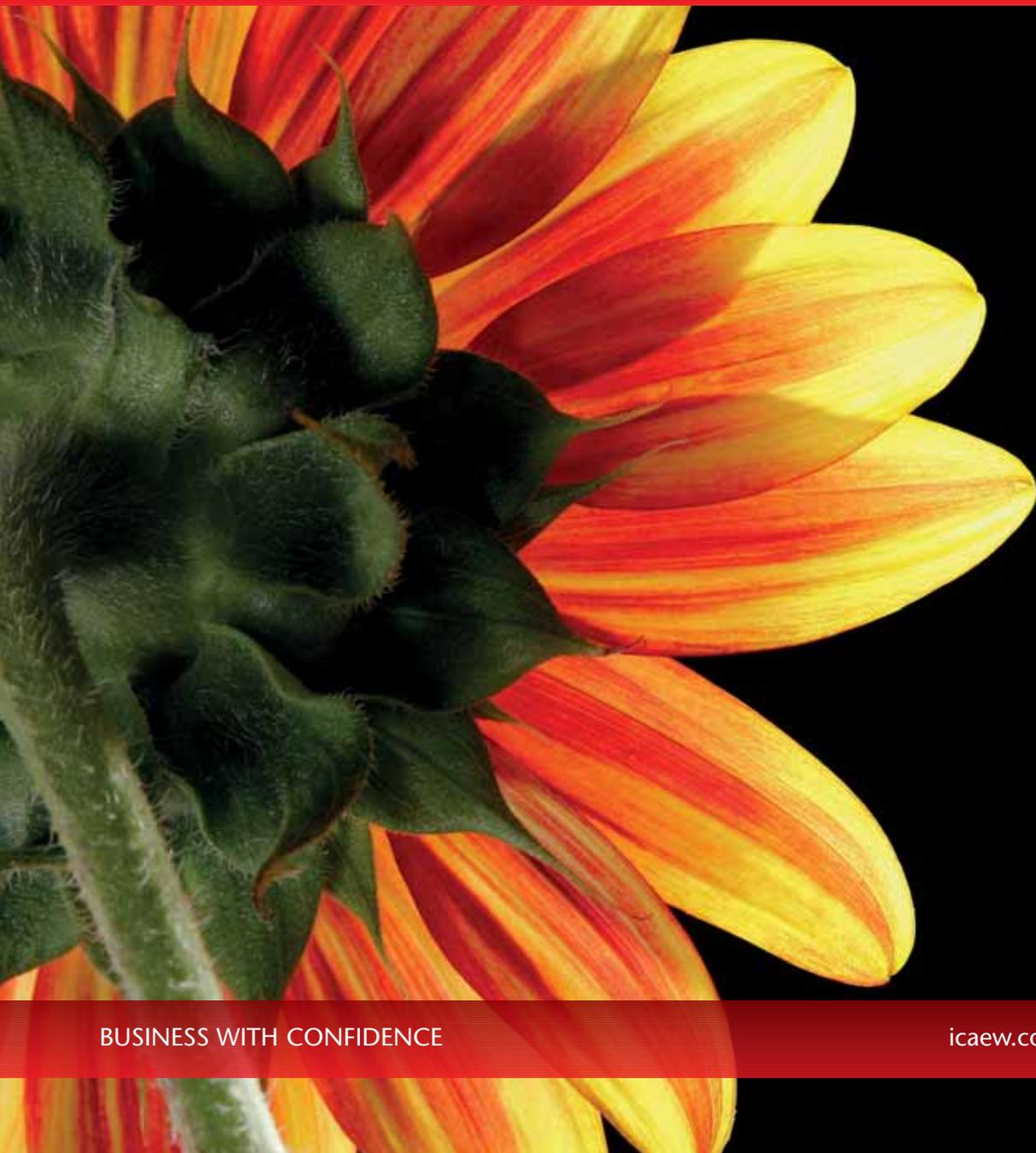


ICAEW



# REPORTING WITH INTEGRITY

MARKET FOUNDATIONS INITIATIVE



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# **REPORTING WITH INTEGRITY**

**INFORMATION FOR BETTER MARKETS INITIATIVE**



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# Executive summary

Following business scandals in 2001 and 2002 there has been increased interest from regulators, governments and business itself in initiatives which reinforce integrity and enhance trust in business and reporting. Integrity underpins and supports high quality information that is fit-for-purpose. Reliable information is of critical importance to the efficient functioning of markets and the effectiveness of public policy initiatives. Integrity is also vital to the reputation of individuals and organisations and the economic development of nations. Yet, paradoxically, whilst the importance of integrity is widely acknowledged, there is no generally accepted understanding of what it means.

The purpose of this report is to look at what integrity is and why it is important not only in its own right but also for economic activity in general and business reporting in particular. In order to obtain a more comprehensive understanding of what is meant by integrity, both as a concept and in practice, the report brings together ideas from a variety of disciplines. Moreover, because this report sees reporting with integrity as a joint endeavour of individuals, organisations and professions, including the accounting profession, the concept of integrity is considered in all these contexts. This report is innovative and challenging in that it sets out how integrity – which is essentially a personal quality – can be promoted through organisations, including professional bodies.

A useful starting point is to refer to the origin and historical development of the word. It is derived from the Latin word *integritas* which has a variety of meanings ranging from correctness of language, chastity, innocence and purity to the undiminished or unimpaired condition of an object or whole. The literature of modern moral philosophy in the English language gives substance to this idea of wholeness and collectively captures many commonly understood meanings of integrity. From this literature we highlight five key aspects of integrity:

- moral values;
- motives;
- commitments;
- qualities; and
- achievements.

An individual of integrity is guided by moral values and motives which are translated into commitments. Such an individual draws on qualities such as rationality and open-mindedness to assess what the right thing to do is from a wider community perspective. An individual's commitments in pursuit of doing the right thing are also likely to require personal qualities, including perseverance and courage, if they are to lead to the hard-won achievements expected of individuals of integrity.

Integrity is special because all its aspects need to be linked and aligned in a consistent manner to form a whole. This wholeness or congruence may be easy to express, but it is difficult to put into practice since many disparate factors influence behaviour. Personal, social, organisational and environmental factors influence judgements and decisions that are reflected in behaviour, and potentially, in achievements that evidence integrity. Whilst it is helpful to list the characteristics which are usually linked to behaving with integrity, there will always be ambiguity when evaluating whether or not an individual has integrity. Integrity is not something that is generally self-assessed; it relies on the assessment of an observer who may be influenced by their own beliefs and expectations of how a person of integrity ought to behave. Such an observer will also have limited

knowledge of another person's moral values, motives, commitments, qualities and achievements even though these are crucial to judging whether that person is behaving with integrity.

Nevertheless, certain behavioural characteristics are associated with integrity. The report proposes that a person of integrity will be likely to:

- be honest and truthful;
- be fair;
- comply with laws;
- promote community interests;
- be open and adaptable;
- take corrective action; and
- show consistency.

Consistency is a particularly challenging behavioural characteristic given the ability of people to compartmentalise different areas of their life.

Integrity is a quality that is ascribed to individuals and their behaviour and it is also applied directly to organisations and their behaviour. Achieving the five aspects of integrity is challenging for an individual but it is even more difficult for an organisation. An organisation, because it is a collection of individuals, needs a robust framework that links individuals to a common view of the organisation's moral values, motives, commitments, qualities and achievements.

The report proposes five drivers of organisational integrity:

- leadership;
- strategy;
- policies;
- information; and
- culture.

The drivers need to be interconnected with each other, mutually reinforcing and effective throughout the organisation. This requires determined and energetic management. Although the drivers are relevant to organisations of all sizes and in all sectors, it is clear that there are no one-size-fits-all answers and that managers need to exercise judgement in deciding what will be effective in their organisation.

Professional bodies should be expected to instil integrity in their members through their leadership, strategy, policies, information and culture. Professional bodies promote integrity in professions, including the accounting profession by, amongst other things, setting out standards to which members are expected to adhere. A fundamental principle of integrity, which generally refers to being straightforward and honest, is included in a substantial number of professional accounting bodies' codes of ethics. However, while the principle of integrity includes moral values, the other aspects of integrity – motives, commitments, qualities and achievements – are only evident when looking at the more detailed ethical guidance within codes of ethics. Even then, the links to integrity are not always obvious.

In the light of the analysis in this report, professional accounting bodies might want to accord pre-eminence to integrity over other fundamental ethical principles and explicitly incorporate motives, commitments, qualities and achievements into their definition of integrity. Moreover, in the context of their current contribution to the promotion of integrity, professional accounting bodies also need to keep under review:

- the support and financial assistance they can provide to members if they are disadvantaged as a result of standing up for integrity;
- pre-entry requirements which assess the integrity of individuals, their moral reasoning and their personal qualities;
- the requirements and scope of continuing professional development (CPD);
- the transparency of disciplinary processes;
- helplines and other means of providing ethical advice and support to members; and
- the balance of the content of professional qualifications and the ways in which ethics is taught.

The overall process of financial reporting in a country or market is a complex web of interactions, communications and discussions between individuals in different organisations including many who do not work for reporting entities. An overall reporting process with the integrity to inspire confidence will be seen to be honest and truthful, to be fair, to comply with laws, to promote community interests, to be open and adaptable, to take corrective action and to show consistency.

Integrity in reporting needs to be underpinned by moral values such as honesty, motives such as a desire to inform, commitments to the interests of shareholders and others, qualities such as scepticism and perseverance, and achievements in the face of opposition. Reporting with integrity relies on reporting entities, audit firms, professional bodies and other organisations taking steps to promote integrity through their leadership, strategy, policies, information and culture.

Public policy mechanisms that link together the various organisations involved in reporting include requirements and prohibitions enshrined in legislation and regulation. Whilst these can be a great source of strength for individuals of integrity, there is a risk of externally imposed regulation dissolving the very notion of integrity and its sense of identity and standing for something. The accounting profession therefore continues to have a central role to play in instilling integrity across the reporting process. Professional bodies also have a crucial responsibility to develop and support individuals of integrity who set a broader example within the organisations and societies where they make their contribution.

# Invitation to comment

ICAEW welcomes comments on the analysis in this report. Readers are also invited to answer any of the questions at the end of each chapter, all of which are reproduced below. Several questions seek to identify areas needing either summaries of existing knowledge or further research on specific issues. Comments received on these and other matters will be taken into account in deciding on ICAEW's future work on integrity.

1. This report argues that integrity is important not only in its own right but also because it:

- helps establish trust;
- underpins high quality information that people can rely on;
- enables markets to develop and allocate resources more efficiently;
- delivers value to individuals, organisations and nations by supporting the achievement of desired outcomes; and
- inspires public policy responses when there is a loss of confidence in markets.

Are there any other reasons why integrity is important? If so, what are they?

2. It is argued that integrity helps establish trust because it is associated with honesty, truthfulness, consistency and predictability. Is it possible to be more specific about the links between integrity and trust, for example by saying that integrity is a necessary and/or sufficient condition for trust to exist?

3. What is the empirical evidence about connections between perceptions of integrity and:

- personal well-being;
- the performance and reputation of organisations; and
- economic development and welfare?

What further research should be conducted into perceptions of individual and organisational integrity and their association with indicators of success?

4. This report proposes that integrity has five key aspects:

- moral values;
- motives;
- commitments;
- qualities; and
- achievements.

Are the proposed key aspects of integrity appropriate, comprehensive and internally consistent? If not, why not and should any other aspects be included?

5. Are the moral values of truthfulness, honesty and fairness essential to integrity and are there any other such moral values?

6. The analysis of the concept of integrity presented in this report draws on a range of accounts from modern moral philosophy in the English language. What additional insights might be obtained from a broader historical survey of different cultures and religions?

7. This report proposes that a person of integrity will be likely to:

- be honest and truthful;
- be fair;
- comply with laws;
- promote community interests;
- be open and adaptable;
- take corrective action; and
- show consistency.

Are these proposed behavioural characteristics of a person of integrity and the analyses of the tensions they raise appropriate? If not, why not?

8. Should a person be described as having integrity if they show integrity in their business or professional life but not in their private life and if not, why not?
9. Are there any additional aspects of evaluating individuals' integrity which are not covered by this report but which merit further discussion or research?
10. Is it useful to think in terms of leadership, strategy, policies, information and culture when looking at how to promote organisational integrity?
11. What specific examples are there of initiatives and techniques that are particularly effective or ineffective in promoting organisational integrity?
12. What factors affect the effectiveness of codes of conduct in changing behaviour and promoting organisational integrity?
13. Should the accounting profession's ethical codes give a greater status and fuller definition to integrity and what might be the practical implications?
14. What are the most effective mechanisms for promoting integrity in the accounting profession and how is this supported by empirical evidence?
15. What suggestions do you have in relation to areas for potential improvement in the accounting profession's support for integrity identified in this report including ethical codes, pre-entry requirements, training, CPD, disciplinary processes, helplines and financial support?
16. Can the integrity of reporting as a whole be usefully debated and taken forward as a public policy issue and if so how? If not, why not?
17. Do you agree that a reporting process with the integrity to inspire confidence needs to be honest and truthful, to be fair, to comply with laws, to promote community interests, to be open and adaptable, to take corrective action and to show consistency?
18. Do you agree that integrity in reporting can be analysed using the proposed key aspects of moral values, motives, commitments, qualities and achievements? If not, why not?
19. Do you believe that changes made since 2001 have significantly reduced the threat of aggressive earnings management across the world's markets and why? If not, what more needs to be done?
20. What further research is needed on different institutional arrangements covering reporting entities, audit firms, professional bodies, regulators and other organisations and their impact on the integrity of reporting?

Responses should be sent by 30 November 2007 to:

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or emailed to [marketfoundations@icaew.com](mailto:marketfoundations@icaew.com). All written comments will be regarded as being on the public record unless confidentiality is requested.

ICAEW would also welcome dialogue with individuals and organisations having an interest in any of the issues addressed by this report or the *Market Foundations* campaign more generally, and would be pleased to hear from them.

# 1. Why integrity is important

This chapter introduces *Reporting with integrity* by looking at why integrity is important not only in its own right but also for economic activity in general and business reporting in particular. It draws on ideas in *Information for markets and society*<sup>1</sup>, an earlier report in the *Information for Better Markets* campaign, which are summarised in Appendix 1. The overarching objective of the campaign is to improve business reporting and the earlier report sought to explain how business reporting is linked to the use of information in the wider context of society.

We see reporting with integrity as a joint endeavour of individuals, organisations and professions, including the accounting profession. That is why the concept of integrity is analysed in each of these different contexts in later chapters. The final chapter draws on this analysis to identify practical ways of promoting integrity in reporting. Anyone picking up this report expecting to find instant tips on reporting with integrity is asked to be patient. Reporting is an area in which the accounting profession faces particularly high expectations about its integrity, but in order to respond to those expectations, we need to have a good understanding of integrity in a broader context.

This report is innovative and challenging in that it sets out proposals for how integrity – which is most readily seen as a personal quality – can be promoted through organisations, including professional bodies. It is timely to do this given heightened interest in the integrity of business in general and reporting in particular. It is also necessary in view of the dearth of serious analysis that is currently available to back up demands and claims about integrity. However, our proposals are put forward as working hypotheses to stimulate debate and research, not as fixed ideas.

## 1.1 Renewed interest in integrity

The leading American moral philosopher John Rawls noted in his 1972 book *A Theory of Justice*<sup>2</sup> that ‘in times of social doubt and loss of faith in long established values, there is a tendency to fall back on the virtues of integrity: truthfulness and sincerity, lucidity, and commitment, or, as some say, authenticity.’ It is therefore not surprising that, following business scandals in 2001 and 2002, there has been increased interest from regulators, governments and business itself in initiatives designed to reinforce integrity and enhance trust in business and reporting. ‘Failure to recognize the primacy of integrity has been a major contributor to the financial scandals of recent years’, concluded an independent task force established by the International Federation of Accountants (IFAC) in its 2003 report, *Rebuilding Public Confidence in Financial Reporting: An International Perspective*.<sup>3</sup>

Whilst integrity appears to matter more when things go wrong, some would argue that integrity is always of paramount importance in business and that it is when people forget this that things go wrong. In *The Integrity Advantage*,<sup>4</sup> published in 2003, Adrian Gostick and Dana Telford support this point of view. They recount how investment guru Warren Buffet responded to a question about how he made hiring decisions: ‘I look for three things...The first is personal integrity, the second is intelligence, and the third is a high energy level...But...if you don’t have the first, the second two don’t matter.’

The quotation from Warren Buffet shows the importance of integrity in influencing business decisions. The following sections build on this and argue that integrity is also vital to individuals and society because it provides a basis for:

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<sup>1</sup> *Information for markets and society*, London: ICAEW, 2005.

<sup>2</sup> John Rawls, *A Theory of Justice*, Oxford: Clarendon Press, 1972.

<sup>3</sup> IFAC, *Rebuilding Public Confidence in Financial Reporting: An International Perspective*, July 2003.

<sup>4</sup> Adrian Robert Gostick and Dana Telford, *The Integrity Advantage*, Salt Lake City, Utah: Gibbs Smith, 2003.

- establishing trust;
- relying on information;
- developing markets;
- achieving desired outcomes; and • inspiring public policy.

## 1.2 Establishing trust

Integrity, both actual and perceived is fundamental to establishing trust. Trust relates to an individual's beliefs and expectations regarding the reliability and dependability of something or somebody else. The establishment of trust relies on relationships, actions and interactions, as well as perceptions. Trust can be built up over time through engagement, joint activity and accountability, supported by reporting, disclosure and assurance. It can also be rapidly destroyed by behaviour which betrays trust.

Individuals and organisations derive value from being trusted, but trust is also important because of the wider social and economic value that it brings. Trust contributes towards the efficient allocation of resources because it:

- encourages delegation and the appointment of agents with the resulting benefits of the division of labour and specialisation;
- enhances relationships, co-operation and co-ordination amongst individuals and organisations; and
- facilitates transactions and minimises the validation costs associated with those transactions and the related information flows.

Whenever there is a lack of trust, there will be missed opportunities. In his 2006 book *The Speed of Trust: The One Thing That Changes Everything*,<sup>5</sup> Stephen M.R. Covey draws attention to the direct relationship between trust and the speed of doing business and the inverse relationship between trust and the cost of doing business.

So, what is it about integrity that encourages trust in others? Integrity is generally associated with honesty and truthfulness. When somebody lies or is suspected of lying, an element of doubt is introduced in the minds of others regarding the reliability and credibility of that individual and by association, anything that the individual is involved with.

However, people who are sincere and honest in everything they say but who constantly change their views on matters of importance would probably not be trusted or described as people of integrity. Whilst individuals of integrity may change their opinions and behaviour in the light of new information and will learn from making mistakes, such individuals would not inspire confidence and trust if they were forever changing their minds. Thus, consistency and predictability, as well as honesty and truthfulness, seem to be associated with both trust and integrity.

D. Harrison McKnight and Norman L. Chervany's 1996 paper on 'The Meanings of Trust'<sup>6</sup> provides empirical evidence relevant to the link between integrity and trust. This research notes that over 90 per cent of the beliefs associated with trusting another person are accounted for by four attributes: benevolence, honesty, competence and predictability. Thus, two characteristics which appear to be closely linked to integrity – honesty and predictability – invite trust from others.

<sup>5</sup> Stephen M. R. Covey with Rebecca R. Merrill, *The Speed of Trust: The One Thing That Changes Everything*, New York: Free Press, Simon & Schuster, 2006.

<sup>6</sup> D. Harrison McKnight and Norman L. Chervany, 'The Meanings of Trust', Working Paper 96-04, University of Minnesota.

### 1.3 Relying on information

Integrity underpins high quality information that is fit-for-purpose and its importance is captured in the Information for Better Markets Framework reproduced in Appendix 1. High quality information is needed by individuals and organisations to plan, evaluate, implement, monitor and report activities and achieve desired goals. One of the key attributes of high quality information is reliability, both actual and perceived.

