. Utilitarianism

- John Stuart Mill, One of the figures who proposed the concept of utilitarianism (source: Wikipedia.org)

ETHICAL MODEL (CONT'D)

Four commonly cited ethical models - 1. Utilitarianism

- In ethical philosophy, **utilitarianism** is a family of normative ethical theories that prescribe actions that maximize happiness and well-being for all affected individuals
- generally requires the attainment of the maximum level of happiness and the reduction of the level of suffering.

Four commonly cited ethical models - 1. Utilitarianism

- Utilitarianism is a version of consequentialism,
  - which states that the consequences of any action are the only standard of right and wrong.
- Unlike other forms of consequentialism, such as
  - egoism and altruism,
  - utilitarianism considers the interests of all sentient beings equally.

Four commonly cited ethical models - 1. Utilitarianism

- Proponents of utilitarianism have disagreed on a number of issues,
  - such as whether actions should be chosen based on their likely results (*act utilitarianism*), or
  - whether agents should conform to rules that maximize utility (*rule utilitarianism*).
- There is also disagreement as to whether
  - total utility (*total utilitarianism*),
  - average utility (*average utilitarianism*) or
  - the utility of the people worst-off[3]

  should be maximized

ETHICAL MODEL (CONT'D)

Four commonly cited ethical models - 2. Rights and duties

- Every individual has certain moral entitlements in virtue of their being human.

- Every right that an individual has creates a duty for someone else to provide, or at least not to interfere

Limitations:

- Difficult to get agreement as to what rights different individuals or groups of

  individuals should have because rights can proliferate, and they can conflict.

ETHICAL MODEL (CONT'D)

Four commonly cited ethical models - 3. Justice/fairness

- People should be treated the same way
  - except when they are different in relevant ways.

Limitations:

- It is easy to ignore effects on both aggregate social welfare and specific individuals

ETHICAL MODEL (CONT'D)

Four commonly cited ethical models - 4. Virtues

- Integrity, loyalty, and courage.
  - Individuals with integrity have the intent to do what is ethically right without regard to self-interest.
  - Loyalty is faithfulness to one's allegiances.
  - Courage is the strength to stand firm in the face of difficulty or pressure

ANALYZING ETHICAL ISSUES

- Good ethical behavior needs to be guided by more than people's opinions, intuitions, or good feel.

- The following steps should be present in any ethical analysis:
    1. Clarify the facts
    2. Define the ethical issues
    3. Specify the alternatives
    4. Compare values and alternatives
    5. Assess the consequences
    6. Make a decision

WHY DO PEOPLE BEHAVE UNETHICALLY

There are four basic reasons:

1. Some people are just basically dishonest.

2. Moral disengagement: no foundation in ethics.

3. Some people who recognize ethical issues develop rationalizations to justify their perhaps unethical behaviors.

4. Some people who are well trained in ethics and who know they are doing something wrong are not able to stop because they lack moral courage; the strength to do the right thing despite fear of the consequences

WHY DO PEOPLE BEHAVE UNETHICALLY

There are four basic reasons:

The Fraud Triangle

- Internal Controls
  - None in place
  - Not enforced
  - Not monitored
  - Ineffective
- Too much trust
- No "tone at the top"
- No segregation of duties (do more with less)
- Increased span of control = less review
- No management oversight/ knowledge
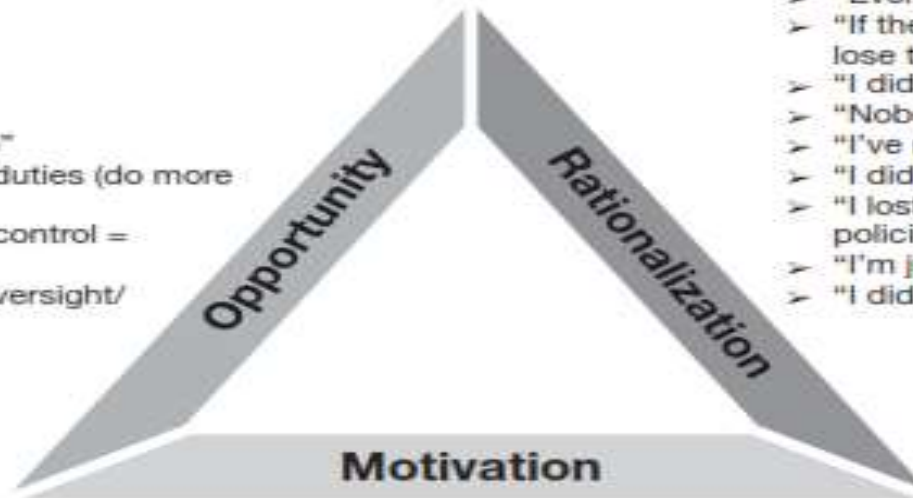
- "The company owes me, I am underpaid."
- "Everyone else is doing it."
- "If they don't know i'm doing it, they deserve to lose the money."
- "I did it for a noble purpose."
- "Nobody will miss the money."
- "I've made this company a lot of money"
- "I didn't get the bonus I deserved"
- "I lost income due to stupid management policies."
- "I'm just borrowing the money. I'll pay it back."
- "I didn't personally benefit."

