

ETHICAL CLIMATE AND ETHICAL LEADERSHIP IN PUBLIC ACCOUNTING FIRMS

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ABSTRACT

The purpose of this paper is to explore the relationship between ethical work climate and corporate leadership. We discuss leadership style, ethical work climate, and ethical leadership. We seek to explore these relationships among established conceptual frameworks, and we intend to apply them to public accounting firms at the conceptual level. The paper concludes with a proposed model to empirically investigate how the frameworks and concepts apply to the public accounting setting. The goal is to ascertain whether the proposed relationships hold within the setting of professional service firms in order to better understand the factors impacting ethical behavior in public accounting firms.

Key words: ethical work climate, ethical leadership, organizational culture, public accounting firms

INTRODUCTION

Victor and Cullen's (1987, 1988) conceptualization of ethical work climate theory and subsequent development of the ethical climate questionnaire (ECQ) has supported numerous and significant research streams. Public accounting firms, as professional service firms, may be less influenced by organizational culture due to the impact of professional duties and obligations that transcend organizational membership. As such, ethical climate may be different in accounting firms and the role of leadership may be different in such professional service firms. Accounting firms are responsible for ensuring ethical financial reporting of businesses; it is of interest how the firms themselves employ leadership style to influence firm

culture and how both leadership style and organizational culture work together to establish and support an ethical work climate within the professional accounting firm. The objective of this paper is to explore the relationships between leadership style, organizational culture, ethical work climate, and ethical leadership with a specific lens of how these relationships may be different within public accounting firms as professional service firms. Additionally, we set forth a proposed method of empirical investigation into the relative importance of each construct in the determination of ethical behavior within public accounting firms.

LEADERSHIP AND CULTURE

Schein (1992) provides a discussion of the relationship between leadership and organizational culture. Leaders create (and potentially destroy) culture. Gottlieb and Sanzgiri (1996) discuss the reciprocal relationship between culture and leadership and illustrate assumptions embedded in culture that guide the ethical decision-making process. Carlson and Perrewe (1995) outline the elements of culture that combine with transformational leadership to create an ethical organization. Yet, when applied to the specific environment of the public accounting firm, the influence of external professional standards, codes of conduct, and government sanctions for SEC violations may alter the relative importance of leadership and culture. It is within this context that we seek to understand how the two constructs of leadership style and organizational culture jointly impact ethical behavior in public accounting firms.

Schein (1992) points out that “organizational cultures are created in part by leaders, and one of the most decisive functions of leadership is the creation, management and sometimes even destruction of culture” (p.5). Schein suggests culture emerges from three sources: beliefs, values, and assumptions of the founder; learned experiences of group members as their organization evolves; and new beliefs, values, and assumptions brought in by new members and leaders. The founder’s role in setting and establishing the culture is critical. Bass and Avolio (1993) suggest that “founders often create an organizational culture from a preconceived ‘cultural scheme in their heads’” (p. 114).

Bass and Avolio (1993) discuss the importance of leadership style in the formation of culture and suggest a reciprocal relationship between culture and leadership. Effective leaders develop and maintain a strong

culture that supports the organization's vision. The authors contrast transactional leadership, where leaders approach subordinates with a series of transactional exchanges that assumes a give-and-take workplace environment conducted primarily through negotiation, with transformational leadership, where negotiation gives way to shared vision, subordinate empowerment, and leading by example. They suggest how the two styles can produce dramatically different cultures. Gottlieb and Sanzgiri (1996) discuss the pervasive nature of the reciprocal relationship between organizational culture and leadership, pointing out that "included in organization culture are basic ethical assumptions concerning what is right and wrong, proper and fair. It acts as an unconscious judge for ethical behavior and ethical decision making" (p. 1278).

Leadership style must adjust to different organizational environments (Schein, 1992). On the one hand, transactional leadership may be appropriate for an organization comfortable with its ethical and cultural domain. On the other hand, an organization experiencing tension from challenges to its moral underpinnings may require more transformational leadership. Carlson and Perrewe (1995) suggest that certain characteristics of transformational leadership are well suited to influence the development of a "strong" organizational culture including vision, understanding of human needs, and a strong set of personal core values. In other words, they have the ability to "transform their followers by activating higher order needs, emphasizing the value of certain outcomes, influencing followers to put organizations before their own self interest" (p. 831).