Although there is no general agreement as to the precise meaning of reliability, insofar as information can be described as being accurate, complete and fair, it is likely to be seen as trustworthy. People need to have confidence that the information they are looking at can be trusted. Two ways of achieving this underline the importance of reporting with integrity by showing how integrity underpins and supports the reliability of information flows:

- Where information is prepared and reported by individuals and organisations that have and are seen to have integrity, it is more likely to be trusted and relied on.
- The reliability of information can be enhanced through assurance, in the form of an objective and independent opinion. However, for assurance to be of value, the individuals involved in the assurance process must have integrity. If they lack or are perceived to lack integrity, the opinions they deliver will be worthless to others.

### 1.4 Developing markets

Society depends on markets for the supply of the goods and services that it consumes. High quality information is the 'lifeblood of markets'<sup>7</sup> and is of critical importance to their effective and efficient operation. Reliable information flows underpinned by integrity are necessary to allocate resources efficiently through markets. The ability to exercise choice depends on information. Suppliers rely on information about customers, prices, resource availability and other matters to make decisions about what to produce. Customers depend on price, product and service information when deciding what to buy.

If information is to be relied on by market participants and society, it needs to be trusted. Reasons for information being untrustworthy are varied, but one of the most prominent reasons is dishonesty. According to Akerlof in his 'Market for Lemons' paper of 1970, the major costs of dishonesty relate to the effect of untrustworthy information on the willingness to trade and this is clearly seen in the damaging effects on stock markets of suspicions of insider trading.

'Consider a market in which goods are sold honestly or dishonestly: quality may be represented, or it may be misrepresented. The purchaser's problem, of course, is to identify quality. The presence of people in the market who are willing to offer inferior goods tends to drive the market out of existence.... It is this possibility that represents the major costs of dishonesty – for dishonest dealings tend to drive honest dealings out of the market. There may be potential buyers of good quality products and there may be potential sellers of such products in the appropriate price range; however, the presence of people who wish to pawn bad wares as good wares tends to drive out the legitimate business. The cost of dishonesty, therefore, lies not only in the amount by which the purchaser is cheated; the cost must also include the loss incurred from driving legitimate business out of existence.'<sup>8</sup>

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<sup>7</sup> John McMillan, *Reinventing the bazaar: a natural history of markets*, New York: W. W. Norton, 2002.

<sup>8</sup> George A. Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism', *The Quarterly Journal of Economics*, vol 84, issue 3, pp 488-500, 1970.

Hence, lack of integrity results in a reduced willingness to trade at appropriate prices that are acceptable to buyers and sellers. In some situations, suppliers will be left with goods and services that they cannot sell and customers will be unable to meet their demand for goods and services. This will result in resources being inefficiently allocated or wasted altogether.

Integrity underpins trust in information and in markets. A good example of a market that has developed and flourished by establishing trust is the E-bay market. It relies on feedback from market participants about the integrity of suppliers and customers in completing transactions.

## 1.5 Achieving desired outcomes

Integrity is important to individuals, organisations and nations. At an individual level, integrity can be seen as bringing its own rewards. Individuals of integrity will try to do the right thing which can lead to personal well-being as well as respect and admiration from others. Individuals who strive for goals that lack moral purpose are likely to lack the satisfaction and sense of accomplishment which are derived from doing the right thing. Nevertheless, for an individual operating within an economy or an organisation that lacks integrity, the costs of acting with integrity may be very great. The rewards are perhaps more obvious when integrity is widely practised.

Integrity is important for setting and achieving desired outcomes for organisations and nations. Lack of integrity adversely affects not only the reputation of individuals involved in such practices, but also the organisations they work for. The performance and reputation of an organisation depend not only on individuals having the necessary skills, knowledge and experience to carry out their roles but also on the integrity of such individuals. Individuals who lack integrity adversely affect the performance and reputation of organisations for several reasons:

- they are more prone to dishonest behaviour and more likely to commit unethical and unlawful acts which result in adverse publicity and sometimes irreversible damage to the reputation of the organisation;
- they discourage others from doing business with an organisation; and
- they may have been recruited under false claims about their competencies and skills, potentially leading to inappropriate and costly decisions being made that are detrimental to the organisation and its stakeholders.

At a national level, the achievement of public policy goals such as improving people's health or education, reducing crime, protecting the environment or improving economic performance is also reliant on the integrity of individuals and organisations in government and business. The achievement of public policy goals is hindered by the existence of pervasive bribery, corruption and money laundering. Such unethical practices show how a lack of integrity on the part of some individuals benefits those individuals at the expense of whole countries by distorting resource allocation and adversely affecting economic development. The importance of integrity in economic development and welfare is widely promoted by international development organisations such as the World Bank.

### **Panel 1.1: World Bank Group**

The World Bank Group provides international development assistance to countries with the aim of reducing global poverty and improving living standards. In doing so, it recognises that not only does it need to promote high standards of conduct amongst its staff but it also needs to fight fraud and corruption in the projects it funds.

As Suzanne Rich Folsom, Director for the Department of Institutional Integrity at the World Bank stated: 'Pervasive corruption has a devastating impact on the capacity of governments to function properly; on the private sector to grow and create employment; on the talents and energies of people to add value in productive ways; and ultimately on societies to lift themselves out of poverty.'

Source: World Bank, Annual Integrity Report – Fiscal Year 2005/06 (Message from the Director).

## **1.6 Inspiring public policy**

Integrity is the inspiration for public policy responses to address perceptions of unreliable information and mistrust of markets. Other reports in the *Information for Better Markets* campaign refer to the mechanisms that public policy can use to persuade, require or incentivise individuals to change their behaviour. Such mechanisms include voluntary codes, rating and benchmarking, and requirements and prohibitions. For example, the requirements of the Sarbanes-Oxley Act 2002 were introduced in the US to try to restore public trust in the reliability of financial reporting.

### **Panel 1.2: Sarbanes-Oxley Act 2002**

Following the well-publicised corporate collapses of Enron and WorldCom, the Sarbanes-Oxley Act 2002 was introduced with the specific intention of enhancing the credibility of financial reporting. It applies to all SEC registered companies and their subsidiaries worldwide. Section 302 and Section 404 require senior management to include information in their regulatory filings regarding disclosure controls and procedures as well as an assessment of the effectiveness of internal control over financial reporting. Auditors must attest to and report on the effectiveness of such internal control.

The increased involvement of executive management in disclosure and the need for them to focus on the effectiveness of internal control were aimed at bolstering the integrity of financial reporting and reducing the risk of fraudulent reports.

Whether or not any particular legislation, regulations and standards actually enhance integrity is debatable. Indeed, intervention by government and regulators may result primarily in increased costs, complexity and confusion amongst market participants, especially businesses and investors operating internationally who have to work under different national regimes. On the other hand, externally imposed requirements can provide individuals and organisations with much needed spurs to action. What is certain, however, is that integrity or the lack of it, affects not only market activity but also public policy measures affecting market behaviour.

Whilst the importance of integrity is widely acknowledged, the promotion of integrity across organisations and nations made up of individuals from different backgrounds and cultures represents a real challenge. There is no generally accepted understanding of what integrity means and what behavioural characteristics are associated with individuals of integrity. Part of the explanation for this is that integrity is a relative concept and in different cultures and different times may be associated with different types of behaviour. What makes somebody an individual of integrity depends in part on society's expectations and views, which, in turn, are influenced by social conventions, religion and law. However, whilst we recognise that integrity is a relative concept, we think that there are core aspects of integrity associated with the term and these are discussed in the following chapter.

### **Panel 1.3: Summary of the argument**

- Integrity is vital to individuals and society because it provides a basis for:
  - establishing trust;
  - relying on information;
  - developing markets;
  - achieving desired outcomes; and
  - inspiring public policy.
- Promoting integrity in society is a real challenge since integrity is a relative concept, influenced by culture and the passage of time.
- In spite of this, it is our view that there are core aspects of integrity associated with the term.

## **1.7 Questions for discussion**

1. This report argues that integrity is important not only in its own right but also because it:

- helps establish trust;
- underpins high quality information that people can rely on;
- enables markets to develop and allocate resources more efficiently;
- delivers value to individuals, organisations and nations by supporting the achievement of desired outcomes; and
- inspires public policy responses when there is a loss of confidence in markets.

Are there other reasons why integrity is important? If so, what are they?

2. It is argued that integrity helps establish trust because it is associated with honesty, truthfulness, consistency and predictability. Is it possible to be more specific about the links between integrity and trust, for example by saying that integrity is a necessary and/or sufficient condition for trust to exist?

3. What is the empirical evidence about connections between perceptions of integrity and:

- personal well-being;
- the performance and reputation of organisations; and
- economic development and welfare?

What further research should be conducted into perceptions of individual and organisational integrity and their association with indicators of success?

## 2. The meaning of integrity

Integrity inspires trust and is vital to the reputation of individuals and organisations, the economic development of nations and the reliability of information and reporting. Yet, paradoxically, whilst the importance of integrity is widely acknowledged, there is no generally accepted understanding of what it means.

People are often happy to explain integrity by reference to examples or modern idioms such as 'being true to yourself', 'telling it how it is' and 'doing rather than talking'. Some would also argue that it is not necessary to articulate precisely what is meant by integrity since its absence is painfully obvious. However, whilst this may be true, a more analytical approach is likely to lead to:

- a more comprehensive understanding of what integrity is;
- a greater ability to distinguish weak and strong claims to integrity; and
- a better grasp of how to uphold integrity, for example in reporting, and thereby promote the public good.

A useful starting point is to refer to the origin and historical development of the word. Integrity is derived from the Latin word *integritas* which has a variety of meanings ranging from correctness of language, chastity, innocence and purity to the undiminished or unimpaired condition of an object or whole. This richness of application has been carried over into the modern day English word *integrity*. The term is relatively easy to apply to an object, such as a report, since it usually refers to something which is free from error and inconsistency, but its application to people is more complex. In the words of Hank Paulson, US Treasury Secretary and former Chairman and CEO of Goldman Sachs: 'It completes us.... To me, integrity the root word, really has to do with the whole man....'<sup>9</sup> However, what does wholeness refer to in the context of an individual, let alone an organisation or a social activity such as reporting? Looking at the literature of modern moral philosophy in the English language provides initial answers to this question.

### 2.1 Four philosophical accounts

We recognise that a comprehensive appreciation of the meaning of integrity would need to be based on a sweeping historical survey of many cultures and religions. However, different accounts of integrity found in modern moral philosophy in the English language provide a good starting point and collectively capture many commonly understood meanings of integrity. These accounts can be summarised under four headings: self-integration, identity, moral purpose, and standing for something.

The self-integration account highlights the importance of wholeness in relation to an individual through the integration of different parts of an individual into an intact whole.

The identity account, as the name suggests, focuses on the link between integrity and an individual's identity, that is, their motives and commitments.

The moral purpose account of integrity involves experiencing and overcoming adversity. From this perspective, integrity involves doing what is morally right and taking into account the interests of the wider community.

The standing for something account emphasises being true to motives and commitments and captures the idea that integrity is something worth striving for. This may involve experiencing and overcoming adversity arising from personal and social obstacles.

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<sup>9</sup> Quoted in Adrian Robert Gostick and Dana Telford, *The Integrity Advantage*, Salt Lake City, Utah: Gibbs Smith, 2003.

## 2.2 Five aspects of integrity

Based on our analysis of four accounts of how integrity is applied to individuals in modern philosophical literature, we have developed a working hypothesis that there are five key aspects of integrity. These are set out below and summarised in Figure 2.1:

Figure 2.1: Aspects of integrity



- **Moral values.** Everyday usage of the word integrity suggests that it requires a moral component which reflects society-approved values. Integrity is usually associated with moral values such as honesty, truthfulness and fairness. The moral purpose account of integrity suggests that a person of integrity should be committed to the pursuit of a moral life which includes virtues such as prudence, justice, fortitude and temperance. The scope and completeness of the moral values that are associated with integrity can be debated although the concept of integrity will more easily apply across borders and diverse cultures if the list of moral values is short and limited to widely accepted values such as honesty, truthfulness and fairness. However, where individuals espouse additional moral values then they must carry these through consistently in order to be seen as people of integrity.
- **Motives.** The self-integration and identity accounts of integrity highlight the importance of an individual's own motives which include desires, interests and ideals whilst the standing for something account and the moral purpose account of integrity emphasise the importance of motives that draw on a wider community perspective. In spite of different focuses, what is clear is that a person of integrity will be motivated by the desires, principles and ideals they believe in. This is likely to involve acting in the interest of others and for the general good, not self-interest and personal gain.
- **Commitments.** The identity account of integrity defines integrity in terms of commitments that an individual relates to most deeply. Individuals of integrity are true to their commitments in thoughts, words and deeds. Individuals who make commitments but have no intention of keeping them, cannot be described as having integrity. Similarly, individuals who pretend to be committed or fail to keep their commitments due to inconvenience are not likely to be described as people of integrity.
- **Qualities.** Different accounts of integrity emphasise different personal qualities. In order to have and demonstrate integrity, the self-integration and identity accounts of integrity require individuals to be rational and have a good self-knowledge and understanding of what motivates them. The moral purpose account emphasises the qualities of open-mindedness and adaptability, whilst the standing for something account refers to a person of integrity having recourse to qualities such as courage and perseverance in situations of adversity.

- **Achievements.** An individual who pursues their commitments may experience confrontation and adversity. Adversity can manifest itself in different forms such as a feeling of discomfort, being shunned by an employing organisation, financial loss or destruction of career. Achievements in the face of adversity are widely recognised as marks of a person of integrity.

In summary, an individual of integrity is guided by moral values and motives which are translated into commitments. Such an individual draws on qualities such as rationality and open-mindedness to assess what the right thing to do is from a wider community perspective. An individual's commitments in pursuit of doing the right thing are also likely to require personal qualities, including perseverance and courage, if they are to lead to the hard-won achievements expected of individuals of integrity.

Integrity is special because all its aspects need to be linked and aligned in a consistent manner to form a whole. In an individual of integrity everything is directed towards an end goal of doing the right thing from a wider community perspective. At a personal level, integrity requires congruence between 'an individual's observable sayings and doings and his inner views and feelings.'<sup>10</sup> Congruence between thoughts, feelings, words and actions may be easy to express, but it is difficult to put into practice, especially in countries or cultures where freedom of will and the opportunity to act responsibly are curtailed.

Integrity does not become optional when it is inconvenient or difficult or when no-one is looking. It requires belief and commitment rather than mere compliance with what is required or expected by other individuals or organisations. The alignment and consistency of all the aspects of integrity mean that it is strongly associated with overall strength of character, resilience, reliability and dependability that are proved over time and so inspire trust.

Having presented the working hypothesis that integrity has five key aspects, the remainder of this chapter presents in more detail the moral philosophical accounts on which this hypothesis is based.

### 2.3 Self-integration

The self-integration account of integrity has an intuitive appeal since it captures the root meaning of the term integrity, that is, the integration of parts into an intact whole. This self-integration view was initially described in 1971 by Harry Frankfurt in 'Freedom of the Will and the Concept of a Person'.<sup>11</sup>

Frankfurt proposes that a wholly integrated person brings into harmony various types of desires (wants) and effective desires referred to as volitions (wills or intentions). He states that 'it is these acts of ordering and of rejection – integration and separation – that create a self out of raw materials of inner life.'

Frankfurt distinguishes between first and second order desires. First order desires are when an individual wants 'to do or not to do such-and-such.' A second order desire is when an individual 'wants to have or not to have a certain desire of the first order'. For example, a first order desire may be to be honest. However, even if an individual does not want to be honest, he or she may have a second order desire to be a person who wants to be honest.

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<sup>10</sup> Albert Musschenga, 'Integrity – Personal, Moral and Professional', in Musschenga A. W., et al. (eds), *Personal and Moral Identity*, Dordrecht: Kluwer Academic Publishers, 2002.

<sup>11</sup> Harry Frankfurt, 'Freedom of Will and the Concept of a Person', *Journal of Philosophy*, LXVIII, Lancaster Press Inc., January 1971.

Not all of an individual's desires result in action. An effective first order desire is one that moves an individual to action, that is, a first order volition. In the example of honesty, a first order volition would be that an individual decides to act on their desire to be honest. A second order volition is one where the individual desires to have a first order volition. Second order volitions do not move an individual to action and thus are not distinguishing characteristics of a person who has integrity.

According to Frankfurt, an individual of integrity evaluates and prioritises their desires and volitions by referring to a hierarchy which endorses particular first order desires and volitions and rejects others. In order to discriminate between different levels of desires and volitions, an individual must have strong will power and self-knowledge. Thus, integrity requires endorsing particular 'first order desires and volitions'. If one simply acts at each moment out of the strongest current desire, with no deliberation or discrimination between more or less worthwhile desires, then one acts without integrity. Frankfurt calls an individual who is simply motivated by their strongest current desires as a 'wanton'.

Gabriele Taylor<sup>12</sup> broadly supports and expands further Frankfurt's self-integration account of integrity by suggesting that an individual's reasoning on the structure and hierarchy of desires and volitions is important to the definition of integrity. If the hierarchical structure is based on an individual's own values rather than another person's or group's values, then this individual is likely to have integrity.

In summary, the self-integration account of integrity recognises the importance for integrity of desires (wants), volitions (wills or intentions) and qualities. It also recognises the importance of commitments, that is, volitions (wills or intentions) that move an individual to action. Underlying this view of integrity is the assumption that a person has freedom of will and is able to act on their desires and volitions.

Whilst useful in capturing some elements of everyday usage, there are a number of weaknesses with the self-integration account of integrity:

- The account is based solely on an individual's desires and volitions without any constraints regarding what those motives should be. Although in everyday usage, individuals of integrity are usually thought of as being honest, truthful and fair in their dealings with others, these moral values are not captured in the self-integration account of integrity. According to this account, if an individual were acting on their first order desire of making a profit, they would be acting with integrity. However, surely a person who maximises profits by lying or misleading cannot be described as a person of integrity. Gabriele Taylor argues that integrity cannot be achieved without an individual possessing a firm grounding of moral values such as tolerance, altruism, trust, respect, empathy, fairness and justice.
- The self-integration account is based on an individual's own personal desires, volitions and commitments and does not recognise any obligation to do the right thing from a wider community perspective. This goes against the everyday meaning of the term integrity which seems to involve doing the right thing for the general good, regardless of self-interest and personal gain.
- Frankfurt focuses solely on personal obstacles to acting with integrity such as weakness of will, self-deception, lack of rationality and so on. Although such personal obstacles are relevant, there are also social threats and obstacles which make behaving with integrity difficult. For example, a person may be concerned that integrity will lead to them losing their job.

<sup>12</sup> Gabriele Taylor, *Pride, Shame and Guilt: Emotions of Self-assessment*, Oxford: Oxford University Press, 1985.

<sup>13</sup> Bernard Williams, 'A Critique of Utilitarianism', in J. J. C. Smart and B. A. O. Williams *Utilitarianism: For and Against*, Cambridge: Cambridge University Press, 1973.

## 2.4 Identity

The identity account of integrity was proposed by Bernard Williams<sup>13</sup> in 1973 in a critique of utilitarianism and all forms of morality based purely on an evaluation of the consequences of different courses of action. He argues that such consequentialism cannot accommodate the idea of integrity because it could require people to do virtually anything, including acts which they find repellent.

