CHAPTER 3
Organizational Ethics

Chapter Summary

This chapter examines how each functional department, within an organization, manages the challenge of building and maintaining an ethical culture. The chapter begins by defining organization’s culture and an organization in terms of its functional areas within a value chain. Then the chapter begins looking at the ethics involved in research and development, manufacturing, marketing, human resources, and finance. The ethical challenges presented by GAAP are explained and how the accounting industry is dealing with those challenges. The chapter also goes over potential conflicts of interest within various organizational functions and discusses how and why some organizations begin to act in unethical manners.

Learning Objectives

After studying this chapter, the student should be able to:

1. Define Organizational Ethics.
2. Explain the respective ethical challenges facing the functional departments of an organization.
3. Discuss the position that HR should be at the center of any corporate code of ethics.
4. Explain the potential ethical challenges presented by generally accepted accounting principles.
5. Determine potential conflicts of interest within any organizational function.
6. Discuss how and why an organization’s ethical culture can get off track.

Extended Chapter Outline

Objective 1: Define Organizational Ethics
1.1. The opening Frontline Focus case shows how a new employee faces an ethical decision of skipping initial training videos because his boss has a backlog of work to be done.
   1.1.1. Organizational culture can be defined as the values, beliefs, and norms shared by all the employees of that organization.
   1.1.2. Value chain is the key functional inputs that an organization provides in the transformation of raw materials into a delivered product or service.
     1.1.2.1. Research and development
     1.1.2.2. Manufacturing
     1.1.2.3. Marketing
     1.1.2.4. Sales
     1.1.2.5. Customer service
   1.1.3. Supporting each of these functional areas are the line functions:
     1.1.3.1. Human resource management
Objective 2: Explain the respective ethical challenges facing the functional departments of an organization.

2.1 Research and development professionals carry the responsibility for the future growth of the organization.
   2.1.1 Commitment to consumer that products are of highest quality, safety, and reliability.
   2.1.2 Defective products put consumers at risk and generate negative press coverage and very expensive lawsuits
   2.1.3 Real ethical dilemmas come when decisions are made about product quality.

2.2 Manufacturers face the ethical question of “do you want it built fast, or do you want it built right?”

2.3 The marketing process (which includes advertising, public relations, and sales) is responsible for ensuring that the product reaches the hands of a satisfied customer.
   2.3.1 Marketers see themselves as providing products to customers who have already expressed a need for and a desire to purchase those products.
   2.3.2 Marketers emphasize customer service and argue that since their customers are satisfied, the good outcome justifies the methods used to achieve that outcome no matter how misleading the message or how unnecessary the product sold.
   2.3.2.1 Utilitarianism is the ethical choices that offer the greatest good for the greatest number of people.
   2.3.2.2 Universal ethics are actions which are taken out of duty and obligation to a purely moral ideal, rather than based on the needs of the situation.
   2.3.3 Marketing professionals abide by a code of ethics adapted by the American Marketing Association (AMA).

Objective 3: Discuss the position that HR should be at the center of any corporate code of ethics.

1.1 The human resources function within an organization should ideally be directly involved in the relationship between the company and the employee throughout that employee’s contract with the company:
   1.1.1 The creation of the job description for the position.
   1.1.2 The recruitment and selection of the right candidate for the position.
   1.1.3 The orientation of the newly hired employee.
   1.1.4 The efficient management of payroll and benefits for the (hopefully) happy and productive employee.
   1.1.5 The documentation of periodic performance reviews.
1.1.6 The documentation of disciplinary behavior and remedial training, if needed.

1.1.7 The creation of a career development program for the employee.

1.2 HR department should coordinate final paperwork and should host an exit interview to ensure that anything the organization can learn from the departure is fed back into the company’s strategic plan.

1.3 If the right people are hired in the first place, it is believed, many other problems are avoided down the road.

1.4 Many advocates of ethical business conduct argue that HR should be at the center of any corporate code of ethics – not as the sole creator of the code, since it is a document that should represent the entire organization.