Opportunity

Rationalization

Motivation

- Debt
- Greed
- Vices: gambling, drugs

- Pressure to perform
- Too much work

SOME COMMON MANAGEMENT CONTROL-RELATED ETHICAL ISSUES

Four common management control-related ethical issues:

1. Creating budgetary slack

2. The ethics of managing earnings

3. The ethics of responding to flawed control indicators

4. The ethics of using control indicators that are 'too good'

BEBERAPA MASALAH ETIKA TERKAIT PENGENDALIAN MANAJEMEN (CONT'D)

Four common management control-related ethical issues - 1. Menciptakan senjangan anggaran:

- Managers negotiate about performance targets and they want to distort their positions in order to be given more easily achievable targets.

- Managers at all levels of the organization negotiate for slack in their budgets, and everyone is aware of the behavioral norm

BEBERAPA MASALAH ETIKA TERKAIT PENGENDALIAN MANAJEMEN (CONT'D)

Four common management control-related ethical issues - 2. The ethics of managing earnings

- Any action that changes reported earnings while providing no real economic advantage to the organization and, sometimes, actually causing harm.

- They are designed to:
  - Boost earnings
  - Smooth earnings: to give the impression of higher earnings predictability and, hence, lower corporate risk.
  - Reduce earnings: save profits for a future period when they might be needed or to lower the stock price to facilitate a management buyout.

BEBERAPA MASALAH ETIKA TERKAIT PENGENDALIAN MANAJEMEN (CONT'D)

Four common management control-related ethical issues - 2. Etika mengelola laba

Unethical because:

- Most of the actions are not apparent to either external or internal users of financial statements.
  - Those engaging in earnings management may be deriving personal advantage through deception.
- Many people believe that professional managers and accountants have a duty to disclose fairly presented information.
- Distortions can be interpreted as not being consistent with managers' and accountants' integrity obligations to be honest, fair and truthful.
- The rewards earned from managing earnings are not fair when the reported performance is only cosmetic, not real.

BEBERAPA MASALAH ETIKA TERKAIT PENGENDALIAN MANAJEMEN (CONT'D)

Four common management control-related ethical issues - 3. The ethics of responding to flawed control indicators

- When the targets and prescriptions are not defined properly,

- they can actually motivate behaviors that employees know are not in the organization's best interest.

BEBERAPA MASALAH ETIKA TERKAIT PENGENDALIAN MANAJEMEN (CONT'D)

Four common management control-related ethical issues -

4. The ethics of using control indicators that are 'too good'

SPREADING GOOD ETHICS IN AN ORGANIZATION

- Corporate specialists develop lists of specific standards, rules, and regulations embodying good ethical principles.

- They communicate these lists either through corporate policies and procedures manuals, corporate codes of conduct, or less formal sets of memoranda

SPREADING GOOD ETHICS IN AN ORGANIZATION (CONT'D)

- Managers have to make sure that the employees follow the rules.

- Top-level managers must set a good tone at the top, and
    - they must endeavor to maintain a good internal MCSs
    - so that potential violators know there is a high probability they will be caught.

CONCLUSION

This chapter has provided a brief introduction to the topic of ethics

- as it relates to the design and use of MCS.

- To create the right ethical environment, management must have moral expertise and know where and how to provide it

CONCLUSION (CONT'D)

Sampling of the problems discussed in this chapter should have explained that

- many ethical issues associated with MCS, and

- Many important ethical issues do not have black or white answers

- Someone cannot conclude unequivocally that, for example, creating slack in budgets is always unethical or that controls are too tight to be ethical.

CONCLUSION (CONT'D)

- "Gray" in judgment makes it all the more important for managers to subject to a variety of ethical issues for formal analysis, despite the many situational factors that must be considered in making ethical judgments.

- Judgments about what is ethically acceptable vary across national cultures,
  - suggests that multinationals wishing to achieve the same level of ethics across entities located in different countries must rely on different sets of controls.

CONCLUSION (CONT'D)

Employees face a lot of pressure and temptation that can cause them to act unethically.

- They can easily bow to performance deadlines and crises, appreciating temptations, pressure for conformity, and even counterproductive orders from their bosses.

- If managers do not act to fend off these pressures and temptations consistently enough, their company's ethical atmosphere will weaken.

- Managers should help guide the behavior of their employees who are unable to think through ethical issues (distinguish right from wrong) themselves.

- They have to understand how and why individuals will reach different ethical conclusions, and, importantly, they have to take a stand on how they want employees in their organizations to behave ethically.

CONCLUSION (CONT'D)

Every organization has such an ethical culture or environment; whether good, bad, or mixed.

- It is important for managers to establish a good ethical atmosphere,
- one of them is one that respects the rights, duties, and interests of internal and external stakeholders of the company.

- An organization that fosters unethical behavior from its employees, even those that benefit the company in the short term, may eventually find itself a victim of its own policies.
  - The organizations are more likely to attract people who are comfortable bending the rules;
  - They might even attract sincere people to bend the rules.
  - Bad culture is contagious.
  - A weakened or bad ethical environment can lead to unethical behavior that can damage or destroy the reputation of individuals and organizations.
  - Once the ethical atmosphere is weakened and reputations damaged, they can be very difficult to rebuild.

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