### Panel 2.1: Two dilemmas that illustrate integrity

In his critique of utilitarianism Bernard Williams discusses two situations:

- George, a chemist, is told of a job in a laboratory which researches chemical and biological warfare. George is opposed to chemical and biological warfare but there are strong family reasons why he needs a job and he learns that if he does not take this job it is likely to go to one of George's college contemporaries with no scruples who will push the research along with great zeal.
- Jim finds himself in a foreign town square with an army captain and his men and a random group of 20 local inhabitants who are about to be killed as a reprisal for protests against the government. Since Jim is seen as an honoured foreign guest, the captain offers him the opportunity to kill one of the prisoners and, if he accepts, the others will be let off. If Jim refuses, all 20 will be killed.

Williams uses these situations to explore the concept of integrity. Utilitarians would say that it is obvious that George should accept the job and that Jim should kill a prisoner. Yet the notion of integrity means that individuals should not be expected to set aside values that matter to them simply because of the interventions of other people, such as George's college contemporary or the army captain.

Williams defines integrity in terms of commitments that an individual identifies with most deeply, that is, 'ground projects' or 'identity conferring commitments'. The abandonment of one's commitments, for example as a result of some calculation of the consequences, will result in a loss of integrity. An identity conferring commitment, according to Williams, is 'the condition of my existence, in the sense that unless I am propelled forward by conatus of desire, project and interest, it is unclear why I should go on at all'.

Commitments are what an individual considers that their life is fundamentally about and reflect the deeper concerns and values of a person. If a person's commitments reflect another's values or beliefs rather than their own deeper concerns and values, then that person cannot be described as having integrity.

This perspective on integrity proposes that an individual acts in a way that reflects who they are. Integrity is a statement about who a person is – their motives and commitments – that is, their identity. If an individual acts from motives and commitments that are their own, they will be acting with integrity. The identity account proposes that a person of integrity will possess qualities such as strong will-power and self-knowledge which help them decide what is of importance to them. At times, they may also have to draw on other qualities, for example courage, in order to overcome personal obstacles such as weakness of will, inertia and hypocrisy.

Like the self-integration account of integrity, the identity account recognises the importance of motives, commitments and qualities. However, a number of criticisms can be made of the identity account of integrity:

<sup>14</sup> Damian Cox, Marguerite Lacaze and Michael P. Levine, 'Should we strive for integrity?', *The Journal of Value Inquiry*, 33, 1999, pp 519-530.

- The account focuses on an individual's own motives and commitments. Yet the term integrity is usually associated with society approved moral values such as honesty and truthfulness and doing the right thing from the community's point of view.
- The identity account of integrity does not recognise – according to Cox, Lacaze and Levine<sup>14</sup> – that integrity is a quality, state of affairs or virtue of some kind that is worth protecting and striving for. This is one reason why integrity is often associated with perseverance and having the courage to maintain a decision or course of action under conditions of adversity.
- Williams focuses on personal obstacles to acting with integrity such as self-deception rather than the wider social threats and obstacles which may prevent an individual from behaving with integrity including unpopularity, social exclusion, financial loss or damaged career prospects.
- The identity account places no restrictions on the kind of commitments or behaviour a person of integrity may display. Apparently, one might have integrity even though one's commitments are deemed by others to be immoral. According to this account of integrity, even though the consequences could be devastating, an individual of integrity can be committed to any principle, ideal or action provided that they act in accordance with their commitments.

## 2.5 Moral purpose

It is possible to follow critics of the identity account by saying that the concept of integrity itself is morally incomplete. For example, in his 1972 book *A Theory of Justice*, John Rawls states that the virtues of integrity – which he limits to truthfulness, sincerity, lucidity and authenticity – are necessary but not sufficient for constructing a complete moral view: 'a tyrant might display these attributes to a high degree.' According to Rawls, integrity needs to be joined to an appropriate conception of justice such as fairness. In his view fairness is not essential to integrity.

By contrast, Mark Halfon emphasises the moral element of integrity in his 1989 book *Integrity: A Philosophical Inquiry*.<sup>15</sup> According to Halfon: 'a person of integrity embraces a moral point of view that urges them to be conceptually clear, logically consistent, apprised of relevant empirical evidence, and careful about acknowledging as well as weighing relevant moral considerations. Persons of integrity impose these restrictions on themselves since they are concerned, not simply with taking any moral position, but with pursuing a commitment to do what is best.'

Halfon proposes that the motives and commitments of a person of integrity will be aligned to pursuing what is best from a moral point of view for the community as a whole. A person of integrity should consider all relevant moral considerations such as justice, insofar as they are relevant for doing what is right from a wider community perspective. In order to achieve this, a person of integrity should be open-minded and consider all information that is relevant and available.

He goes on to say that a person of integrity 'maintains a consistent commitment to do what is best – especially under conditions of adversity.' Halfon recognises that adversity may manifest itself in different ways. A person may face adversity from personal obstacles such as an individual's feelings, beliefs and attitudes whilst external social threats and obstacles may involve financial loss, social embarrassment and career damage. In order to overcome adversity and maintain their commitments, a person of integrity may have to draw on qualities such as courage.

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<sup>15</sup> Mark S. Halfon, *Integrity: A Philosophical Inquiry*, Philadelphia: Temple University Press, 1989.

Individuals who make a commitment but have no intention of keeping it, cannot be described as having integrity. Similarly, people who pretend to be committed or fail to keep their commitments due to inconvenience are not likely to be described as having integrity. Nevertheless, in pursuing a morally good life, a person of integrity may end up revising, re-evaluating or perhaps abandoning a commitment. Commitments can be re-evaluated but not as a result of moral compromise.

Halfon's moral purpose account of integrity recognises the moral dimension of integrity, as well as the importance of motives, commitments, qualities and achievements. However, some philosophers have criticised this view of integrity for being too narrowly focused on moral purpose. Whilst it is important to recognise the moral elements associated with integrity, concentrating on the pursuit of a morally good life and ignoring an individual's desires, interests and motives may detract from an individual's identity, undermining their integrity. For example, ignoring job or career aspirations or a personal desire for happiness may result in an individual who is not self-integrated and whole.

## 2.6 Standing for something

Cheshire Calhoun proposed in a 1995 article<sup>16</sup> that integrity required individuals to know and stand up for what they believe in. People of integrity will remain steadfast to their commitments, will overcome obstacles and devote their whole lives to those commitments, thereby defining their identity. Their behaviour will be based on their best judgement regarding what is of value and worth doing, taking into account the needs of the wider community.

Unlike the self-integration and identity accounts of integrity, the standing for something account suggests that an individual of integrity must consider the implications for their community when making a judgement about a matter. Individuals of integrity may experience difficulties or confrontation generated from personal or social threats and obstacles. Such threats and obstacles may include personal obstacles of self-deception, irrationality or weakness of will as well as social obstacles such as loss of job and adverse effects on relationships.

Calhoun recognises that an individual of integrity may have recourse to qualities such as courage, loyalty, respect and humility in order to accomplish their aims and triumph over adversity. An individual of integrity, although autonomous, will respect the judgement of others and be open minded.

The standing for something account highlights a number of ideas which are linked with the everyday meaning of the term integrity:

- an individual's motives for acting with integrity will be based on judgements about what is best for the community rather one's own motivations;
- integrity is explicitly associated with something worth striving for and standing up for; and
- a person of integrity will need to draw on qualities such as courage and perseverance to overcome personal and other threats or obstacles imposed by society.

One limitation of Calhoun's account of integrity is that it places no restrictions on the kinds of ideals or behaviour a person of integrity may stand up for. On this account, although a person of integrity is concerned with what in life is worth doing from society's point of view, that person's behaviour is not constrained by moral values. As we have seen, philosophers such as Mark Halfon would argue that it is necessary that a person of integrity should be concerned with acting morally.

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<sup>16</sup> Cheshire Calhoun, 'Standing for Something', *Journal of Philosophy* XCII, No. 5, May 1995.

## Panel 2.2: Summary of the argument

- We have developed a working hypothesis that there are five key aspects of integrity:
  - moral values;
  - motives;
  - commitments;
  - qualities; and
  - achievements
- An individual of integrity is guided by moral values and motives which are translated into commitments. Such an individual draws on qualities such as rationality and open-mindedness to assess what the right thing to do is from a wider community perspective. An individual's commitments in pursuit of doing the right thing are also likely to require personal qualities, including perseverance and courage, if they are to lead to the hard-won achievements expected of individuals of integrity.
- For a person to have integrity, their moral values, motives, commitments, qualities and achievements need to be consistent, aligned and interconnected.

## 2.7 Questions for discussion

4. This report proposes that integrity has five key aspects:

- moral values;
- motives;
- commitments;
- qualities; and
- achievements.

Are the proposed key aspects of integrity appropriate, comprehensive and internally consistent? If not, why not and should any other aspects be included?

5. Are the moral values of truthfulness, honesty and fairness essential to integrity and are there any other such moral values?
6. The analysis of the concept of integrity presented in this report draws on a range of accounts from modern moral philosophy in the English language. What additional insights might be obtained from a broader historical survey of different cultures and religions?

## 3. Behaving with integrity

Integrity is a quality that is most readily studied at an individual, personal level. It describes an individual's character and behaviour. For a person to have integrity, their moral values, motives, commitments, qualities and achievements need to be consistent, aligned and interconnected. Congruence must exist between an individual's observable words and deeds and their inner views and feelings. This wholeness or congruence may be easy to express, but it is difficult to put into practice since many disparate factors influence behaviour.

The behaviour of individuals affects the effectiveness of processes such as reporting, the reputation and performance of organisations and overall economic activity. Hence, identifying behavioural traits which are associated with integrity is useful since it helps individuals and organisations know what might be expected of them and what they should be aiming for. This chapter considers factors that influence behaviour and analyses the behavioural characteristics that are associated with integrity. But first we look at the moral development of individuals. Integrity is not something that people are born with. Some achieve it whilst in others it develops to varying degrees.

### 3.1 Kohlberg's theory of moral reasoning and development

Lawrence Kohlberg's well-known and much discussed theory of moral reasoning and development<sup>17</sup> is summarised in Appendix 2. Kohlberg's original research was based on the responses of white American boys between the ages of 10 and 16 to questions exploring moral concepts and attitudes to situations involving moral choice and conflict. The manner in which an individual arrived at a response was relevant rather than whether the response was right or wrong.

In Kohlberg's view, there are six stages of moral development which can be classified into three levels: pre-conventional, conventional and post-conventional. These stages describe individuals' understanding of what is right, the rationale for doing the right thing and the social perspective behind each stage.

- **The pre-conventional moral level** is the level of most children under nine years of age, some adolescents and many adolescent and adult criminal offenders. The individual at this level does not understand and uphold conventional or societal rules and expectations. In stage 1, an individual's moral development is shaped by obeying authority and avoiding punishment. At this stage, individuals do the right thing because it is the law or required by an authority. Reasons for doing the right thing are framed in terms of consequences (i.e. punishment) rather than moral values. In stage 2, individuals recognise that there are different sides to an issue and there is no single authority. At the pre-conventional level, doing the right thing is seen from an individual's perspective rather than from that of a member of the community. Doing the right thing involves exchanging favours in order to satisfy one's own needs. At this level, the individual does not identify himself or herself with society's rules and expectations.
- **The conventional moral level** is the level of most adolescents and adults. Individuals at this level, uphold conventional rules and expectations of society or authority. In stages 3 and 4, individuals recognise that they are members of society and therefore abide by society's values, norms and expectations. In stage 3, doing the right thing involves conforming with society's values, norms and expectations such as love, trust and empathy by reference to family and close friends. In stage 4, doing the right thing involves obeying laws, respecting authority and maintaining the social order since

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<sup>17</sup> Lawrence Kohlberg, 'The psychology of moral development: the nature and validity of moral stages', *Essays on moral development*; volume 2, San Francisco: Harper & Row, 1984.

society is important to individuals at this stage. At the conventional level, doing the right thing involves compliance with society's rules and expectations just because they are society's norms.

- **The post-conventional moral level** is reached by a minority of adults and is usually reached only after the age of 20. At this level, individuals understand and accept society's rules and expectations, but acceptance of these norms is based on an understanding of the moral principles that underlie them. In stages 5 and 6, individuals are less concerned with maintaining society for its own sake, but more concerned with the principles and values that make for a good society. In stage 5, doing the right thing comes out of a sense of mutual obligation and the public good, which may involve overriding certain laws. In stage 6, an individual's moral reasoning is guided by universal principles which bring justice and equality to all individuals. A commitment to justice may involve civil disobedience. At the post-conventional level, doing the right thing may involve conflict with society's rules and expectations since the individual judges by principle rather than convention.

Kohlberg proposes that everyone passes through the stages of moral development in a pre-determined sequence. Thus, an individual cannot 'jump' stages. For example, an individual cannot jump from stage 1 which is concerned with obeying authority and avoiding punishment to stage 3 which is mostly concerned with the opinions of peers.

Levels of moral development can be seen as indicative of levels of integrity, particularly if integrity is seen as embracing moral values and motives which translate into commitments, personal qualities and hard-won achievements. Thus, only individuals at the post-conventional level who are prepared to challenge social norms in the interests of universal moral principles are likely to be perceived as having integrity. Individuals at the pre-conventional level base their moral reasoning on an individual perspective taking into account obedience, punishment and the exchange of favours. Individuals at this level do not appreciate that they are members of society and have yet to understand the need to uphold socially shared moral values, standards, rules and expectations. Those at the conventional level understand that they are members of society and generally accept society's values, standards, rules and expectations. Acceptance is based on maintaining society's functioning.

In the post-conventional level, acceptance of society's values, standards, rules and expectations is based on universal principles such as justice and equality for all individuals. Acting on such universal principles may, at times, involve going against society's rules, values and expectations if, for example, laws and regulations are unjust. According to Kohlberg, few individuals reach stage 6 of moral development. Examples of individuals he would include in stage 6 of moral development are Socrates, Abraham Lincoln and Martin Luther King. These individuals, argued Kohlberg, demonstrate the principled and autonomous thinking which represents the pinnacle of development in moral thought.

A number of criticisms have been made of Kohlberg's theory.

- The scope of Kohlberg's moral domain has been debated. Carol Gilligan<sup>18</sup> distinguishes between the morality of justice espoused by Kohlberg and the morality of care she proposes as an alternative. Gilligan's theory recognises that morality is tied closely with the welfare of others, a feeling of responsibility, an obligation or duty of care and ongoing relationships and communications with other parties. Turiel<sup>19</sup> criticised Kohlberg for mixing up morality and convention. For Turiel, convention provides the core rules and social regulations for society which may be unrelated to universal principles such as justice. If this is the case, perhaps conventional rules should be excluded from the moral domain.

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<sup>18</sup> Carol Gilligan, *In a Different Voice: Psychological Theory and Women's Development*, Cambridge, Mass.: Harvard University Press, 1982.

- Kohlberg's moral reasoning is based on Western values and beliefs and therefore does not take into account different cultures. By comparing American and Indian cultures, Shweder, Mahapatra and Miller<sup>20</sup> proposed that moral reasoning is closely linked to cultural differences and that people from different cultures build different views of the world, including different moral realities. Based on their research, they concluded that in India social convention transgressions, as envisaged in stages 5 and 6, were more serious than moral transgressions.
- Some psychologists have challenged Kohlberg's assumptions about the nature of moral behaviour. The philosopher, Kleinberger,<sup>21</sup> explains this by identifying different types of theory which explore the relationship between moral reasoning, judgement and action. There is rational ethical theory, of the type supported by Kohlberg, which sees moral reasoning as necessary and sufficient for moral action. By contrast, the naturalist type of theory emphasises the importance of responsibility as a pre-cursor for moral action so that moral reasoning is necessary but not sufficient for moral action.
- Kohlberg's model can be seen as inadequate in its depiction of the role of law in forming moral reasoning and development. The role of the law is at the lower end of the scale in its contribution to integrity, that is, stage 1, the morality of obedience or at best stage 4, the morality of the law and duty to the social order. The model suggests that individuals need to move to stages 5 and 6 and challenge society's laws and rules. However, this may be a dangerous course of action to suggest since it may encourage individuals to place their own principles above society's and the law.

In spite of criticisms, Kohlberg's theory provides helpful insights into the development of moral thought and judgement. It also provides a basis for seeing integrity as a high point in moral development associated with acting in the interests of the wider community as well as being courageous and daring.

### 3.2 Behavioural influences and characteristics

As depicted in Figure 3.1, there are numerous personal, social, organisational and environmental influences on a person's behaviour. Behaviour is influenced by personal factors such as age, gender, abilities, education and nationality, as well as social factors such as friends, colleagues, family, religion and culture. Individuals' behaviour is also influenced by organisations they work for or belong to, as well as the sociological, economic, political, legal and professional influences that define the environment for their behaviour. These influences affect how people form the judgements and make the decisions that are reflected in their behaviour and, potentially, in achievements that evidence their integrity.

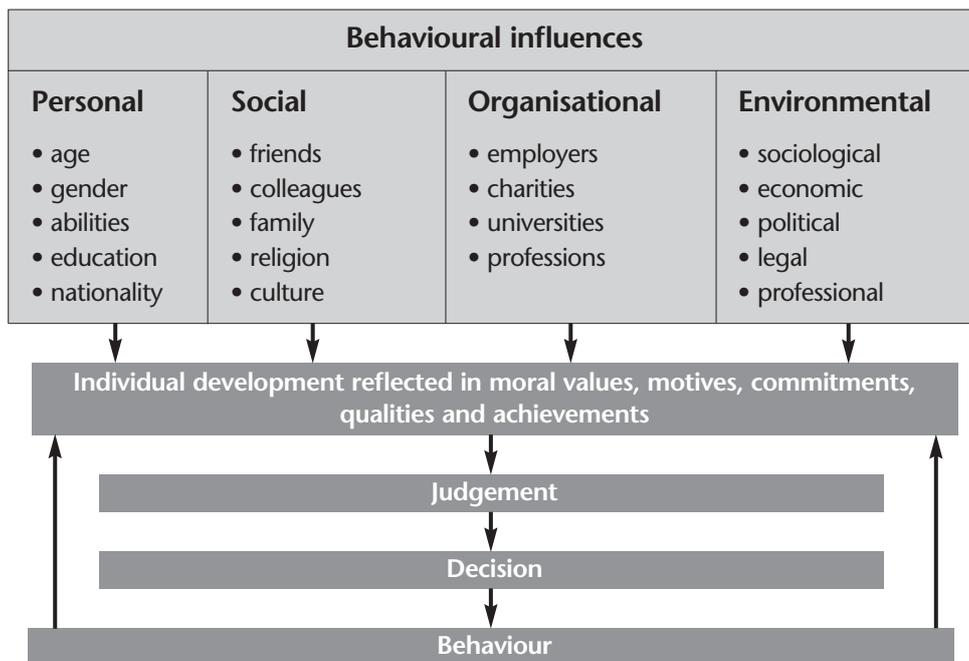
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<sup>19</sup> Elliot Turiel, *The development of social knowledge: morality and convention*, Cambridge: Cambridge University Press, 1983.

<sup>20</sup> R. A. Shweder, M. Mahapatra and J. Miller, 'Culture and moral development' in J. Kagan and S. Lamb (eds.) *The emergence of morality in young children*, Chicago: University of Chicago Press, 1987, pp 1-90.

<sup>21</sup> A. F. Kleinberger, 'The proper object of moral judgment and of moral education', *Journal of Moral Education*, 11, 1982, pp 147-158.

**Figure 3.1: Determinants of behaviour**



Some behavioural influences will help a person of integrity to do the right thing and others will be hindrances. A person of integrity may have to push against personal, social, organisational and environmental influences in order to develop as an individual who is capable of demonstrating integrity. For example, an individual may have to leave an organisation which lacks integrity, even if in doing so, this causes financial distress to their family. Thus, behaving with integrity requires an ability to filter and prioritise influences in order to do the right thing. Integrity is a fundamental principle that shapes an individual’s development and that guides their judgements, decisions and behaviour.