1.4.1 HR professionals must help ensure that ethics is a top organizational priority.

1.4.2 HR must ensure that the leadership selection and development processes include an ethics component.

1.4.3 HR is responsible for ensuring that the right programs and policies are in place.

1.4.4 HR must stay abreast of ethics issues.

1.5 The finance function of an organization can be divided into three distinct areas: financial transactions, the accounting function, and the auditing function.

1.5.1 Financial transactions – the process by which the flow of money through an organization is handled.

1.5.2 **Accounting function** – keeps track of all the company’s financial transactions by documenting the money coming in and money going out and balancing the accounts at the end of the period.

1.5.3 **Auditing function** – the certification of an organization’s financial statements, or “books” as being accurate by an impartial third-party professional.

1.5.4 Existing and potential investors will make the decision to invest in the shares of an organization based on the information presented in the certified financial statements.

**Objective 4:** Explain the potential ethical challenges presented by generally accepted accounting principles (GAAP).

4.1 GAAP – The generally accepted accounting principles that govern the accounting profession – not a set of laws and established legal precedents, but rather a set of standard operating procedures within the profession.

1.2 Accountants face ethical challenges when requests are made for far more illegal practices such as falsifying accounts, underreporting income, overvaluing assets, and taking questionable deductions.

1.3 A set of accurate financial statements that present an organization as financially stable, operationally efficient, and positioned for strong future growth can do a great deal to enhance the reputation and goodwill of an organization.

1.4 The accounting/auditing firm is paid by the corporation, but it really serves the general public, who are in search of an impartial and objective review – presents a clear ethical predicament.
Objective 5: Determine potential conflicts of interest within any organizational function.

5.1 Conflict of interest is a situation where one relationship or obligation places you in direct conflict with an existing relationship or obligation.

5.1.1 Simply meeting the needs of your organization’s stakeholders can present conflicts of interest when you consider the possibility that what is best for your shareholders may not be best for your employees and community.

5.1.2 Selling a product that has the potential to be harmful to your customers represents a conflict of interest.

5.1.3 Selling a product that has the potential to be harmful to the environment also carries a conflict of interest.

Objective 6: Discuss how and why an organization’s ethical culture can get off track.

6.1 The National Business Ethics Survey found that more than half of U.S. employees have observed at least one example of workplace ethical misconduct in the past year.

6.2 Types of misconduct employees observed most include:

6.2.1 Abusive or intimidating behavior toward employees
6.2.2 Lying to employees, customers, vendors, or the public
6.2.3 Situations that placed employee interests over organizational interests
6.2.4 Violations of safety regulations
6.2.5 Misreporting of actual time worked

6.3 The obligation to deliver profits to owners or shareholders has created a convenient “get out of jail free” card, where all kinds of behavior can be justified in the name of meeting your obligations to your shareholders.

6.4 How well companies set ethical standards can be measured by the extensive legislation that now exists to legally enforce ethical behavior in business.

Key Terms

Accounting Function: The function that keeps track of all the company’s financial transactions by documenting the money coming in (credits) and money going out (debits) and balancing the accounts at the end of the period (daily, weekly, monthly, quarterly, annually).

Auditing Function: The certification of an organization’s financial statements, or “books” as being accurate by an impartial third-party professional. An organization can be large enough to have internal auditors on staff as well as using external professionals – typically certified professionals accountants and/or auditing specialists.

Conflict of Interest: A situation where one relationship or obligation places you in direct conflict with an existing relationship or obligation.
GAAP: The generally accepted accounting principles that govern the accounting profession – not a set of laws and established legal precedents, but rather a set of standard operating procedures within the profession.

Organizational Culture: The values, beliefs, and norms that all the employees of that organization share.

Universal Ethics: Actions are taken out of duty and obligation to a purely moral ideal, rather than based on the needs of the situation, since the universal principles are seen to apply to everyone, everywhere, all the time.

Utilitarianism: Ethical choices that offer the greatest good for the greatest number of people.

Value Chain: The key functional inputs that an organization provides in the transformation of raw materials into a delivered product or service.