Schein (1992) outlines five primary mechanisms leaders use to influence culture: a) what they pay attention to, what they measure; b) reaction to critical incidents; c) deliberate role modeling; d) criteria leaders use for allocation of rewards and status; and e) criteria for recruitment, selection, promotion and retirement. These five items may be understood as important parts of a transformational leadership approach, particularly deliberate role modeling. Leaders of newly formed organizations are in a unique position to actively shape a culture that embraces and institutionalizes the highest ethical standards. Using stories of leaders as role models serves to reinforce the pivotal impact of organizational leaders and of organizational founders in particular.

Sims (2000) also emphasizes the role of leadership in developing and then actively managing a culture that integrates ethical standards.

Culture plays a central role in the socialization process and must clearly signal that the organization supports ethical behavior. The author also emphasizes the role of the leader in newly formed organizations: “the goal of today and tomorrow’s leader should be to ensure that they build and maintain a strong ethical organizational culture from the start so they won’t have to undertake the challenges of turning around an unethical culture” (p.76). Park and Kang (2014) investigated the role of the founder’s ethical leadership and reported that ethical leadership impacted the organization’s ethical climate not only in the initial stage of the organization, but also at later points in time throughout the life cycle of the organization. Choi, et al. (2015) found that ethical leadership impacts employee attitudes toward corporate social responsibility.

Brown, et al. (2005) provide a concrete definition of ethical leadership that clearly delineates it from leadership in the broader sense, along with an instrument to measure ethical leadership (the Ethical Leadership Scale, ELS). While ethical leadership bears resemblance to transformational leadership (e.g., Zehir, et al. 2014), there are aspects of transactional leadership that would be found in ethical leaders as well. The authors suggest that ethical leadership encompasses being an appropriate and legitimate role model, making desired behaviors explicitly known throughout the organization, and reinforcing those behaviors via rewards for appropriate behavior and discipline for inappropriate behavior. Brown, et al.’s (2005) definition of ethical leadership is “*the demonstration of normatively appropriate conduct through personal actions and interpersonal relationships, and the promotion of such conduct to followers through two-way communication, reinforcement, and decision-making*” (p. 120, emphasis in original). Not only is an ethical leader someone who serves as a role model, but an ethical leader must also clearly communicate appropriate behaviors and expectations and then follow through with methods of reinforcement of such behaviors. Brown and Trevino (2006) provide a conceptual framework for how ethical leadership impacts several follower outcomes, including ethical decision-making. They suggest that both situational influences and individual characteristics impact the construct of ethical leadership and that ethical leadership has a direct impact on follower outcomes.

ETHICAL WORK CLIMATE

Arguing that individual characteristics were insufficient to explain determinants of ethical decisions in an organizational context, Victor and Cullen (1988) developed the concept of ethical work climate which they defined as: “the prevailing perception of typical organization practices and procedures that have ethical content” (p.101). The approach used to develop a theoretical typology of ethical work climate was based on theories of both moral philosophy and sociology. From moral philosophy, the ethical dimensions were based on egoism, benevolence, and deontology. These roughly correspond to the levels of cognitive moral development espoused by Lawrence Kohlberg (1969). As Kohlberg’s theory is based on individual moral judgments and ethical work climate is a group level phenomenon, the second dimension of climate is based upon the referent group (or level) considered when making ethical judgments. Victor and Cullen (1988) suggest that any one of the three ethical dimensions may operate at the individual, company or cosmopolitan (broad social) level.

Victor and Cullen (1988) argue that ethical climates are multidimensional and represent normative control systems molded by societal norms, organizational form, and certain firm specific factors. Vidaver-Cohen (1998) argued that Victor and Cullen’s (1988) model and ensuing Ethical Climate Questionnaire (ECQ) left several important questions unanswered. Specifically, she points out that the “model does not (a) guide prediction about when, where or how a certain climate type might emerge, nor does it (b) tell managers and field researchers precisely how organizational processes must be changed to transform moral climates in the firm” (p. 1221). When applying this concern to the public accounting profession, we are interested in whether ethical climates are cohesively perceived within firms, whether such ethical climates impact the thinking and behavior of accountants within the firms, and how stable climates emerge given the high turnover at the staff level in public accounting firms.