Whilst it is helpful to list characteristics of behaviour which are usually linked to integrity, there is always ambiguity when evaluating whether or not an individual has integrity. There are a number of reasons for this:

- Integrity is not something that is generally self-assessed and yet an assessment of another person’s integrity requires knowledge not only of their behaviour but also of the person’s moral values, motives, commitments, qualities and achievements. An observer will often not possess this knowledge and, even when they do, such knowledge is likely to be uncertain and incomplete and may have to rely on the explanations of the individual who is being assessed.
- An observer’s own beliefs and expectations may influence their evaluation of how a person of integrity ought to behave. An assessment of someone’s integrity is reliant not only on the assessor’s personal characteristics. Social, organisational and environmental influences are also important. Behaviour in some cultures that would be seen as showing integrity may in other cultures be seen as betraying a lack of integrity. For example, in some cultures, challenging and questioning managers more senior than oneself on areas of concern is likely to be interpreted as behaviour which lacks integrity. In other cultures, challenging and questioning behaviour in such circumstances is likely to be associated with integrity. Hence, the range of influences illustrated in Figure 3.1 is important not only in determining behaviour but also when trying to assess whether a person is acting with integrity.

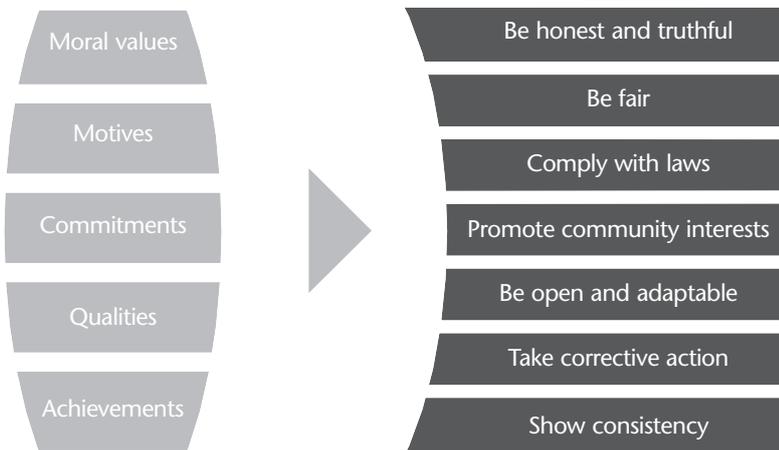
Turning to the behavioural characteristics typically associated with integrity, this report proposes that a person of integrity will be likely to:

- be honest and truthful;
- be fair;
- comply with laws;
- promote community interests;
- be open and adaptable;
- take corrective action; and
- show consistency.

These behavioural characteristics are described in sections 3.3 to 3.9 and represented in Figure 3.2. They often involve tensions and it is also important to note that the typical characteristics exhibited by people of integrity assume that the individual is living in a social and political environment which supports basic civil rights and freedoms. If such conditions do not exist, behaving with integrity may be very difficult if not impossible. This should not necessarily reflect adversely on the individual concerned; it is merely a reflection of the social and political limitations imposed by the society the individual lives in.

Motives and context are important when assessing a person’s integrity and help to explain tensions between the behavioural characteristics associated with integrity. In most circumstances, people of integrity are likely to comply with laws. However, as we noted in section 3.1, people of integrity may also be distinguished by their principled willingness to break the law in circumstances of extreme injustice. Consistency is also a challenging characteristic of integrity. Some would argue that consistency requires that a person of integrity should demonstrate integrity across all of their personal, social and professional roles and activities. Yet there are numerous examples of individuals who are described as persons of integrity in respect of their public or professional life without making any reference to their personal life. This is discussed further in section 3.9.

**Figure 3.2: Behavioural characteristics of integrity**



### 3.3 Honesty and truthfulness

Key behavioural characteristics that are always linked to integrity are honesty and truthfulness. Society expects a person of integrity not to lie, cheat or mislead and to be sincere. Lying, for example in a negotiation such as the purchase or sale of a house, is not likely to be associated with the actions of a person of integrity. In such situations, the main justification for lying is likely to be the overriding pursuit of self-interest and personal gain which is not a characteristic of a person of integrity.

Sometimes people associate honesty and truthfulness with full disclosure and telling someone all you know. This is not necessarily the case. A distinction needs to be made between honesty on the one hand and full disclosure and transparency on the other. Individuals can be completely honest but not tell everything they know since it is not pertinent or appropriate to a particular situation. For example, it is common practice in business situations for individuals not to disclose everything, yet still be regarded as individuals of integrity. However, are there circumstances in which it is acceptable for a person of integrity to lie?

Some people argue that any lying is totally unacceptable for individuals of integrity. This is based on the premise that it is the little things that matter. Little lies, no matter how insignificant, are likely to lead to bigger lies with potentially serious consequences. Whilst this may be true in some circumstances, this line of thought ignores an individual's motives for lying. For example, would a person's integrity be undermined if an individual lied about their availability to attend a social function that they did not think they would enjoy in order to protect somebody else's feelings?

Lying may also be more acceptable in unjust situations, for example where the life of another person is at stake. It may be morally right for individuals not to be truthful regarding certain matters if disclosure would result in harming or hurting others. For example, an individual may feel they have to lie in order to save the lives of others. Whilst still assessing such a person as having integrity because they are trying to do the right thing, one might hesitate to call them honest or dishonest. However, it should also be recognised that a supporter of the identity view of integrity might dismiss attempts to use consequences to justify not telling the truth.

### 3.4 Fairness

Another behavioural characteristic which is generally linked to individuals of integrity is fairness. Fairness usually refers to ideas of justice, equality, morality and goodness. However, there are various ways of assessing fairness.

Fairness may be assessed in terms of costs and benefits to the community. If this utilitarian or consequentialist approach is adopted, a fair outcome would involve maximising the greatest good for the greatest number or the greatest net good, although as has been seen, some people believe that such reasoning undermines the very idea of integrity.

By contrast, a deontological view sees fairness as being based on duties or rights rather than maximising the net good. The deontological approach to fairness involves acting according to rights and duties. Because of the perception that behaviour with integrity goes beyond adherence to laws, the rights and duties involved should not be equated solely with legal rights and duties.

Under either a utilitarian or deontological view, fairness may also involve treating individuals unequally if such action reflects an individual's efforts or makes a disadvantaged individual in society better off. Whichever approach to fairness an individual adopts, fairness involves managing conflict and not acting solely out of self-interest or for personal gain. For this reason, fairness seems to be an important behavioural characteristic of people of integrity.

### 3.5 Compliance with laws

Society generally expects people of integrity to comply with legislation, regulations and standards ('laws'). Laws set out rules, rights and responsibilities of individuals and provide boundaries which guide behaviour. In general, the content of laws should reflect the principles society wants individuals to live by. However, as discussed in section 3.1, Kohlberg's theory of moral reasoning and development suggests that compliance with laws is just a starting point for people of integrity. Integrity requires a personal belief and commitment which precludes unthinking adherence to laws.

In extreme situations, a person of integrity may decide that acting in accordance with laws, for example the former apartheid laws, is not appropriate. Hence, an individual may feel that he or she has to break laws to do the right thing and act in accordance with their beliefs and the interests of the wider community. In other situations, an individual of integrity may have reservations about laws whilst being prepared to accept that there is a wider benefit in complying with them.

By proposing that critical and thinking compliance with laws is a behavioural characteristic of integrity, it is possible to avoid extreme positions of relativism or absolutism whereby integrity becomes either morally empty and compatible with any regime or so morally uncompromising that anarchy prevails. People of integrity are people of their societies and times but they also need to be able to see beyond them.

### 3.6 Promoting community interests

Individuals of integrity are associated with making decisions and acting in the interests of others. There is much debate regarding concepts such as the public interest, particularly on the range of interests and issues which might be considered. For some, promoting community interests means having regard to how decisions and actions affect the welfare of the community. This consideration may be based on any or all of the following: customers, suppliers, investors, the financial and business community, regulators, the government and the public at large.

Whatever interpretation is adopted, acting with integrity involves taking into account the interests of others and not simply acting out of self-interest and for personal gain. In business this will generally mean being sensitive to conflicts of interest and fiduciary duties, not causing direct harm to others and avoiding contrivances that exploit legal loopholes.<sup>22</sup> It is also likely to involve complying with legislation, regulations and standards set by society, but it may not. Motives and context are of particular importance when trying to assess whether a person is acting with integrity.

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<sup>22</sup> These issues are highlighted in the questions and checklists in Avinash D. Persaud and John Plender, *Ethics and Finance: Finding a moral compass in business today*, London: Longtail Publishing, 2007.

### 3.7 Openness and adaptability

A person of integrity will try to overcome prejudice and unconscious sources of bias in their search for the truth or the best course of action. This requires openness and adaptability. A person of integrity is expected to be willing to change their thinking and actions based on new or conflicting information. Being open and adaptable will sometimes require a person of integrity to admit mistakes and take corrective action.

Some may argue that being open and adaptable conflicts directly with the behavioural characteristics of consistency and predictability associated with integrity. There are two reasons why this is not necessarily the case:

- The behavioural characteristic of consistency is highly context sensitive and depends on the circumstances at the time. A person of integrity generally strives to be consistent in similar circumstances at different times but even similar circumstances may differ in important respects or may be seen differently over time.
- The reasons for a person changing their mind, being adaptable and perhaps compromising are important for assessing whether or not a person has acted with integrity. Mark Halfon suggests that a person of integrity may end up compromising by revising, re-evaluating or perhaps abandoning a commitment if such a commitment is seen to be wrong. Reasons for compromise include the need to take account of new evidence but not the abandonment of moral values.

What is important is that any compromise should be part of a strategy for attaining the end goal of doing the right thing from a wider community perspective. What makes a compromise acceptable are the reasons for it and the consequences. For example, if a public official makes a financial concession during a negotiation, this is unlikely to be seen as evidence of lack of integrity. However, if the concession takes the form of accepting a bribe, this is clear evidence of corruption and a lack of integrity. The key difference between the two is that a bribe involves a moral concession in pursuit of self-interest which undermines public trust. Such moral compromises are not acceptable in individuals purporting to behave with integrity.

### 3.8 Taking corrective action

An individual of integrity will try to do the right thing by considering all relevant available information, particularly moral values. At times, it is easy to identify what the right decision is. However, in many situations, doing the right thing is far from clear. Most issues can be seen in shades of grey rather than black and white. Doing the right thing requires reflection, asking questions, thinking about who is affected and considering the short and long-term consequences of decisions and actions.

While there may be guidance, frameworks and key questions which help individuals determine the right course of action, at times individuals will make mistakes because of misjudgement, misunderstanding, inadequate information and human error. Recognising that people of integrity can make mistakes, and accepting the other behavioural traits associated with integrity such as honesty, openness and adaptability, it follows that such individuals must be willing to admit that they were wrong and have made a mistake. This will cause them to take corrective action that may include re-evaluating their commitments. Whilst integrity accommodates making mistakes, it does not accommodate recognising a mistake and not trying to rectify it.

### 3.9 Showing consistency

A person of integrity is normally associated with consistent, credible and predictable patterns of behaviour. These invite trust from others and are important for helping a person of integrity achieve their commitments, which is a key element of integrity. In order for people of integrity to make and maintain their commitments, they will have to demonstrate perseverance and consistent behaviour to achieve their goals. This philosophical view espoused by Mark Halfon is also supported by the theologian, James M. Gustafson. According to Gustafson, consistency and predictability are crucial to integrity since 'if in similar circumstances he always did different things, the word integrity would not come to mind as appropriate'.<sup>23</sup>

However, for consistent behaviour to be a true measure of behaviour with integrity, the behaviour needs to be credible. Whether or not behaviour is credible and is that of a person of integrity will depend in the first instance on the judgements, beliefs and expectations of individuals assessing a person's integrity. A key influence on descriptions of behaving with integrity is whether such behaviour fits in with society's beliefs, expectations and judgements of the behaviour ordinarily associated with individuals of integrity.

Credibility will also be enhanced when others believe that there is consistency between a person's beliefs and actions. For consistent behaviour to be indicative of a person of integrity, it needs to be related back to the five aspects of integrity proposed in Chapter 2: moral values, motives, commitments, qualities and achievements. For an individual to behave with integrity there must be congruence between what they think, say and do. Simply doing what others think and say is not enough. This view is also echoed in popular management literature such as *The Seven Habits of Highly Effective People*.<sup>24</sup> In this book, Stephen Covey describes 'inside-out congruence' as 'living a life of integrity in which our daily habits reflect our deepest values.' There is nothing hidden – what you see is what you get.

Musschenga in *Integrity – Personal, Moral and Professional* identifies manifestations of integrity, which include congruence, consistency and coherence. He describes consistency as consistency of behaviour between similar situations at different times. He also identifies coherence between the various domains and roles in a person's life as another dimension of behaviour with integrity.

Yet every day we see examples of people who demonstrate integrity in one role or area of their life and not in another. For example, some individuals are admired for their integrity in public roles but not necessarily for their private lives. How can an individual be described as having integrity in one area of their life but not in another?

Musschenga points out that it is psychologically possible for people to be consistently honest in a public role but dishonest in their private life. Alasdair MacIntyre in 'Social Structures and their Threat to Moral Agency'<sup>25</sup> states that people have a tendency to compartmentalise themselves according to roles or spheres of personal, professional and social activities. Whilst individuals constantly move from one sphere of activity to another, each sphere of activity is relatively autonomous from others and has its own norms and values. When people make an assessment of a person's integrity, they usually do so in a particular context. Take an example of a professional accountant and their client. From the client's perspective, they are likely to be more interested in the accountant's integrity in their professional life as opposed to integrity in their personal life since this is more pertinent to their relationship with the professional accountant.

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<sup>23</sup> Quoted in Stephen L. Carter, *Integrity*, New York: Basic Books, 1996.

<sup>24</sup> Stephen R. Covey, *Seven Habits of Highly Effective People: Restoring the Character Ethic*, London: Simon & Schuster, 1992.

<sup>25</sup> Alasdair MacIntyre, 'Social Structures and their Threats to Moral Agency', *Journal of Philosophy*, 74, 1999.

Thus, although consistency is an important behavioural trait associated with integrity, it is a matter of debate whether integrity is required in all roles and activities of a person's life. Perhaps the real issue is not whether a person acts with integrity in all their personal, business and social activities but whether a person is perceived to be hypocritical by claiming to pursue their espoused principles, ideals and commitments in areas of activity where this is not true. A case in point may be the British Government's 1993 Back to Basics campaign which emphasised family values but was undermined by allegations of sleaze and instances of ministers having extra-marital affairs.

However, whilst it may still be possible for people to be described as having integrity on the basis of their behaviour in one sphere of activity, increasing debate around the private lives of public figures may eventually limit this. Perhaps, in the future, a person will have to behave with integrity in all areas of life in order to be described as a person of integrity.

### **Panel 3.1: Summary of the argument**

- The report proposes that a person of integrity will be likely to:
  - be honest and truthful;
  - be fair;
  - comply with laws;
  - promote community interests;
  - be open and adaptable;
  - take corrective action; and
  - show consistency.
- Consistency is a particularly challenging behavioural characteristic of integrity given the ability of people to compartmentalise different areas of their life.
- Whilst it is helpful to list characteristics of behaviour which are usually linked to integrity, there is always ambiguity when evaluating whether or not an individual has integrity. Judgements about an individual's integrity are made by another person who has limited knowledge of that individual and who is affected by social, organisational and environmental influences as well as their own perceptions of what constitutes behaving with integrity.

### **3.10 Questions for discussion**

7. This report proposes that a person of integrity will be likely to:

- be honest and truthful;
- be fair;
- comply with laws;
- promote community interests;
- be open and adaptable;
- take corrective action; and
- show consistency.

Are these proposed behavioural characteristics of a person of integrity and the analyses of the tensions they raise appropriate? If not, why not?

8. Should a person be described as having integrity if they show integrity in their business or professional life but not in their private life and if not, why not?
9. Are there any additional aspects of evaluating individuals' integrity which are not covered by this report but which merit further discussion or research?

## 4. How organisations demonstrate integrity

Integrity is a quality that is ascribed to individuals and their behaviour. In previous chapters we have also observed that the organisations individuals work for, or belong to, can influence their development and behaviour. For example, people may find that in order to maintain their own integrity they need to leave organisations at some personal cost to themselves and others.

Integrity is also applied directly to organisations and their behaviour. Today many stakeholders look for high standards of integrity in organisations they deal with. An increasing number of customers, investors and employees are not only interested in the products, services and jobs that organisations provide, but also in the behaviour and reputation of the organisations themselves. Management is interested in enhancing organisational integrity rather than simply pursuing organisational self-interest within the constraints of the law. An organisation's good reputation may lead to a reduction in the cost of capital and other costs of doing business and increase the choice of investment and other resources available to it.

It is also very much in the public interest for organisations to have integrity. Chapter 1 highlighted the importance of integrity in establishing trust and developing markets. It is far more efficient if people can trust others because they trust the organisations they work for, instead of having to assess the integrity of every individual they come across in business.

However, although it is in everybody's interests for organisations to be known for their integrity, the fact that organisations are comprised of many individuals and groups makes this a real challenge. The purpose of this chapter is to consider how to build organisational integrity by taking the analysis of integrity developed in previous chapters of this report for individuals, applying it to organisations and developing it.

### 4.1 Organisational integrity

The analysis of integrity presented so far has been based on philosophical accounts of the concept of integrity as applied to individuals and psychological accounts of individuals' moral development, thought processes and behaviour. How can this analysis be adapted to an organisation made up of many individuals?

Applying the five aspects of integrity implies that an organisation will be seen as an organisation of integrity if there is a consistency between the:

- **moral values** the organisation espouses;
- **motives** that drive the organisation's actions;
- **commitments** the organisation makes and is publicly accountable for achieving;
- **qualities** that the organisation encourages and demonstrates; and
- **achievements** that make up the organisation's track record, including particular examples of triumphs over adversity which are celebrated within the organisation.

Integrity is a fundamental principle that promotes wholeness and consistency. This is challenging for an individual with a conscience who is able to reflect and develop their own sense of identity. It is even more difficult for an organisation. Building an organisation with integrity is not simply a question of assembling a group of people who individually have integrity. Establishing integrity in an organisation is difficult because it

calls for joined-up thinking by a collection of individuals. Those individuals are driven by different beliefs, values and motives, they come from different backgrounds, they work in different departments, they are involved in different processes and activities and they are responsible for attaining different goals.

Whilst organisations can and do publicly declare themselves to be committed to integrity in a way that is rare in individuals, this is not enough. The integrity of an organisation like that of an individual will be judged largely on the basis of how it behaves and on whether it is seen to be honest and truthful, to be fair, to comply with laws, to promote community interests, to be open and adaptable, to take corrective action and to show consistency.

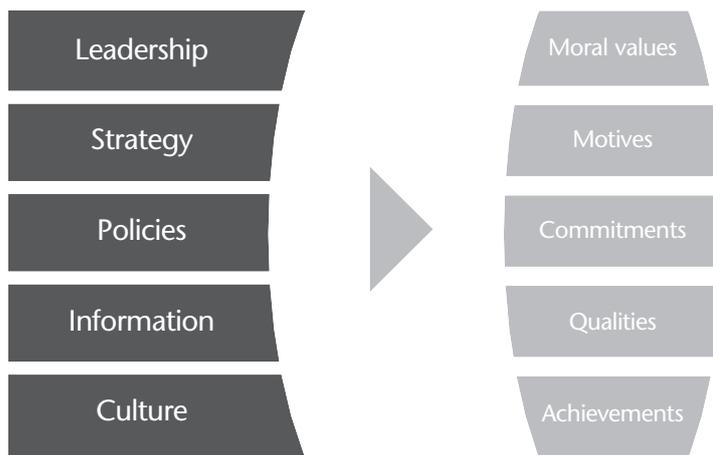
To achieve this, an organisation needs a robust framework that provides ownership and a common view of the organisation's moral values, motives, commitments, qualities and achievements. The existence of such a framework will promote consistency and concern for the integrity of the organisation and help an organisation to demonstrate integrity in both words and deeds. If mechanisms are not consciously established in an organisation to promote, reinforce and support integrity, there is a risk that organisational practices and conventions will arise which undermine integrity and may ultimately result in its antithesis in the form of corruption. The existence of formal mechanisms to promote integrity can restrain the pursuit of self-interest and act as a deterrent to the spread of corruption.

