

MORALITY, ETHICS AND ACCOUNTING'S SOCIO-ECONOMIC ROLE IN THE
CONTROL AND MITIGATING OF CORRUPTION

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1.0 INTRODUCTION

Control and containment of corruption, one of Accounting's more important roles in society, is fraught with difficulties and temptations that put accountants at risk of being sidetracked, confused or (worse yet) corrupted. As Lambsdorff & Schramm (2005, p.1) assert:

“...the world is not short of ideas on how to tackle corruption. While good intentions abound we currently know little about their likely success”

This paper evaluates what accountants can and should do about corruption. The limited success of previous research in this area likely arises from three main factors—that research:

- Started from the most common definition of corruption as “the misuse of power or public office for a private gain or interest”, rather than searching for a first-principles definition,
- Presumed that corruption is always wrong and focused on *what accounting can do about it*, rather than considering socio-economic and moral aspects of corruption so as to expand the research scope to *what accounting can and should do about corruption*, and
- Further limited its scope to the supply-side of corruption (e.g. developing strategies to raise the overall cost of being corrupt) rather than considering both the supply-and the demand-side of corruption.

This paper draws from an earlier study on corruption's socio-economic and moral aspects to redefine it as the tort “harm arising from a breach of an owed a duty of care” (Alzadjali, 2009a). That definition:

- Eases difficulties in proving the existence of corruption,
- Directs the search for perpetrators and victims of corruption and suggests the appropriate restitution,
- Enables *ex-post* controls by creating significant financial risks for the corrupt, and
- Provides insights on the creation of cost-effective *ex-ante* controls.

While a strong moral-and-ethical case can be made that society should limit, mitigate, or where possible, eradicate corruption, the intent of this paper is to work from a clear and useful definition of corruption to develop practical and viable means for accountants to work via the law and other authorities to contain and control the blight of corruption.

2.0 MORAL AND ETHICAL DIMENSIONS

Morality and ethics have historically contributed greatly to the corruption-control strategies of Accounting. These controls have usually been accreted in successive layers of regulation and controls—with new layers being added when and as new corruption-driven outrages high-lighted failings in the extant controls. Typically, these controls impair efficiency, but when and as they are (in turn) shown to be subject to circumvention, they are added to rather than

replaced. As all controls ultimately fail, there is usually a deep succession of controls with most adding little or no value. Thus, a major cost of corruption is the inefficiency imposed on society by the vast and ever growing morass of rules, regulations, controls and norms established to contain and control corruption but never quite succeeding. If a *magic-bullet* was found for corruption, the resulting rise in trust and fall in transaction costs would likely spawn a socio-economic-and-cultural Renaissance that could free most of humanity from the spectres of hunger, poverty, and privation.

The interest in morality and ethics as a potential source of a magic-bullet for corruption is evidenced by a rising number of academic studies. However, the subjectivity associated with morality and ethics tend to cause such studies to be fuzzy and inconclusive, at best. Many organisations seek to ease this subjectivity by codifying what is moral and ethical behaviour. However, as Davies (1991; per Andrew, 1998) notes: these codes tend to be widely ignored in their own organisation, are rarely enforced to any degree or consistency, and almost never influence the actions and choices of corporate decision makers. Such revealed preference strongly suggests that *morality-and-ethics codes* are established more for public relations and display, than for any real, sustained-use as a guide, boundary, constraint, or control on organisation thinking, decisions, and actions.

As far back as Plato, Aristotle, Augustine and Aquinas, morality was authoritative in judging if an action was *right or wrong* and ethics has long been associated with assessing the nature of individuals. Thus, morality and ethics combine to form the core of how many individuals perceive, interpret, and judge their own behaviour and actions. Shared morality and ethics foster and encourage the many different human values that form any given culture. Thus, any attempt to fight corruption, via morality and ethics, is likely to be deflected by serious issues relating to individual and cultural values. For example, one of many attempts to define the nature of Thai corruption focused on the perceptions and experiences of public officials; that study highlighted that most “...respondents thought corruption was part of life in Thai society [and that bribery] was seen as customary” (Bhargava & Bolongaita, 2004, p. 174).