Trevino, et al. (1998) also suggested a broader view may be more appropriate and that empirical evidence of the relationship between ethical climate and ethical behavior is lacking. Further discussion ties ethical work climate and ethical environment under one umbrella while continuing to distinguish between leaders and non-leaders and their corresponding ethical perceptions. For example, partners in the tax profession perceive the ethical environment to be stronger than non-partner professionals (Bobek, et al.

2015). Among firm leaders, a strong public interest orientation (i.e. feeling a responsibility to serve the public interest) and a higher frequency of receiving mentoring are associated with such stronger perceptions of the ethical environment (Bobek, et al., 2015). The higher level of perceived fit to the ethical climate of a firm was associated with higher levels of perceived job satisfaction (Domino, et al. 2015), organizational commitment (Domino, et al., 2015; Dermidas & Akdogan, 2015; McManus & Subramaniam, 2014), and lower turnover intentions (Demirtas & Akdogan, 2015). Within professional accounting firms, where turnover tends to be high (Johnson & Pike, 2018), the relationship between climate fit and organizational commitment warrants further specific investigation.

Additionally, we feel more attention needs to be focused on the relationship between ethical climate and ethical leadership. Demirtas and Akdogan (2015) found that ethical leadership helps shape perceptions of ethical climate. The authors used Brown, et al.'s (2005) Ethical Leadership Scale and Victor and Cullen's (1988) Ethical Climate Questionnaire. Their findings of ethical leadership having both direct and indirect effects on the specific outcomes of affective commitment and turnover intentions may have specific implications for the public accounting profession. The indirect effect of ethical leadership found by Demirtas and Akdogan (2015) was that ethical leadership shapes perceptions of ethical climate. We are particularly interested in the strength of that relationship within the public accounting profession.

PUBLIC ACCOUNTING FIRMS AS UNIQUE WORKPLACE ENVIRONMENTS

Given the paramount importance of ethical behavior (both real and perceived) by accountants, and given the heightened scrutiny of accounting firms (McManus & Subramaniam, 2014) and emphasis given to improved audit firm behavior upon the passage of the Sarbanes-Oxley Act of 2002, we intend to add to the literature investigating aspects of public accounting firms that either promote or deter ethical behavior among accounting professionals. It is understood from the literature discussed above that both organizational ethical climate and ethical leadership play important roles in creating a culture that encourages ethical behavior within corporations. The public accounting profession is one where there are simultaneously professional standards guiding appropriate behavior along with the potential

impact of accounting firm leadership and accounting firm culture. As a result, it is unclear as to whether ethical leadership plays as pivotal a role in enforcing ethical behavior in accounting firms as it does in the corporate setting. Similarly, the importance of a firm's ethical climate to the individual accountant's ethical decision-making process is also worthy of investigation because of historically high turnover rates (Johnson & Pike, 2018), the presence of external professional standards, and the potential of government-imposed sanctions and penalties may play a larger role than the perceived climate or the leadership style of firm managers and partners, or both in concert. We posit that leadership style and ethical climate will still be important in fostering a supportive environment that encourages ethical behavior, but we are interested in determining the relative importance of external regulations, ethical leadership, and ethical climate. The goal of the research is to discern how to positively influence employees' ethical behavior as applied to the public accounting profession and the mission of maintaining the public's trust. While research has increased the knowledge base of the topic over the past two decades, we concur that much is yet to be understood about ethics and unethical choices (Kish-Gephart, et al., 2010).

FUTURE RESEARCH

Our intended sample includes accounting firms of varying sizes and we will include individuals at all levels of the firms included in the sample. The survey instrument will consist of Brown, et al.'s (2005) 10-item Ethical Leadership Scale, Victor and Cullen's (1988) 26-item Ethical Climate Questionnaire, and a series of questions soliciting information about perceived importance of external expectations of the wider profession, internal firm expectations of behavior, and individual perceptions of morality. We will compare responses among various levels within the firms, from staff accountant to senior to manager to partner. The goal is to improve understanding of what the major influencers are to ethical behavior in order to ultimately promote and increase ethical behavior within the public accounting profession.

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