Based on a review of business ethics literature, this report proposes five drivers of organisational integrity:

- **leadership** embeds integrity into the organisation by setting the 'tone at the top', establishing and managing operational practices and articulating the organisation's moral values, motives, commitments, qualities and achievements;
- **strategy** provides direction to the organisation by clearly translating the organisation's moral values and motives into goals and actions which reflect the organisation's commitment to integrity;
- **policies** supplemented by procedures promote, reinforce and support the key elements of integrity;
- **information** articulates and is used to monitor the organisation's commitment to integrity; and
- **culture** celebrates integrity and encourages the openness, accountability and transparency that would expose failures of integrity.

The framework illustrated in Figure 4.1 shows the five drivers of organisational integrity, as well as the five key aspects of integrity. It reflects a working hypothesis of how to overcome the apparent problem of trying to promote organisational integrity when it is clear that the people in any organisation will have varying levels of individual integrity and different views on what behavioural characteristics are associated with integrity. The framework offers a way for organisations to translate their commitment to integrity down to individuals and enable them to feel comfortable about decisions and actions they take since they know what the organisation believes in and is committed to.

**Figure 4.1: Drivers of organisational integrity**



If any of the drivers of integrity is missing or if any part of the business is out of line with the rest, individuals will be confused about the organisation's views and its commitment to integrity. The drivers need to be interconnected with each other, mutually reinforcing and effective throughout the business. This requires determined and energetic management. Failure of one driver or in one area can undermine the integrity of an entire organisation. And simply having a code of conduct which values honesty, as in the case of in Enron, is not adequate for the purpose of sustaining organisational integrity. Where there is a perceived lack of integrity in an organisation's leadership, strategy, policies, information or culture, then cynicism can take hold and corrupt the entire organisation.

#### **Panel 4.1: Enron's code of conduct**

Enron's 64 page Code of Conduct of Business Affairs was distributed to all employees along with an introductory letter from the Chairman noting the 'moral and honest manner' in which the energy firm's business affairs should be conducted. Enron's Code included values such as respect, integrity, communication and excellence. However, having a code of conduct did not prevent the board of directors from approving the setting up of partnerships which were used to undertake a significant number of transactions to remove losses and liabilities from the financial statements. Furthermore, some of Enron's executives such as Andrew Fastow (Chief Financial Officer) were involved in self-enriching transactions which were in direct contravention of Enron's Code of Conduct of Business Affairs and its provisions on related-party transactions.

The remaining sections of this chapter look in turn at each of the drivers of organisational integrity and provide examples of what might be done in practice. Although the drivers are relevant to organisations of all sizes and in all sectors, it is clear that there are no one-size-fits-all answers and that managers need to exercise judgement in deciding what will be effective in their organisation.

## 4.2 Leadership

Organisations frequently make commitments to integrity, moral values and standards of behaviour. These commitments are generally communicated in codes of conduct, policies and procedures, financial statements, press releases and other publicity material. However, such commitments are most readily exposed as lacking substance when they are not translated into the operations of the organisation by its leaders.

Leadership is of central importance to achieving and demonstrating organisational integrity. Directors and top management should lead by example and practice what they preach. Ethical breaches should be acted on and integrity should not be compromised in the face of short-term commercial and operational pressures. Leaders should also demonstrate the behavioural characteristics associated with integrity identified in Chapter 3 such as honesty and truthfulness, fairness and compliance with laws.

Leaders are in a prime position to instil integrity in an organisation by influencing the organisation's vision, strategy, objectives, structure, policies, procedures, decision-making and communication. The corporate governance practices of an organisation should also reinforce its commitment to integrity. Corporate governance refers to the framework by which organisations are directed and controlled and is concerned with relationships and responsibilities between the board, management, shareholders and other stakeholders. It provides the means for setting, monitoring and achieving corporate objectives and performance.

Corporate governance pioneers, such as the Committee on the Financial Aspects of Corporate Governance which produced the 1992 Cadbury Report<sup>26</sup> have always emphasised the importance of integrity in organisations and the application of high ethical standards. According to Cadbury, 'it is important that all employees should know what standards of conduct are expected of them. We regard it as good practice for boards of directors to draw up codes of ethics or statements of business practice and to publish them both internally and externally.'

During the last decade or so, corporate governance practice has developed and contributed to increased confidence in the integrity of corporate leaders through the establishment of governance frameworks covering:

- composition, recruitment and appointment of board members;
- roles and responsibilities of the board;
- remuneration and performance reviews of the board;
- relationships and communications with shareholders;
- voting practices;
- disclosure requirements and transparency;
- risk management strategies and internal control; and
- audit and auditor independence.

However, although organisational integrity is impossible without leadership support, much more is involved. Even well-intentioned and charismatic leaders of great personal integrity need to make sure that their organisation has the strategy, policies, information and culture to sustain a reputation for integrity.

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<sup>26</sup> The Report of the Committee on the Financial Aspects of Corporate Governance (The Cadbury Report) London: Gee & Co., 1992.

### 4.3 Strategy

The strategy of an organisation is its rudder. It provides direction by clearly setting out the organisation's vision, mission and goals. An organisation that aspires to integrity needs to have a strategy that marries that aspiration to its commercial and business objectives. In setting such a strategy, the organisation is providing its employees and other stakeholders with a clear signal that integrity is important to the organisation, with the aim of influencing their behaviour.

However, for strategy to be effective, an organisation must consider not only its objectives but also the environment in which the organisation operates, the adequacy of its resources and the appropriateness of its operational structure, policies and procedures. One of the most fundamental ways in which an organisation can signal the importance of integrity to its strategy is in its recruitment practices.

Recruitment practices which enable an organisation to recruit people who share the organisation's view of integrity are an important means of promoting organisational integrity. Recruitment provides an invaluable opportunity to assess the motivations, skills, competence and qualities of an individual, including their views on integrity. Through their recruitment processes, employers are beginning to assess how individuals think and behave in ethical situations. According to Dan Ferrandino, Director of Recruitment at Reed, 'some of the large graduate employers have redefined their talent framework. Historically, they would measure skills like leadership, drive and teamwork; now they are increasingly taking into account integrity and honesty – qualities they would not have measured before.'<sup>27</sup>

However, evaluating whether an individual has integrity and the necessary competencies for a role is not an easy task. During a recruitment process, an organisation is reliant on information provided by an individual. The recruitment process usually starts off with a CV. However, research by the Risk Advisory Group in October 2005, showed that 25% of 3,000 CVs submitted by candidates applying for financial sector roles contained false or incorrect statements. Each of these incorrect statements contained on average three lies.<sup>28</sup>

### 4.4 Policies

Policies and supporting procedures exist in an organisation to set requirements, provide guidance and incentives and thereby influence individual behaviour. Establishing integrity in an organisation requires careful management. Leaders should try to identify, evaluate and assess factors which affect their organisation's integrity and recommend and implement courses of action to safeguard it. Establishing appropriate policies, procedures and internal controls will help to promote integrity as well as manage risk in an organisation.

Some internal controls are designed to ensure that information is reliable by minimising the possibility of people making mistakes. Other internal controls try to ensure that information processing operations are performed efficiently and effectively. In larger organisations, internal audit can also help in the promotion of integrity by obtaining objective assurance that key risks are being managed to an acceptable level and reporting to those charged with governance.

Whilst there are a number of policies and procedures which are of importance to the operational running of an organisation, this report focuses on two policy tools that are particularly important to establishing organisational integrity, namely disciplinary processes and helplines. One of the main ways in which an organisation communicates its commitment to integrity is in its code of conduct which is discussed in the next section.

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<sup>27</sup> Paul Allen, 'Ethical careers – stay true to your roots', *Accountancy Age*, 11 March 2005.

<sup>28</sup> Professor Tom Lambert, 'Reputational Risk – riches to rags', *Accountancy Age*, 11 February 2005.

Organisations need to keep under review the scope and severity of their disciplinary processes as they relate to integrity. It should also be recognised that punishing people for a lack of integrity as such may not be easy because it involves looking at motives, intentions and effort as well as consequences and outcomes. It might also be unreasonable to make integrity itself the benchmark for action and discipline employees for all behaviour that falls short of an aspirational standard of integrity. Because relatively few people are likely to be seen as having complete integrity, it is probably more practical only to discipline employees for breaches of basic integrity requirements, for example where there is dishonesty.

One area to consider is whether disciplinary processes should cover failures of integrity in an employee's personal life as well as their business life. The resignation of the Boeing CEO shows that the answer may depend on a number of factors such as the seniority and role of the person concerned, the consequences of a lack of integrity and whether any incidents are isolated or part of a recurring pattern.

#### **Panel 4.2: An example from Boeing**

The CEO of Boeing was asked to resign and did resign in March 2005 after an affair between him and a female executive was anonymously disclosed by an employee. While the affair did not break Boeing's code of conduct, it did breach the requirement that 'employees are not to engage in conduct or activity that may raise questions as to Boeing's honesty, impartiality, or reputation or that may cause embarrassment to [it].' Boeing was reported as stating that 'the CEO must set the standard for unimpeachable professional and personal behaviour.' Undisclosed affairs are difficult to commit without some lying or cheating.

Another matter to consider in relation to disciplinary processes is the relative size of penalties for behaviour which lacks integrity and the potential rewards for such behaviour. For example, in order to be effective, the penalties for overstating profits should exceed the bonuses that might be earned through overstated profits.

Helplines offer a useful means of support for individuals experiencing difficulties associated with trying to uphold organisational integrity. Much attention in recent years has been directed at establishing whistleblowing hotlines which allow employees to report suspected misconduct. Whilst these are useful, helplines can play a complementary and preventive role, especially in consensual cultures where whistleblowing can be seen as disloyal. Helplines can provide individuals with an opportunity to obtain information and advice and discuss issues relating to integrity. Due to the sensitivities involved, they are generally confidential. From an individual's perspective, it may be more beneficial to have a point of reference to resolve integrity issues and someone to discuss them with rather than being referred to methods for resolving ethical dilemmas or other documentation.

### **4.5 Information**

Information is essential in securing the alignment and consistency at the heart of the idea of organisational integrity. Moreover, its content should be consistent with the organisation's vision of integrity. It should encourage certain attitudes and standards of behaviour and the idea that everyone in the organisation is responsible and accountable for behaving with integrity. Everyday communications on strategy, planning and business activities should also take into account an organisation's commitment to integrity. This commitment should not be seen as an add-on or an afterthought that is peripheral to the organisation's activities.

Organisational commitment to integrity and supporting policies are increasingly communicated through codes of conduct. They are usually available on the organisation's website and referred to in the annual financial statements and corporate responsibility reports. Codes of conduct have different names including codes of ethics, codes of practice, guides, standards and specific organisational titles such as 12 point plans and credos. Some are concise and straightforward and others are detailed and elaborate. Some are functional and descriptive while others are aspirational. Codes of conduct can be advisory or contain mandatory requirements that are supported by disciplinary procedures. Whilst codes of conduct have different names, styles and content, they all have one aim in common – to influence behaviour.

Codes of conduct aim to influence behaviour by setting out the values, behaviour and standards of business conduct that are expected of individuals employed within an organisation and other stakeholders. They typically demand the 'highest standards of honesty, integrity and fairness from each and every employee'<sup>29</sup> Thus, by clearly articulating the ethical principles of the organisation and setting out appropriate standards of behaviour, a code of conduct promotes integrity.

In order to be effective, the development and implementation of a code must be carefully considered. An article in the Harvard Business Review in December 2005 by Paine, Deshpandé, Margolis and Bettcher<sup>30</sup> notes that 'dozens of industry, government, investor, and multisector groups worldwide have proposed codes and guidelines to govern corporate behaviour' and the article summarises these in a Global Business Standards Codex. However, whilst external sources can be useful in raising ideas, development needs to take into account the organisation's objectives, strategy and culture. Codes should reflect the true values and behaviours that the organisation wants to uphold rather than being a public relations exercise.

Codes should be widely distributed and their implementation actively monitored. There also needs to be training and support for individuals to enable them to deal with circumstances which may threaten the integrity of themselves or the organisation. One of the unknown factors in developing and implementing a code of conduct is how individuals are likely to respond to it. An organisation needs to understand how codes will affect individuals' decision making and behaviour. The effectiveness of a code of conduct depends on the individual's desire and capacity to interpret and apply the code and its values to a variety of situations.

Codes of conduct can be characterised as either principles based and high level or rules based and detailed. A rules-based code may be easier to follow since there is more guidance relating to how to behave in particular situations. However, such an approach will not be able to cover every eventuality and may also encourage individuals to abdicate responsibility for ethical behaviour and exploit loopholes. A principles-based approach is powerful because it provides guidance that can be applied to a number of situations. However, it relies on individuals' ability to make judgements based on principles. An individual's ability to make ethical decisions should not be taken for granted as is illustrated in Rest's model of ethical decision-making as summarised in Panel 4.3.

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<sup>29</sup> Kenneth H. Blanchard and Norman Vincent Peale, *The power of ethical management*, London: Heinemann Kingswood, 1988.

<sup>30</sup> L. Paine, R. Deshpande, J. D. Margolis, K. E. Bettcher, 'Does your company conduct meet world-class standards?', *Harvard Business Review*, Vol. 83, Issue 12, December 2005.

### Panel 4.3: Rest's model of ethical decision making

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|--------|--|
| Step 1 | It must be recognised that there is a moral issue involved. The decision maker must be able to appreciate that the selection of a particular course of action will affect the welfare of other interested parties. |
| Step 2 | The decision maker must be able to select an appropriate action.   |
| Step 3 | The decision maker must attach priority to moral values, rather than – say – acting out of self-interest.  |
| Step 4 | The decision maker must have sufficient moral strength to implement the resolution identified in the previous steps.   |

Source: J. R. Rest *Moral Development: Advances in Research and Theory*, New York: Praeger Publishers, 1986.

As well as communicating their commitment to integrity, some organisations attempt to monitor the integrity of the organisation by reporting indicators of organisational integrity such as the number and nature of instances of misleading information and misconduct, the frequency of whistleblowing or the number of queries on integrity issues received by helplines. Some organisations also use specific integrity tests such as the Defining Issues Test (DIT) to measure the integrity of individuals in the organisation. These organisations tend to assume that the integrity of individuals in an organisation is a useful proxy for the organisation's integrity.

The DIT has been used since the 1970s and is consistent with Kohlberg's theory of moral development and reasoning discussed in Chapter 3 and summarised in Appendix 2. It was developed by James Rest as a method of assessing an individual's stage of moral development. In the DIT, participants are presented with several moral dilemmas and items for consideration in solving the dilemmas. Participants are required to rate and rank the items in terms of their importance in solving the dilemma and their importance in making moral decisions. Ratings and rankings of the items are used to derive a participant's score, known as the P score, which is the weighted sum of ranks for post-conventional items derived from Kohlberg's stages 5 and 6. The P score is interpreted as the degree to which the participant thinks post-conventional considerations are important, which is believed by some to be indicative of levels of integrity.

Leaving aside criticisms of Kohlberg's model, the problem with measuring integrity in this way is that, as with the majority of attempts at measuring integrity, it seems to be reliant on questions, scenarios or case studies. Many people, especially those who lack integrity, are very good at giving the answer that is expected of them. What seems clear is that although integrity tests are not necessarily accurate or conclusive, an organisation may choose to monitor a variety of indicators of organisational integrity. Whatever methods are adopted by an organisation to manage, monitor and report on integrity, they need to be fully incorporated into the organisation's business practices and culture to be effective.

## 4.6 Culture

Organisations can go a long way towards establishing organisational integrity through strong leadership, clear strategy, up-to-date policies and information that supports effective communication and monitoring. However, the journey does not stop there. Culture is also important.

An organisational culture which promotes openness, accountability and transparency is more likely to motivate individuals to act with integrity. A culture which encourages individuals to raise issues and grievances before there is a need for whistleblowing is more likely to be successful at establishing and maintaining organisational integrity. Openness enables an individual to act with integrity, accountability makes a person responsible for doing the right thing and transparency demonstrates that an individual is doing the right thing. The extent to which an organisation's culture is really aligned with the promotion of integrity can be judged in large part by looking at its appraisal systems, reward policies and training.

- **Appraisal systems.** Organisational integrity can be aided by including discussions on integrity and related behaviour as part of the organisation's appraisal systems. A 360 degree appraisal system lends itself particularly well to assessing an individual's integrity since it incorporates input from others as well as the individual's own comments. A gap analysis in which actual values and behaviours are compared to the organisation's values and behaviours can be identified for development purposes and linked to rewards and changes in expected behaviour over time.
- **Reward systems.** Individuals can be encouraged to behave with integrity by ensuring that the organisation's reward policies are aligned to its commitment to integrity. Organisations may want to assess how the link between incentives and rewards influences organisational integrity and performance and reduces the pressures or opportunities to behave without integrity. It is important to be aware of the types of incentives and pressures individuals face so as to be able to eliminate them or help individuals to resist them. For example, remunerating senior managers through share options may create an incentive for earnings management and short-term gain. An organisation may need a wider range of qualitative and quantitative measures ranging from feedback from stakeholders to information on cash flows, dividend levels and the quality of earnings. This may provide a more appropriate and balanced method of motivating individuals and promoting organisational integrity. Recognising and rewarding individuals who have acted with integrity also provides a powerful motivational tool for encouraging organisational integrity.
- **Training.** Without the necessary skills, training and support, an employee who is committed to integrity may nevertheless fail to act appropriately and in accordance with their beliefs. The success of training will largely depend on the approach taken. Ultimately, training should do more than communicate the organisation's views on integrity. It should enable employees to be more confident that they are making correct decisions and taking appropriate actions. Staff should feel confident that a selected course of action is consistent with the organisation's moral values. An instructional approach to integrity training that emphasises factual testing is unlikely to be successful. Resolving ethical dilemmas involves other people and is interactive. Dialogue provides opportunities to raise ethical dilemmas and discussion not only fosters moral development, it also helps to cement employees' beliefs and standards of behaviour in an organisation. However, discussions on integrity issues and how to resolve them need to be realistic and credible.

#### Panel 4.4: Social influence

Linda Thorne, Dawn Massey and Joanne Jones address the issue of how social influence on group discussion may influence consensus judgement. Using a theory of social influence, they identify three types of social influence that occur in group discussions:

- conformity: in which individuals who are in the minority conform to the majority view;
- innovation: in which the majority view accedes to the minority view
- normalization: in which the majority and minority influence each other.

They find that when the discussion is about what should be done ideally, conformity takes place. On the other hand, normalization occurs when the subject of the discussion is how a situation would be resolved realistically. These results are interesting because they indicate that reaching consensus occurs in different ways, depending on how the ethical issues are presented.

Source: L. Thorne, D. Massey and J. Jones, 'An Investigation of Social Influence: Explaining the Effect of Group Discussion on Consensus in Auditors' Ethical Reasoning', *Business Ethics Quarterly*, Vol 14, part 3.

Thus, the style and context for training is important for promoting integrity in an organisation. For example, using day-to-day scenarios to cover issues such as discrimination, bullying and harassment which may have a direct bearing on the employee is more likely to be successful since individuals will get a better understanding of the process for resolving ethical dilemmas as well as the organisation's views on integrity and related matters. Training can also foster integrity by making reference to an organisation's own history, its celebrated achievements and episodes in which it was tested and came through.