Morality and ethics are intangibles that are often context sensitive and often arise from a long history that may not be apparent to an observer or (even) to the actual actors—as a result, efforts to combat corruption via morality and ethics tend to be deflected by the enormous difficulty and inertia of displacing extant, but often implicit, cultural values and norms.

Morality and ethics have been the focus in a large number of corruption studies across a wide array of disciplines (sociology, criminology, psychology, political science, etc) but, because of the aforementioned issues, these studies provide little or nothing that is not inclusive or indeterminate. While morality and ethics may ultimately provide a long-term way to resolve corruption, currently unresolved, conflicting and compounding issues confound the search for a workable moral-and-ethical resolution to corruption. Thus, in the short- to intermediate-term, a workable resolution to corruption is more likely to arise from a combination of the more focused-and-applied accounting and law disciplines.

While a strong moral-and-ethical case can and has been made for limiting, mitigating, and (where and as possible) eradicating corruption, there are currently no means to effect such aspirations. Less elegant but more practical temporary means are needed, in the interim, to control and contain corruption, while more elegant long-term corruption-control strategies are developed to change attitudes and behaviour.

Stapenhurst & Kpundeh (1999, p.8) conclude that "...curbing corruption is not merely about ethics and morality; it is about sound governance and the effective, efficient use of public resources for the public good". Wright & Sayed (2003), in their article "Accounting Practice and Theory: A Social-Institution Account", assert that "...deviations from fairness break trust, increase transaction costs and, when breaches in trust become endemic ...our civilization will lose legitimacy and then fail." This notion is consistent with the definition, mentioned earlier, that corruption is a breach of duty of care.

Accounting can, in fulfilling its other roles (e.g. providing information and organising control systems), implement strategies to help participants more easily prevent or resolve corruption by identifying and avoiding such situations, or providing exit strategies (for situations where corruption is foreseeable), or exposing/documenting corruption when it occurs. Accounting can, therefore, cost-effectively mitigate corruption via prevention (where possible) or helping to identify, convict, and strongly discipline culprits after corruption occurs.

2.1 Moral and Ethical Dimensions of Corruption Resolution

While the next section shows how trust is essential to most successful relationships, Everett et al. (2007, p. 521) assert in counter-point that a reduction of trust can reduce opportunities for corruption and suggest that eliminating subsidies, lowering trade barriers, privatising government assets, and minimising regulation will "...*unambiguously* reduce opportunities for corruption". However, corruption in these examples is less a matter of trust gone-wrong

and more an example of the old Roman adage “*quis custodiet ipsos custodes?*” (i.e. who will guard the guards themselves; Juvenal, a Roman satirist, 55-127 CE). This is a common issue—e.g. the police have a duty protect the public and catch criminals, but there is a risk they will use their authority to become criminal, so the police have an internal-affairs department, who may be tempted by corruption, and so forth. Thus, the only effective way to reduce the opportunity for corruption is to attack corruption at its root. However, as Thoreau (1854, p. 80) noted: “There are a thousand hacking at the branches of evil to one who is striking at the root...”

In a variant of the above issue Sterling, (1971, p.34 and 1975) asserts that accountants conceive of “...issues in such a way that they in principle are unresolvable [and, as a result,] ... move from one unresolved issue to another, while the stock of unresolved issues continues to increase.” Accounting, in developing a resolution to corruption, should recognize that the needs of the direct and indirect victims of corruption may differ from the general needs of society. It is also important to note that, as Alzadjali, et al. (2009b, p. 14) found, corruption is never victimless, it is “...pernicious at all levels...—there is no corruption sweet-spot”. Thus, any resolution of corruption must not only contain and control it, but also inform its victims in such a way as to assist them in demanding and winning compensation.