#### 4.7 Questions for discussion

10. Is it useful to think in terms of leadership, strategy, policies, information and culture when looking at how to promote organisational integrity?
11. What specific examples are there of initiatives and techniques that are particularly effective or ineffective in promoting organisational integrity?
12. What factors affect the effectiveness of codes of conduct in changing behaviour and promoting organisational integrity?

# 5. The role of the accounting profession

It was noted in Chapter 3 that professions influence the behaviour of individuals and their ability to behave with integrity. Clearly those who belong to a profession are directly influenced by the organisations of which they are members. But professions also exert a broader influence and are part of the context in which non-members operate. This chapter looks at the contribution of professions and in particular the accounting profession to promoting integrity in business and reporting. It pays particular attention to the role of professional bodies since they define standards to which their members are expected to adhere.

On the basis of the analysis in earlier chapters, we would expect to see professional bodies and their memberships supporting integrity through their leadership, strategy, policies, information and culture. We would also expect to see professional bodies and their members behaving in such a way that they are seen to be honest and truthful, to be fair, to comply with laws, to promote community interests, to be open and adaptable, to take corrective action and to show consistency.

## 5.1 Professional ethics

A profession encompasses various roles, functions and organisations but at the same time unites members of that profession by having, amongst other things, common principles, values and standards of behaviour. According to Claire Bellis,<sup>31</sup> a profession consists of three types of elements:

- normative elements including values, ethical standards and a commitment to provide a service for the public good;
- cognitive elements such as specialised knowledge and prolonged training; and
- organisational elements including a body with disciplinary powers which provides support for the normative and cognitive elements of the profession.

Recently, professional accounting bodies have tended to give integrity a pre-eminent position in summarising the normative elements of the profession. Indeed, the three values of the International Federation of Accountants (IFAC) – integrity, expertise and transparency – can be seen as encapsulating Bellis's three types of elements. Public expectation about the accounting profession has not only latched on to the term integrity to capture the normative elements of the profession but it has also tended to give it a pre-eminent position.

### Panel 5.1: Expectations of integrity

Public expectation about the integrity of the accounting profession might be summed up in the following quotation from the Prince of Wales speaking at ICAEW in May 2005:

'...it seems to me that the essence of an accountant's professional contribution is not knowledge of figures and finance, important as this is, but integrity: the integrity to provide the meaningful, accurate and timely information needed for the financial decision-making that underpins the success of our economy, the integrity of the independent audit which is fundamental to business trust and confidence and the integrity and impartiality of the business advice offered by firms and individuals.'

Source: HRH The Prince of Wales, speech to mark the 125th Anniversary of ICAEW, 25 May 2005, [www.princeofwales.gov.uk/speechesandarticles](http://www.princeofwales.gov.uk/speechesandarticles).

<sup>31</sup> Claire Bellis, 'Professions in Society', *Australian Actuarial Journal*, Volume 6, Issue 1, 2000.

According to the philosopher Frankel, 'a profession's code of ethics is perhaps its most visible and explicit enunciation of its professional norms. A code embodies the collective conscience of a profession and is testimony to the group's recognition of its moral dimension.'<sup>32</sup> Nevertheless, the professional ethical codes of accountants need to be understood from a historical perspective. In a lecture delivered at ICAEW in July 2006, Professor Shyam Sunder of Yale University drew attention to the fact that such codes were originally, and for many years, concerned principally with prohibitions on advertising and soliciting on the basis that free competition in markets for professional services was not in the public interest and would have adverse economic and social consequences.

Critics of the accounting profession claim that its increasing emphasis on ethics is a calculated attempt to ward off regulation and protect exclusive rights of members of professional bodies, for example to perform statutory audits.<sup>33</sup> Certainly, there was little relish for drafting ethical codes as moral tracts in an era when the professions could assume a higher level of implicit trust from the public than today. Historically, professional codes were seen as convenient confirmations of what every professional was expected to know.

Integrity was first mentioned in ICAEW ethical guidance only in 1975 when the Chairman of ICAEW's Ethics Committee was quoted as likening ethical rules to the friendly warning a golfer would give an opponent who inadvertently grounded his club in a hazard, saying that it was preferable to waiting and claiming a penalty after an illegal stroke had been played. It is against this background that we consider how the treatment of integrity in the accounting profession's codes measures up against our analysis of integrity and its five key aspects.

## 5.2 Codes of Ethics

A good starting point for understanding the standards of conduct that professional accountants are expected to adhere to is IFAC's Code of Ethics for Professional Accountants as issued by the International Ethics Standards Board for Accountants (IESBA). IFAC's membership includes 155 professional accounting bodies in 118 countries, representing more than 2.5 million accountants. A substantial number of professional accounting bodies in the world, including ICAEW, have adopted the IFAC Code of Ethics in their own codes to meet their membership obligations to IFAC.

According to the IFAC Code of Ethics,<sup>34</sup> a professional accountant's behaviour must be guided by five fundamental principles including the principle of integrity which refers to being 'straightforward and honest'. The principle of integrity appears to be of equal importance with the other fundamental principles of objectivity, professional competence and due care, confidentiality and professional behaviour. Little more is said about integrity in the IFAC Code or indeed in the codes of any other professional or public bodies whether in accounting or other fields. Integrity is generally seen as signifying honesty or objectivity or freedom from conflicts of interest. It is also presented as something that should not be compromised, rather than something that should be actively developed and applied.

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<sup>32</sup> M. S. Frankel, 'Professional Codes: Why, How, and with What Impact?', *Journal of Business Ethics*, Volume 8, Numbers 2-3, February 1989.

<sup>33</sup> A. Mitchell, T. Puxty, P. Sikka and H. Willmott, 'Ethical statements as smokescreens for sectional interests: the case of the UK accountancy profession,' *Journal of Business Ethics*, Vol 13(1), 1994.

<sup>34</sup> Code of Ethics for Professional Accountants, New York: IFAC, June 2005.

## **Panel 5.2: IFAC Code of Ethics**

### **Fundamental Principles**

#### **Integrity**

A professional accountant should be straightforward and honest in all professional and business relationships.

#### **Objectivity**

Professional accountants should not allow bias, conflict of interest or undue influence of others to override professional or business judgements.

#### **Professional Competence and Due Care**

Professional accountants have a continuing duty to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques. Members should act diligently and in accordance with applicable technical and professional standards when providing professional services.

#### **Confidentiality**

Professional accountants should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of the member or third parties.

#### **Professional Behaviour**

Professional accountants should comply with relevant laws and regulations and should avoid any action that discredits the profession.

Source: IFAC, Code of Ethics, paragraph 100.4, June 2005.

Based on our analysis of integrity, it can be argued that all the other fundamental principles in the IFAC Code of Ethics support integrity and are applications of it. A professional accountant of integrity would surely be expected to be objective, to show professional competence and due care and to demonstrate professional behaviour. If one of these characteristics is lacking, then a professional accountant is likely to be described by the wider community as lacking integrity. The relationship between integrity and confidentiality is rather more complex.

Integrity's close link to honesty may lead some to believe that professional accountants should disclose everything they know, thereby breaching the principle of confidentiality. Yet, failing to disclose everything might suggest that the professional accountant was not acting with integrity. Such beliefs fail to take into account the context in which a professional accountant works. Honesty is about disclosing information which is appropriate to the circumstances, within the confines of the law and the principle of confidentiality. Nevertheless, professional accountants need to be careful when applying the principle of confidentiality to ensure that their integrity, whether actual or perceived, is not undermined by failure to observe the moral values of honesty and truthfulness.

Whilst it would apparently be possible to give pre-eminence to integrity over the IFAC Code's other fundamental principles, the fundamental principle of integrity might also need to be strengthened. It is instructive to compare the IFAC definition of integrity, against the five aspects of integrity proposed in Chapter 2. It is clear from the analysis below that the principle of integrity includes moral values. However, other aspects of integrity – motives, commitments, qualities and achievements – are only evident when looking at more detailed ethical guidance within codes of ethics. Even then, the links to integrity are not always obvious:

**Moral values** in the form of honesty in all professional and business relationships are included in the definition of integrity. Nevertheless, other moral values such as truthfulness and fairness are not mentioned.

**Motives** are recognised insofar as the public interest is referred to in the IFAC Code of Ethics and ICAEW Code includes additional material. Therefore, whilst the accounting profession recognises the importance of acting in the interests of the wider community through its ethical guidance, this link could be made explicit in the definition of integrity.

### Panel 5.3: IFAC Code of Ethics

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.

Source: IFAC, Code of Ethics, paragraph 100.1, June 2005.

### Panel 5.4: ICAEW Code of Ethics

Acting in the public interest involves having regard to the legitimate interests of clients, government, financial institutions, employers, employees, investors, the business and financial community and others who rely upon the objectivity and integrity of the accounting profession to support the propriety and orderly functioning of commerce. This reliance imposes a public interest responsibility on the profession. Professional accountants should take into consideration the public interest and reasonable and informed public perception in deciding whether to accept or continue with an engagement or appointment, bearing in mind that the level of the public interest will be greater in larger entities and entities which are in the public eye.

Source: ICAEW, Code of Ethics, paragraph 100.1, September 2006.

**Commitments** are identified to the extent that professional accountants have to 'observe and comply with the ethical requirements of this Code.' (IFAC Code of Ethics: paragraph 100.1.)

**Qualities** relating to integrity, other than straightforwardness, are not referred to in the IFAC Code of Ethics. Discussion of additional qualities is limited in the UK accountancy profession's ethical guidance since all the UK professional bodies have adopted the IFAC definition of integrity. However, the Auditing Practices Board (APB), which is responsible for setting independence standards for auditors in the UK and Republic of Ireland, goes further and defines integrity in terms of a broad range of other qualities:

### Panel 5.5: Auditing Practices Board Ethical Standards

Integrity requires 'not only honesty but a broad range of related qualities such as fairness, candour, courage, intellectual honesty and confidentiality.'

Source: Auditing Practices Board, *Integrity, Objectivity and Independence*, Ethical Standard 1, paragraph 7, December 2005.

**Achievements** are clearly central to adhering to the fundamental principle of integrity. The IFAC Code of Ethics requires professional accountants to assess threats relating to adherence to the fundamental principles which need to be eliminated or reduced to an acceptable level by implementing various safeguards. Professional accountants may find themselves in situations which give rise to conflicts and other threats which make it more difficult to act with integrity. These threats or conflicts may arise from personal, social, organisational and environmental influences as discussed in Chapter 3. For example, if a professional accountant working in business is pressurised to 'make the figures look good', the resulting intimidation threat must be overcome, for example, through discussions with senior management to persuade them that such a course of action would be inappropriate.

### 5.3 Professional bodies

Following the analysis of the five drivers of organisational integrity presented in Chapter 4, professional accounting bodies like any organisations face significant challenges in sustaining organisational integrity. However, the focus in the remainder of this chapter is on the particular additional challenges that professional accounting bodies face because they are expected to instil integrity in their members. This involves:

- **Leadership** that challenges the status quo and conventional wisdom and influences the public policy agenda;
- **Strategy** that provides vision and direction to the accounting profession;
- **Policies** that support members but also enforce professional standards and disciplinary processes when members fall short;
- **Information** that is clear on what is expected of members and how they measure up; and
- **Culture** that fosters openness, transparency and accountability on issues of integrity.

These areas are looked at in greater detail in the remaining sections of this chapter. The main emphasis is on the current contribution of professional accounting bodies to the promotion of integrity and how it needs to be kept under review so that potential enhancements are considered, albeit with a clear respect for proportionality and principles of better regulation.

### 5.4 Leadership opportunities

One of the public interest activities of a professional accounting body is to foster and influence debate on public policy issues and stand for what it believes to be right even if this involves challenging established thinking in areas of concern to the accounting profession. Through its professional bodies, the accounting profession also has the power to convene key opinion formers from a variety of organisations to share experience and knowledge, thereby improving both understanding and the quality of public debate.

A wide variety of individuals and organisations also look to the professional accounting bodies to speak out on issues of public concern. They can be impatient if the bodies appear to prevaricate either on the basis that the issues are outside their professional competence or because their lack of detailed knowledge of the facts puts them at risk of discrediting the profession.

Professional bodies can however lead the way and act as catalysts for change in a variety of areas. For example, in the mid-1990s ICAEW pioneered the principles-based threats and safeguards approach to ethics codes which has now been adopted as the most appropriate solution by many regulators and the profession worldwide. Thus, the public interest activities of professional bodies and their engagement with business and public policy issues can contribute to the development and evolution of the professional and business environment, including the promotion of integrity.

In the light of the analysis in section 5.2 and elsewhere in this report, professional accounting bodies might want to demonstrate leadership in promoting integrity by:

- according pre-eminence to integrity over other fundamental ethical principles in their ethical codes; and
- explicitly incorporating moral values, motives, commitments, qualities and achievements into their definition of integrity.

These developments would need to be thought through carefully and there appear to be no precedents in other professional bodies or other institutions for introducing a broad and pre-eminent principle of integrity. However, such developments may result in the accounting profession's approach to integrity being more rounded and better reflecting society's expectations. They could also enable the accounting profession to make its codes of ethics truly ethical instead of being increasingly complex technical regulations about auditor independence.

As noted in section 5.1, a profession is characterised by normative as well as cognitive elements. There is a danger that increasing the technical complexity of ethics codes will mean that the normative elements of the accounting profession are transformed into cognitive elements and that accountants will focus on technical compliance rather than on doing the right thing.

Changes to ethical codes that enriched the treatment of integrity could also pave the way for professional accounting bodies to make further changes to reflect expectations of behavioural characteristics associated with integrity. For example, the discussion in section 3.8 of the idea that integrity does not preclude making mistakes is already reflected in the Code of Professional Conduct of the American Institute of Certified Public Accountants (AICPA)<sup>35</sup> (Section 54 Article III paragraph 2): 'Integrity can accommodate an inadvertent error or difference of opinion. However, it cannot accommodate subordination of principle, moral values and motives.'

Professional bodies might also want to keep under review the support and financial assistance that they can provide to their members if they are disadvantaged as a result of standing up for integrity. Professional accountants may find themselves in serious financial and other difficulties as a result of maintaining their integrity and doing the right thing. Acting on one's commitments and standing up for something may involve overcoming personal and social threats and obstacles and experiencing confrontation and adversity. Adversity can manifest itself in different forms ranging from feelings of discomfort and being shunned within an employing organisation to serious financial loss and lasting damage to career prospects.

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<sup>35</sup> American Institute of Certified Public Accountants, Code of Professional Conduct, June 2006.

## 5.5 Strategic challenges

Due to their remit of acting in the public interest, the strategies of professional bodies include providing leadership on professional and technical issues, influencing debate on public policy issues and providing support and advice to their members. However, it can be argued that their most important strategic decisions relate to the positioning of their qualifications and their standards for admitting individuals to membership.

The professional bodies' entrance requirements for students focus on compliance with the law and levels of education rather than moral values, motives and qualities such as openness, perseverance and courage which are vital aspects of integrity. Whilst these may be assessed by employing organisations, as a general rule, they are not assessed by professional accounting bodies. Consequently, bodies may want to consider whether it would be appropriate and feasible to develop pre-entry requirements which assess the integrity of individuals, their moral reasoning and their personal qualities.

Once students have qualified and been admitted to membership, the existence and mandatory nature of continuing professional development (CPD) in the accounting profession demonstrates the profession's commitment to ensuring that accountants remain competent despite changing requirements throughout their career. CPD requirements vary across professional bodies in the accounting profession. Some professional bodies require their members to achieve a certain number of hours and CPD points by attending courses and seminars. Other schemes follow the results-based approach pioneered by ICAEW and require professional accountants to judge what their development and learning needs are in relation to their role.

When thinking about the effectiveness of CPD, particularly in relation to the promotion of integrity, the requirements and scope of CPD and the support provided by the professional body are important. For example, ICAEW's CPD website ([icaew.com/cpd](http://icaew.com/cpd)) supports its members by providing information on relevant areas of responsibility, including ethics guidance and ethical dilemma case studies that are designed to help members address practical ethical issues.

A proposed International Education Practice Statement (IEPS) *Approaches to Developing and Maintaining Professional Values, Ethics and Attitudes* was issued by the International Accounting Education Standards Board (IAESB) of IFAC in September 2006. It emphasises developing ethical behaviour in CPD by focusing on factors affecting ethical decision-making and behaviour. The overall aim is to ensure an understanding of contexts in which ethical issues arise and how to apply ethical knowledge, sensitivity and judgement and how to remain committed to ethical behaviour at a level expected of a professional accountant. The IFAC *Ethics Education Framework* that underpins the proposed IEPS is reproduced in Appendix 3 to this report.

The professional accounting bodies need to keep under review the requirements and scope of CPD to remind members of their ethical commitments and ensure that they remain competent in a complex and fast changing world. When thinking about the effectiveness of CPD, professional bodies need to consider the extent to which CPD requirements and the support provided by the professional bodies contribute to maintaining the integrity of the accounting profession.

## 5.6 Enhancing policies

Professional accounting bodies promote, reinforce and support integrity through a variety of policies and supporting procedures, many of which give effect to initiatives related to leadership, strategy, information and culture. This section focuses on disciplinary processes and helplines.

A powerful motivational mechanism for promoting integrity in the accounting profession is the existence of disciplinary processes. The professional conduct and competency of accountants are monitored by various regulatory and professional bodies. These bodies are responsible for ensuring that professional accountants and accounting firms meet the reasonable expectations of the public and other accountants. Complaints are evaluated in order to determine if there is a case to answer and if there is, complaints are brought to the attention of investigation committees. Disciplinary actions are made public and range from accountants being reprimanded and cautioned through fines to having their membership revoked.

There will always be pressure to ensure that the disciplinary processes of the accounting profession are as transparent as possible whilst still being fair to the parties directly involved. One reason for this pressure is that the public's perception of the integrity of the profession can be adversely affected by any suggestion that professional bodies have something to hide regarding disciplinary matters. Furthermore, increasing the transparency of the disciplinary process to members of the accounting profession may promote integrity by giving them the opportunity to learn from others' mistakes.

Holding people to account for integrity involves looking at evidence on consequences and outcomes. However, assessing whether an individual has behaved with integrity also requires an understanding of their values, motives and commitments. Integrity is assessed by another person but relies on explanations of the individual who is being assessed. How this can be achieved within the confines of a disciplinary process is perhaps a matter for future debate, along with the implications for disciplinary processes of adopting a broader definition of integrity and making integrity a pre-eminent principle as discussed in section 5.4. As was indicated in section 4.4 it may only be appropriate to discipline people for breaches of requirements which involve clear failures of integrity rather than shortfalls against an aspirational character standard.

Whilst a small proportion of professional accountants is always likely to face disciplinary processes, it needs to be recognised that every day professional accountants face personal, financial and other pressures which test their judgement and threaten their individual integrity. They can use formal and informal support processes to resolve the resulting ethical dilemmas and these may involve colleagues, peers, mentors and their professional body.

For example, ICAEW's Ethics Advisory Services ([icaew.com/ethicsadvice](http://icaew.com/ethicsadvice)) offers a confidential, free helpline service for members and provisional members (students) of ICAEW to discuss professional ethical issues and problems with experienced and knowledgeable ethics advisers. Confidential helplines encourage people to call without fear of being incriminated and reported to the professional body or another organisation. Providing better support for accountants with ethical queries across the entire profession is likely to promote integrity, both actual and perceived. Therefore professional accounting bodies need to keep under review the helplines and other means they use for providing ethical advice and support to members.

## 5.7 Sharing information

One of the ways that the accounting profession influences debate is through the professional bodies' representations to regulators, governments and their agencies and other organisations on areas of concern to the profession and the wider community. Representations are made in a number of areas including legislation, regulation and professional and other standards covering accounting and reporting, auditing and taxation and wider business issues, such as corporate governance, corporate responsibility and sustainability.

Professional bodies reinforce and support the integrity of the accounting profession by communicating matters of interest to their members such as changes in regulation, legislation and professional and other standards as well as other areas of specific concern to their members. In order to achieve this, professional bodies use a variety of communication channels such as websites, email, magazines and the news media.

The most explicit statement of the accounting profession's views on integrity is found in its codes of ethics. These unite professional accountants by providing them with common principles, values and standards as well as guidance about the application of these principles in particular circumstances. However, as set out in section 5.2 there are several ways in which the treatment of integrity in the IFAC Code of Ethics and in codes derived from it might be enhanced in the light of the analysis of integrity in this report.

## 5.8 Cultural change

Taken as a whole, the accounting profession needs to foster a culture where there is openness, accountability and transparency about issues of integrity. This type of culture is more likely to promote integrity since individuals are encouraged to accept responsibility as well as challenging others and raising concerns and grievances early.

However, the creation of such a culture should be supported by appropriate regulatory and professional standards requirements. Since the corporate scandals of 2001 and 2002, an increased tendency has been observed to make professional standards and regulation more prescriptive and rules-based. There is a related danger of encouraging a box-ticking compliance attitude and stifling a sense of responsibility. Some limited research suggests that accountants prefer a rules-based approach. Based on Kohlberg's theory of moral development, a research paper 'Moral Reasoning and the Accountant: Rules and Principles' commissioned by the Association of Chartered Certified Accountants (ACCA)<sup>36</sup> suggests that accountants have a preference for rules-based guidance rather than principles-based guidance to inform their judgements. The results are interesting but are limited in scope and the low response rate means that the results are of limited statistical significance.

However, even where research suggests that accountants prefer rules-based standards, this may indicate fear of litigation and attitudes which are pervasive in different areas of work rather than reflecting the moral ability of accountants or a true preference for these types of standards. For example, some would suggest that tax work is inevitably rules based. In addition, recent research in this area has been concerned with accountants in public practice. Further research would be helpful to establish with a greater degree of certainty if there is a gap between the demands of a principles-based approach and the ability of accountants in terms of their moral development and ability to resolve ethical dilemmas.

Questions might also need to be asked about the nature of the training of professional accountants, since this is an important contributor to shaping an accountant's judgement, ability to resolve ethical dilemmas and attitudes towards responsibility and accountability. Professional accounting qualifications are currently based on a mixture of theoretical and practical training and experience covering topics such as audit, assurance, financial reporting, finance, management reporting, information technology, law and taxation. Integrity is taught as part of the ethics syllabus in the qualification through written and classroom learning material. For some professional bodies such as ICAEW, ethics is also learned through work-based learning programmes which consist of questions or case studies designed to help students integrate their exam studies with work experience and develop their professional skills.

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<sup>36</sup> ACCA, 'Moral Reasoning and the Accountant: Rules and Principles', Occasional Research Paper No. 36, 2003.

Although ethics is implicit in ICAEW's training and qualification, the balance of the content of professional qualifications and the ways in which ethics is taught represent a continuing challenge. In general, the content of the exams is technically biased by the exclusion of ethical problems which may be taught elsewhere, for example via work-based learning. The pressures and demands of clients and employers may result in work-based learning being relegated to the back burner and 'time out of the office' to support it can be seen as a cost not a benefit to the employer.

R. F. Carroll's paper on integrity and accounting education<sup>37</sup> considers how ethics is taught in the accounting profession and suggests that:

- ethics should be an explicit and implicit component part of the accounting curriculum;
- there should be explicit recognition of ethical issues in accounting at an early stage in the accounting curriculum; and
- there should be an ethical dimension throughout the accounting syllabus to avoid the compartmentalisation of thinking.

The paper also suggests that ethics training should include case studies which encourage thinking and analysis on ethical issues. Such case studies would normally ask open ended questions such as 'what would you do in these circumstances?' or 'how would you resolve such a dilemma?' However, in order for students to be able to analyse ethical issues effectively, they should be provided with analytical frameworks and conceptual tools to make ethical judgements.

Some argue that what is needed is an appropriate framework for induction, training and work experience, as well as CPD, that enhances an accountant's understanding and knowledge of ethics, ethical sensitivity, ethical judgement and ethical behaviour. The proposed IEPS discussed earlier seeks to provide this through the framework reproduced in Appendix 3.

In the light of these challenges, professional accounting bodies will want to keep under review the balance of the content of their qualifications and the ways in which ethics is taught to ensure that there is sufficient support for integrity.

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<sup>37</sup> R. F. Carroll, 'The Integrity Factor – Critical To Accounting Education', *Teaching Business Ethics*, Volume 2, Number 2, June 1998.

### Panel 5.6: Summary of the argument

- Professional bodies should be expected to instil integrity in their members through their leadership, strategy, policies, information and culture.
- Professional bodies promote integrity in professions, including the accounting profession by, amongst other things, setting out standards to which members are expected to adhere. A fundamental principle of integrity, which generally refers to being straightforward and honest, is included in a substantial number of professional accounting bodies' codes of ethics. However, while principles of integrity clearly include moral values, other aspects of integrity are only evident when looking at the more detailed ethical guidance within codes of ethics. Even then, the links to integrity are not always obvious.
- Professional accounting bodies might want to consider according pre-eminence to integrity over other fundamental ethical principles and explicitly incorporating motives, commitments, qualities and achievements into their definition of integrity. Moreover, in the context of their current contribution to the promotion of integrity, professional accounting bodies also need to keep under review:
  - the support and financial assistance they can provide to members if they are disadvantaged as a result of standing up for integrity;
  - pre-entry requirements which assess the integrity of individuals, their moral reasoning and their personal qualities;
  - the requirements and scope of continuing professional development (CPD);
  - the transparency of disciplinary processes;
  - helplines and other means of providing ethical advice and support to members; and
  - the balance of the content of professional qualifications and the ways in which ethics is taught.

### 5.9 Questions for discussion

13. Should the accounting profession's ethical codes give a greater status and a fuller definition to integrity and what might be the practical implications?
14. What are the most effective mechanisms for promoting integrity in the accounting profession and how is this supported by empirical evidence?
15. What suggestions do you have in relation to areas for potential improvement in the accounting profession's support for integrity identified in this report including ethical codes, pre-entry requirements, training, CPD, disciplinary processes, helplines and financial support?

## 6. Promoting integrity in reporting

As discussed in Chapter 1 of this report, high quality information underpinned by integrity creates the trust that is required for the effective and efficient functioning of markets and the economic development and welfare of nations. It might be helpful in due course to look at the attributes associated with different types of reports which have or are perceived to have integrity. However, the most pressing issue from a public interest perspective is that there should be confidence in the integrity of the business reporting process as a whole and in the integrity of the individuals and organisations involved in that process. That will be the main concern of this final chapter.

Earlier chapters have suggested that a consistent analysis of the concept of integrity can be applied to individuals, organisations and professions, including their professional bodies. This chapter therefore sets out to apply to the business reporting process the working hypotheses we have developed to analyse integrity – key aspects, behavioural characteristics and organisational drivers. The reporting process is a complex set of activities and involves large numbers of different individuals across different organisations.

### 6.1 Interest in reporting integrity

Ever since the corporate scandals of 2001 and 2002 there has been concern, expressed for example in the work of Michael C. Jensen of Harvard Business School, about a lack of integrity in business reporting, manifested in alleged lying in both internal reporting about performance against budgets and in external reporting against analyst expectations. This has led to calls for a radical new emphasis on integrity, for example in the article 'Just Say No to Wall Street' by Jensen and Fuller,<sup>38</sup> and for radical new approaches to corporate reporting more generally, for example in *The Value Reporting Revolution: Moving Beyond the Earnings Game* written by partners at PricewaterhouseCoopers.<sup>39</sup>

Calls for a renewal of integrity in business reporting are common whenever there is a lack of public confidence in business, for example in the UK in the early 1990s after the corporate scandals of BCCI, Polly Peck and Maxwell and later in the decade after the South East Asian crisis. Less dramatically but no less importantly, the need to instil integrity in business reporting is an enduring theme of agencies such as the World Bank in their work to support economic development.

In most of these cases the most visible response to calls to foster integrity is the enactment of legislation to establish new regulatory institutions to set and enforce standards and exercise oversight over reporting-related activities. The US Sarbanes-Oxley Act of 2002 and the revised EU Statutory Audit Directive of 2006 are leading examples of such responses.

### 6.2 The complexity of reporting

The reporting process of a country or a market is a complex web of interactions, communications and discussions between individuals in different organisations. A variety of individuals and organisations are involved in the preparation, presentation and communication of different types of reports including financial statements, management accounts, budgets, forecasts, corporate responsibility and sustainability reports, risk assessments and other types of analysis. Individuals come from different backgrounds and cultures and have different values, beliefs, motives and experiences. Many individuals involved in such a corporate reporting process work for reporting entities but many do not.

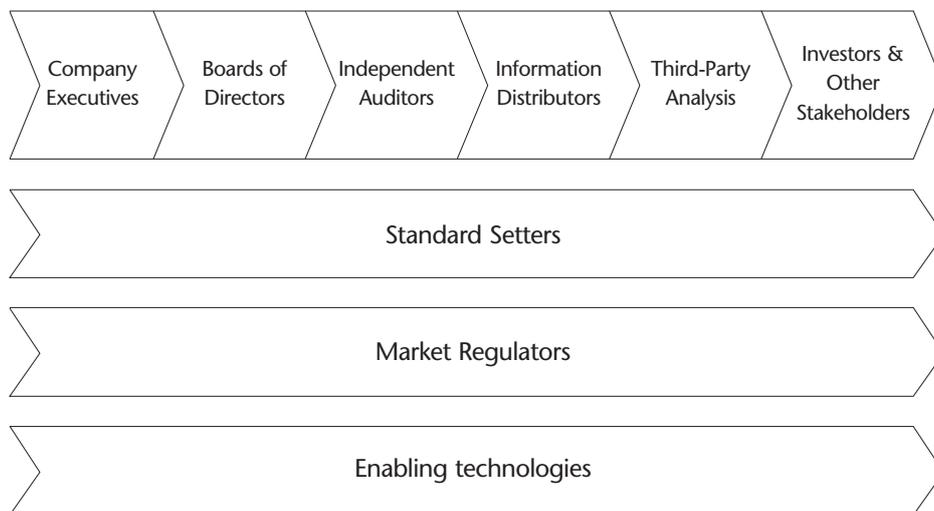
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<sup>38</sup> Joseph Fuller and Michael C. Jensen, 'Just Say No to Wall Street', *Journal of Applied Corporate Finance*, Vol 14, Winter 2002.

<sup>39</sup> Robert G. Eccles, Robert H. Herz, E. Mary Keegan and David M. H. Phillips, *The Value Reporting Revolution: Moving Beyond the Earnings Game*, New York: John Wiley & Sons, 2001.

The US public reporting system is illustrated in Figure 6.1 which shows the corporate reporting supply chain, as presented in *Building Public Trust: The Future of Corporate Reporting*<sup>40</sup> by Samuel A. DiPiazza and Robert G. Eccles of PricewaterhouseCoopers, published in 2002.

**Figure 6.1: The Corporate Reporting Supply Chain**



© PricewaterhouseCoopers

According to this model, the board is seen as setting the ‘tone at the top’ and overseeing the performance of company executives including the chief executive officer (CEO) and the chief financial officer (CFO) who prepare financial reports. Boards have responsibilities, including through audit committees, in relation to the preparation of timely and credible reports which comply with accounting and reporting standards and reflect the operations of the corporation.

Independent auditors obtain assurance and provide opinions on whether reports are free from material misstatements and conform to the relevant accounting and reporting requirements. Independent auditors may refer to the work of internal auditors and management in order to help them form their opinion on the credibility of the reports. For example, internal auditors play an important role in detecting improper treatments and providing advice on policies, procedures and internal controls which act as checks and balances to ensure that reports are prepared with integrity.

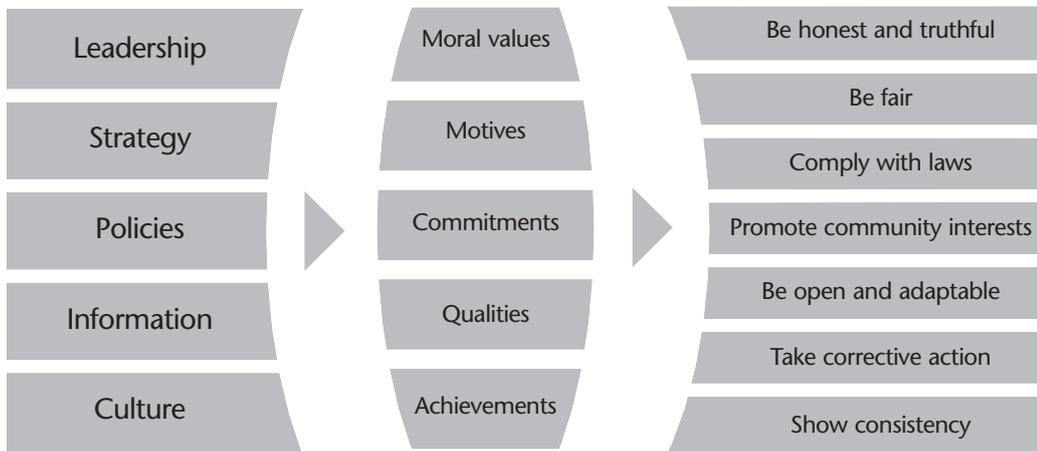
The reporting organisation’s media relations staff and the external media are heavily involved with the presentation and communication of reports through providing information and opinions in news articles and other commentaries. Third-party analysts, investors and potential investors rely on these communications, reports and opinions to make judgements about the organisation’s strengths and weaknesses.

<sup>40</sup> Samuel A. DiPiazza and Robert G. Eccles, *Building Public Trust: The Future of Corporate Reporting*, New York: John Wiley & Sons, 2002.

Standard setters and regulators influence the integrity of reports by providing the accounting, auditing and regulatory framework for the reports as well as monitoring and acting as a deterrent to reports which lack credibility or are fraudulent.

In order to bring clarity and coherence to our discussion of how to promote integrity across a complex reporting chain we summarise below in Figure 6.2 the working hypotheses we have developed in the earlier chapters of this report to analyse integrity.

**Figure 6.2: Framework for reporting with integrity**



### 6.3 Reporting that inspires confidence

The overall reporting process is ultimately dependent on the actions of individuals and organisations. Not only do they have different objectives and responsibilities, they are also likely to have varying levels of integrity. If the behavioural characteristics associated with a person or organisation of integrity are applied to reporting activities, it seems reasonable to suppose that a reporting process with the integrity to inspire confidence will similarly be seen to be honest and truthful, to be fair, to comply with laws in a thinking and critical way, to promote community interests, to be open and adaptable, to take corrective action and to show consistency.

A reporting process which is honest, truthful and fair and complies with legislation, regulations and standards should be free of material omissions, misrepresentations and false or misleading statements. It should also serve the interests of the wider community by providing people with accurate, complete and reliable information which contributes towards the efficiency and effectiveness of markets. All these behavioural characteristics are captured in Professor David Flint’s summary of the meaning of a true and fair view.

### Panel 6.1: A true and fair view

'...accounts which are required to give a true and fair view should comply with specific statutory requirements of disclosure and presentation, and disclose the accounting policies and bases which have been adopted; they should ordinarily be prepared in accordance with normal accounting practice and in compliance with Statements of Standard Accounting Practice, recognising, however, that these are a means to an end and not the end itself. They should be prepared so as to satisfy the professional technical information requirements of what is necessary as a basis of opinion and decision on the part of those who may legitimately expect their needs to be met. They should meet both the general legal requirement for protection of shareholders of full and frank disclosure of information on matters on which they ought to be informed in relation to the company's affairs, and the social expectation of what is necessary, judged against the ethical standards of society in communication with shareholders and other relevant groups.'

Source: David Flint, *A True and Fair View in Company Accounts*, London: Gee & Co., 1982.

No matter how strong a commitment there is to true and fair reporting, it is to be expected that errors will sometimes occur, for example as a result of human misjudgement or misinterpretation. In such cases, the reporting process should be open and adaptable and permit corrective action by the individuals and organisations concerned without undermining confidence in consistency.

A reporting process which is lacking in consistency is unlikely to be described as having integrity. However, achieving consistency in reporting is difficult and absolute consistency should not be the overriding objective of reporting. Due to the costs and benefits involved, it may not be appropriate to have the same narrative disclosures and measurement bases for organisations of different sizes and ownership structures which operate in different industries. The report *Measurement in financial reporting*<sup>41</sup> in the *Information for Better Markets* series argues that good regulatory practice in the public interest might justify the retention of a mixed approach to measurement for different items in the accounts and differences between classes of entity depending on their industry, ownership and governance structure, and size.

## 6.4 Underlying aspects of reporting with integrity

The analysis of integrity presented in earlier chapters distinguishes between the outward behavioural characteristics of integrity and the key aspects of integrity that underlie it. Applying the same distinction to reporting with integrity means supplementing the previous section's description of reporting that inspires confidence with a description of the character of the individuals and organisations that make such reporting possible.

Integrity in reporting can therefore be seen as having five key aspects:

- **Moral values.** People with reporting responsibilities need to embrace honesty, truthfulness and fairness and also the associations that these values have in a reporting context with notions such as substance over form, timeliness and refraining from 'hiding things in the small print.'

<sup>41</sup> *Measurement in Financial Reporting*, London: ICAEW, 2006.

- **Motives.** Reporting should be motivated by a desire to inform and allow recipients of reports to make sensible decisions, rather than by self-interested goals such as securing a bonus, enhancing the value of share options, avoiding awkward questions or saving face.
- **Commitments.** Those who report should have a commitment to the interests of the shareholders and other stakeholders to whom they are reporting and accept that they are accountable to them.
- **Qualities.** People who are involved in reporting need to be: knowledgeable about reporting; objective and analytical; sceptical and persevering in satisfying themselves that what they are reporting reflects reality; courageous enough to resist pressure and deliver unpopular news; and capable of exercising independent judgement.
- **Achievements.** Those who are involved in reporting should demonstrate their moral values, motives, commitments and qualities in facing down opposition, rejecting soft options and resisting pressure.

The importance of getting behind the behavioural characteristics of reporting with integrity is illustrated by current debates on tax avoidance. Tax avoidance, unlike tax evasion, uses legal means to reduce tax liabilities. Whilst tax avoidance complies with laws, some of the other behavioural characteristics which are normally associated with individuals of integrity may not be evident in cases of tax avoidance and can be the subject of spirited but inconclusive discussion.

Individuals of integrity are said to be honest and truthful and promote community interests. It can be argued that recent changes in national legal frameworks have encouraged honesty and truthfulness in tax reporting through requirements for early disclosure to the tax authorities of planning that meets certain criteria. However, critics of tax avoidance continue to argue that the existence of tax avoidance schemes is contrary to the promotion of community interests. Tax revenues are used for the development and maintenance of infrastructure which benefits the wider community and promotes economic activity. On the other hand, it can be argued that the existence of tax avoidance reflects individuals' and organisations' views on what they perceive to be a fair contribution to tax revenues and their perception that mitigating tax liabilities is something they have to do if they are to promote the community interests represented by the investing public.

This discussion helps to show that in public policy discussions of tax avoidance the focus should not just be on the behaviour of the individuals and organisations involved but also on the moral values that underpin the tax regime itself and whether it is seen as fair. Clarifying the ultimate objectives of a tax regime and the way in which they should be pursued would appear to be a prerequisite for enhancing the integrity of tax-related reporting.

## 6.5 Organisational drivers of integrity in reporting

The achievement of integrity in reporting depends on the efforts of individuals working in a variety of organisations. In Chapter 4 we identified the drivers of organisational integrity as leadership, strategy, policies, information and culture. Organisations of integrity need to play their part in enhancing the integrity of reporting. For integrity to live in organisations, it is necessary to embed the concept in everyday discussions, decisions and actions. Integrity needs to be internalised in an organisation, in both words and deeds.

A reporting entity that is seeking to embed the moral values, motives, commitments, qualities and achievements that are essential for reporting with integrity might be expected to take the following steps:

- **Leadership.** Executive management can set the right tone at the top by committing itself to high quality financial reporting and inviting direct communication of any concerns about reporting. The membership, resourcing and the remit of the audit committee can also send a strong signal of a company's commitment to reporting with integrity.
- **Strategy.** A company can identify clear balanced reporting to shareholders and other stakeholders as a means of maintaining their support and also state its commitment to recruiting people to senior positions with appropriate professional accounting qualifications and consequential obligations to comply with professional codes of conduct.
- **Policies.** Regular reviews of the appropriateness of accounting policies, internal controls and key risks will enhance confidence as will a well-resourced internal audit function and disciplinary procedures for misleading reporting.
- **Information.** Accounting policies should be kept up to date and clearly documented and it will be helpful to share to the fullest extent possible lessons learned, for example as a result of internal audit work or reporting lapses.
- **Culture.** Appraisal and reward systems should encourage high quality reporting rather than exerting pressure to 'make the numbers'.

Audit firms also need to address the same drivers of integrity in a similar vein and, as we saw in Chapter 5, professional accounting bodies can help to instil integrity in their members by paying attention to their own issues of leadership, strategy, policies, information and culture. This is particularly the case in countries such as the UK where membership of professional accounting bodies is not limited to auditors or those in public practice but embraces the full breadth of the economy. In such circumstances the shared ethical obligations of ICAEW members who work for reporting entities, audit firms, investors and other organisations strengthen the integrity of the reporting process.

## 6.6 The regulation of reporting

Whatever the strengths of any reporting system, whenever there is a loss of confidence in reporting, governments feel forced to take the lead in deciding what steps need to be taken to restore integrity and trust. Instilling integrity in every organisation involved in reporting is difficult since, other than the reporting process itself, there is no common link between these different organisations in different industries. In order to provide this common link, public policy mechanisms exist which span the breadth of reporting. They include requirements and prohibitions enshrined in legislation and regulation.

Legislation has played a prominent role in promoting integrity in public reporting in the UK ever since the 1840s. Company legislation created the Registrar of Companies and the requirement that accounts be audited and filed with the Registrar and made available for public inspection. In the United States of the 1930s, federal securities legislation created the Securities and Exchange Commission (SEC) and the requirement that SEC registrants' financial statements be audited and filed with the SEC and made available to investors.

In more recent times, crises have resulted in increasing measures to enable regulators to ensure that reporting entities, audit firms and professional bodies do a better job and pay attention to the drivers of integrity. In the UK, the Financial Reporting Council (FRC) aims to promote confidence in corporate reporting and governance through its own corporate governance code responsibilities and its constituent bodies which set, monitor and enforce accounting, auditing and actuarial standards and oversee the regulatory activities of the relevant professional accounting and actuarial bodies.

In the US, the Sarbanes-Oxley Act of 2002 imposed new corporate governance requirements on SEC registrants and established the Public Company Accounting Oversight Board (PCAOB) to regulate audit firms and take over certain functions previously performed by the professional accounting body, the AICPA. Legislative measures inspired by Sarbanes-Oxley have subsequently been introduced in many countries around the world.

A good overall test of the effectiveness of recent measures to restore integrity and confidence in reporting is whether they are seen to have reduced the threat of 'aggressive earnings management'. In 2001, the APB, which sets auditing standards in the UK and Republic of Ireland, published a paper<sup>42</sup> on the subject and used the term to refer to the adoption of aggressive accounting practices, including inappropriate accounting policies and unduly stretched estimates, to present the financial performance of a company in a favourable light that does not necessarily reflect the underlying reality. The SEC Chairman at that time also referred to the problems of earnings management and 'the numbers game'.

The APB identified commercial pressures on companies and management as the root cause of aggressive earnings management. Changes introduced in the US and the UK and around the world since 2002 have sought to reduce these pressures insofar as they relate to share option schemes for management and investor and analyst expectations. They have also strengthened governance arrangements so that companies and their auditors are better able to resist such pressures.

A survey was conducted by John Collier and published by ICAEW in October 2004 under the title *Aggressive earnings management: Is it still a significant threat?*<sup>43</sup> The survey showed that auditors believed that almost any form of earnings management was much less acceptable and harder to get away with. The overall view of respondents, who comprised finance directors, audit committee chairmen, investment analysts and journalists, as well as auditors, was that the incidence of aggressive earnings management was probably less than when the APB issued its report. Anecdotal evidence, for example in comments made by Jim Turley, Ernst & Young's Global Chairman and CEO, at ICAEW's *Emerging Issues* roundtable in January 2007,<sup>44</sup> suggests that this trend has continued across major markets since 2004 and that aggressive earnings management is now much reduced.

## 6.7 The future of reporting with integrity

So what does the future hold? Should we assume that any future loss of confidence and calls to restore integrity will result in further strengthening of the regulation and oversight of reporting companies, audit firms and professional accounting bodies? Although history indicates that this is inevitable, there are other possibilities.

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<sup>42</sup> *Aggressive Earnings Management*, Auditing Practices Board, 2001.

<sup>43</sup> John Collier, *Aggressive earnings management: Is it still a significant threat?*, London: ICAEW, 2004.

<sup>44</sup> Beyond the myth of Anglo-American corporate governance: Emerging issues roundtable and dinner, 9 & 10 January 2007. DVD available via [corporategovernance@icaew.com](mailto:corporategovernance@icaew.com).

- When there is a loss of trust in reporting, it might be suggested that the allocation of responsibility and follow-up action should not be too narrow in their focus. The IFAC commissioned taskforce to look at ways of restoring confidence in financial reporting drew on the idea of the corporate reporting supply chain in its 2003 report *Rebuilding Public Confidence in Financial Reporting: An International Perspective*. According to taskforce member Graham Ward, the taskforce was of the view that integrity should apply to the whole reporting chain and should apply to ‘an organisation’s management, board of directors, the audit committee, the people who advise them – such as lawyers and PR consultants – regulators and users. Everyone in the financial reporting chain has to put the truth and fairness of the financial reports above any other considerations’.<sup>45</sup> The recent work of the *Audit Quality Forum*, convened by ICAEW, on the forthcoming publication, *Third Parties*,<sup>46</sup> points to the challenges involved in ensuring that, so far as is possible, all those who can affect the quality of reporting promote its integrity.
- It can be debated whether regulatory responses really restore trust by boosting integrity. Regulation can be a great source of strength and backup for individuals of integrity who embrace the moral values of honesty, truthfulness and fairness, who are motivated not by self-interest but a desire to inform, who are committed to the interests of shareholders and who have qualities of objectivity, perseverance, courage and judgement. However, there is always the risk that regulation will become overbearing and discourage such people of integrity from wanting to be involved in reporting. A particular risk arises if in an understandable attempt to ensure that professionals are accountable for their work, regulation drains professional work of its challenge and judgement and reduces it to box-ticking.

Integrity requires a personal belief in principles; it is also a matter of personal reflection and judgement. Some would argue that because regulation is externally imposed and is there to be complied with, it fails to inspire a sense of identity and standing for something, two ideas which are closely associated with integrity. If this is the case, regulation could make matters worse by dissolving the very notion of integrity.

Moreover, no matter how genuine regulators are in their willingness to develop their leadership, strategy, policies, information and culture to build integrity across the reporting process, they will encounter limits to what they can do if only due to resource constraints. As a result, regulators, who themselves employ members of the accounting and other professions, should continue to count on the support of professional bodies and their members to achieve their objectives and instil integrity in the reporting process. It should also be remembered that codes developed within a profession often carry greater weight and are complied with in spirit to a greater degree than those imposed from outside.

The accounting profession encompasses people in various roles, functions, organisations and industries with the ability to enhance the integrity of reporting. What unites members of a profession are common principles, values and standards which apply to them wherever they work. They are a community bound together by mutual obligations to each other as well as obligations to their professional body. The broader the membership base of a professional accounting body and the more widely dispersed it is across the economy, the greater is its beneficial impact on the integrity of reporting. The accounting profession therefore continues to have a central role to play in instilling integrity across the reporting process. Professional bodies also have a crucial responsibility to develop and support individuals of integrity who set a broader example within the organisations and societies where they make their contribution.

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<sup>45</sup> Lesley Bolton, ‘In the Public Interest’, *Accountancy*, March 2005.

<sup>46</sup> Audit Quality Forum, *Third Parties*, London: ICAEW, 2007 (forthcoming).

## Panel 6.2: Summary of the argument

- The reporting process of a country or a market is a complex web of interactions, communications and discussions between individuals including many who do not work for reporting entities.
- An overall reporting process with the integrity to inspire confidence will be seen to be honest and truthful, to be fair, to comply with laws, to promote community interests, to be open and adaptable, to take corrective action and to show consistency.
- Integrity in reporting needs to be underpinned by moral values such as honesty, motives such as a desire to inform, commitments to the interests of shareholders and others, qualities such as scepticism and perseverance, and achievements in the face of opposition.
- Reporting with integrity relies on reporting entities, audit firms, professional bodies and other organisations taking steps to promote integrity through their leadership, strategy, policies, information and culture.
- Public policy mechanisms that link together the various organisations involved in reporting include requirements and prohibitions enshrined in legislation and regulation. Whilst these can be a great source of strength for individuals of integrity, there is a risk of externally imposed regulation dissolving the very notion of integrity and its sense of identity and standing for something.

## 6.8 Questions for discussion

16. Can the integrity of reporting as a whole be usefully debated and taken forward as a public policy issue and if so how? If not, why not?
17. Do you agree that a reporting process with the integrity to inspire confidence needs to be honest and truthful, to be fair, to comply with laws, to promote community interests, to be open and adaptable, to take corrective action and to show consistency?
18. Do you agree that integrity in reporting can be analysed using the proposed key aspects of moral values, motives, commitments, qualities and achievements? If not, why not?
19. Do you believe that changes made since 2001 have significantly reduced the threat of aggressive earnings management across the world's markets and why? If not, what more needs to be done?
20. What further research is needed on different institutional arrangements covering reporting entities, audit firms, professional bodies, regulators and other organisations and their impact on the integrity of reporting?

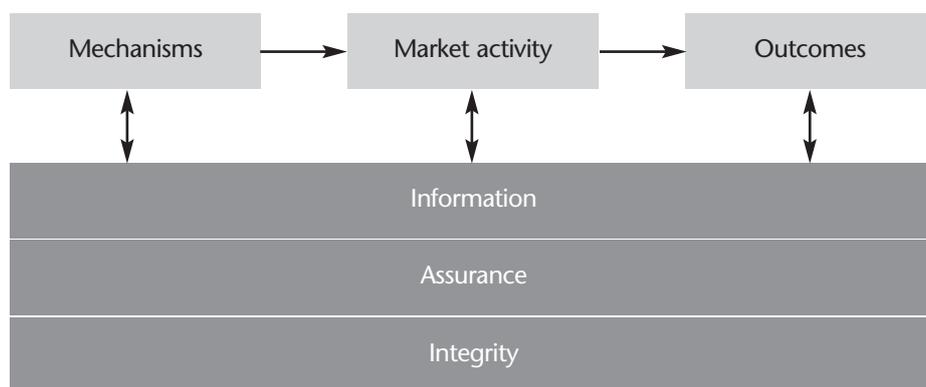
# Appendix 1:

## The role of integrity in public policy

An earlier report in ICAEW's *Information for Better Markets* campaign, *Information for markets and society*, sets out a way of approaching public policy issues that stresses the role of information in the design, implementation and assessment of public policy.

*Information for markets and society* provides a sample model – the Information for Better Markets Framework – for illustrating the importance of integrity, assurance and information for guiding mechanisms and market activity towards the achievement of desired outcomes. This is illustrated below.

**Figure A1.1: The Information for Better Markets Framework**



**Outcomes** are desired results of public policy, such as improving people's health or education or national economic performance, or protecting the environment, or reducing crime. The desired outcomes of public policy are usually achieved through lower level subordinate outcomes, which are in turn achieved through outcomes at a yet lower level, and so on. Potentially this process can go on ad infinitum, but in practice it is usually sufficient to trace outcomes down through no more than a few levels.

**Mechanisms** are the means that society employs to promote the outcomes that it desires. Mechanisms are ways of persuading, requiring or incentivising individuals to change their behaviour. They include corporate policies, supply chain pressure, stakeholder engagement, voluntary codes, rating and benchmarking, taxes and subsidies, tradable permits, and requirements and prohibitions.

**Market** activity in this context is a term used to describe all the activities of individuals and organisations that lead to the achievement (or non-achievement) of desired outcomes.

**Information** influences and is itself influenced by mechanisms, market activity and desired outcomes. This feedback loop in turn affects the design of mechanisms, market activity and the specification of market outcomes. Information also provides evidence as to whether desired outcomes have been achieved. If desired outcomes have not been achieved, this may cause mechanisms to be changed in order to guide market activity towards the attainment of desired outcomes. Alternatively, the specification of the desired outcomes may change.

However, the ability of market activity and public policy to deliver desired outcomes is dependent on society's ability to rely on high quality information which in turn needs to be prepared and reported by people and organisations who have and are perceived to have **integrity**. At times, the reliability of information can be enhanced by objective and independent verification from a third party, that is, **assurance**. However, for assurance to be of value, it must be conducted by people who have and are perceived to have integrity.

## Appendix 2: Kohlberg's six stages of moral development

Level and Stage	Content of stage		
	What is Right	Reasons for Doing Right	Social Perspective of Stage
<b>Level I: Preconventional</b> Stage 1 – Heteronomous Morality	To avoid breaking rules backed by punishment, obedience for its own sake, and avoiding physical damage to persons and property.	Avoidance of punishment, and the superior power of authorities.	<b>Egocentric point of view.</b> Doesn't consider the interests of others or recognize that they differ from actors; doesn't relate two points of view. Actions are considered physically rather than in terms of psychological interests of others. Confusion of authority's perspective with one's own.
Stage 2 – Individualism, Instrumental Purpose, and Exchange	Following rules only when it is to someone's immediate interest; acting to meet one's own interests and needs and letting others do the same. Right is also what's fair, what's an equal exchange, a deal, an agreement.	To serve one's own needs or interests in a world where you have to recognise that other people have their interests, too.	<b>Concrete individualistic perspective.</b> Aware that everybody has his own interest to pursue and these conflict, so that right is relative (in the concrete individualistic sense).
<b>Level II: Conventional</b> Stage 3 – Mutual Interpersonal Expectations, Relationships, and Interpersonal Conformity	Living up to what is expected by people close to you or what people generally expect of people in your role as son, brother, friend, etc. 'Being good' is important and means having good motives, showing concern about others. It also means keeping mutual relationships, such as trust, loyalty, respect and gratitude.	The need to be a good person in your own eyes and those of others. Your caring for others. Belief in the Golden Rule. Desire to maintain rules and authority which support stereotypical good behaviour.	<b>Perspective of the individual in relationships with other individuals.</b> Aware of shared feelings, agreements, and expectations which take primacy over individual interests. Relates points of view through the concrete Golden Rule, putting yourself in the other person's shoes. Does not yet consider generalized system perspective.
Stage 4 – Social System and Conscience	Fulfilling the actual duties to which you have agreed. Laws are to be upheld except in extreme cases where they conflict with other fixed social duties. Right is also contributing to society, the group, or institution.	To keep the institution going as a whole, to avoid the breakdown in the system 'if everyone did it', or the imperative of conscience to meet one's defined obligations. (Easily confused with Stage 3 belief in rules and authority; see text.)	<b>Differentiates societal point of view from interpersonal agreement or motives.</b> Takes the point of view of the system that defines roles and rules. Considers individual relations in terms of place in the system.

Level and Stage	Content of stage		
	What is Right	Reasons for Doing Right	Social Perspective of Stage
<b>Level III: Postconventional, or Principled</b> Stage 5 – Social Contract or Utility and Individual Rights	Being aware that people hold a variety of values and opinions, that most values and rules are relative to your group. These relative rules should usually be upheld, however, in the interest of impartiality and because they are the social contract. Some non-relative values and rights like <b>life</b> and <b>liberty</b> , however, must be upheld in any society and regardless of majority opinion.	A sense of obligation to law because of one’s social contract to make and abide by laws for the welfare of all and for the protection of all people’s rights. A feeling of contractual commitment, freely entered upon, to family, friendship, trust and work obligations. Concern that a laws and duties be based on rational calculation of overall utility, ‘the greatest good for the greatest number’.	<b>Prior-to-society perspective.</b> Perspective of a rational individual aware of values and rights prior to social attachments and contracts. Integrates perspectives by formal mechanisms of agreement, contract, objective impartiality, and due process. Considers moral and legal points of view; recognizes that they sometimes conflict and finds it difficult to integrate them.
Stage 6 – Universal Ethical Principles	Following self-chosen ethical principles. Particular laws or social agreements are usually valid because they rest on such principles. When laws violate these principles, one acts in accordance with the principles. Principles are universal principles of justice: the equality of human rights and respect of the dignity of human beings as individual persons.	The belief as a rational person in the validity of universal moral principles, and a sense of personal commitment to them.	<b>Perspective of a moral point of view from which social arrangements derive.</b> Perspective is that of any rational individual recognising the nature of morality or the fact that persons are ends in themselves and must be treated as such.

Source: Lawrence Kohlberg, ‘The psychology of moral development: the nature and validity of moral stages’, *Essays on moral development*; volume 2, San Francisco: Harper & Row, 1984.

# Appendix 3: The IFAC Ethics Education Framework

In September 2006 the IAESB issued the proposed International Education Practice Statement: *Approaches to Developing and Maintaining Professional Values, Ethics and Attitudes*. This contains the Ethics Education Framework reproduced below which recognises that there is a continuum in ethics education which begins during the training period before qualifying and continues post-qualification as part of the commitment to CPD.

**Figure A3.1: The IFAC Ethics Education Framework**

**The Learning Continuum: Pre- and Post-Qualifying Stages**

Stage	Learning Outcome	Competence Required	Focus of Program Content
<b>Stage 4:</b> Maintaining an ongoing commitment to ethical behavior (Professional Accountants)	Maintaining an ongoing commitment to ethical behavior.	An understanding of organizational and situational contexts and the application of ethical knowledge, sensitivity and judgment into ethical behavior.	Factors affecting ethical decision-making and ethical behavior.
<b>Stage 3:</b> Improving ethical judgment (Students and Professional Accountants)	Improving professional judgment by sharpening ethical decision-making skills.	Ability to make ethical judgments and decisions based on an understanding and application of ethics knowledge and ethical sensitivity.	Application of ethical theories, social responsibilities, codes of professional conduct and other ethical decision models.
<b>Stage 2:</b> Developing ethical sensitivity (Students)	Developing a sense of professional responsibility with ethical sensitivity and an appreciation of ethical threats.	Sensitivity to ethical issues and threats in the functional disciplines of accounting.	Common issues and ethical threats facing students and accountants in real work environments.
<b>Stage 1:</b> Enhancing ethics knowledge (Students)	Enhancing the knowledge of (i) relevant standards and (ii) expectations of ethical and professional conduct.	Knowledge of traditional ethical concepts and theories, and of those relating to the professional accountant's work.	Fundamental theories and principles of ethics, virtues and individual moral development.

APPROACHES TO DEVELOPING AND MAINTAINING PROFESSIONAL VALUES, ETHICS AND ATTITUDES

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None of the commentators should be assumed to agree with the views expressed in this report, and they are not responsible for any errors or omissions.

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