Everett et al. (2007) suggest that to precisely address corruption, we should consider three broad categories of solution: control, exit, and voice. The definition of corruption used in this paper, considers these possible strategies so as to provide accountants with more control and information to make better judgments. In addition, it helps provide an appropriate exit from corrupt situations, and enables victims (individual and/or groups) to voice their losses and needs so as to claim restitution from those who have harmed them and/or otherwise failed to discharge a legitimate duty of care. A large part of the corruption controls will be embedded in written or implied legal and social contracts that explicitly state what duties of care are owed, by whom and to whom. The greatest harm to society from corruption is not in what is stolen (i.e. in economic terms, it merely transfers value and, thus, nets to a zero-sum game), but rather in what is destroyed and trust is one of the greatest values destroyed by corruption. As by Zaghloul & Hartman (2003) note: “[in] the absence of trust in business relationships [there] is significant need for a good and powerful control system to manage and administrate the contracting process”. An additional significant advantage of inherent or enforced trust is that it greatly reduces information and transaction costs and, thus, significantly reduces the cost of doing business.

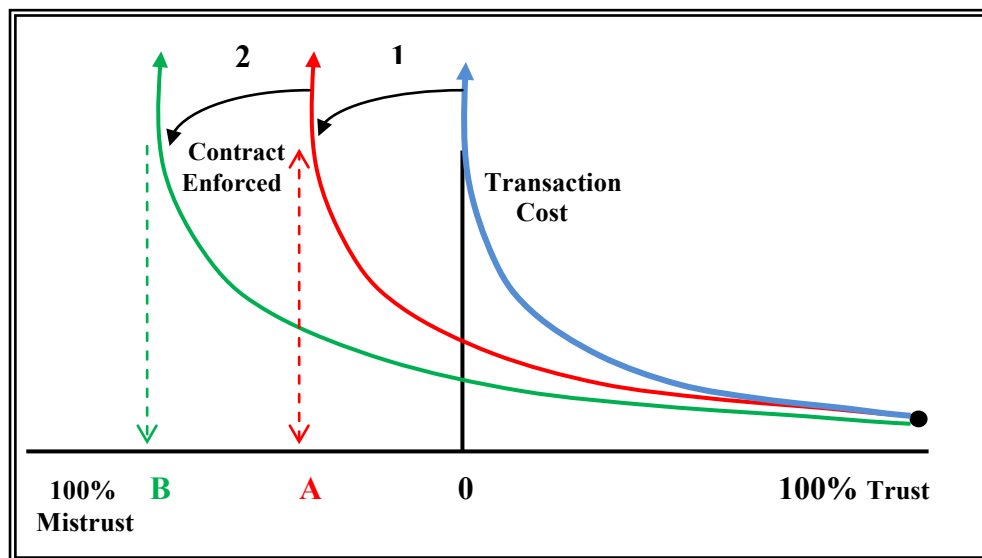
3.0 TRUST VS. TRANSACTION COST

Trust between parties helps to minimize information and transaction costs in most situations (Akerlof, 1970). Mistrust adds to costs in several ways, including (as Zaghloul & Hartman, 2003, note):

- Uncertainty of work conditions,
- Delaying events,
- Indemnification,
- Liquidated damages, and
- Excessive documentation.

The effect of the trust-to-mistrust continuum on transaction costs are illustrated in Figure 1.

Figure 1: The Effect of the Trust-to-Mistrust Gradient on Transaction Costs



The main points drawn from Figure 1 are:

- 1. Trust reduces transaction costs** – As trust declines, transaction costs rise exponentially and approach infinity as trust approaches nil. Actual or potential corruption makes it difficult and/or unwise to sustain trust.
- 2. Accounting and a trustworthy legal system complement or enhance trust** – This causes the transaction-cost curve to rotate downward and even allows transactions to occur where a minor degree of mistrust exists. However, as shown in Figure 1, mistrust imposes serious costs on business and makes transactions too costly where the mistrust is high.
- 3. If high and certain cost are imposed on trust breakers, transactions are viable even with great mistrust** – This situation can occur where there is effective accounting and law (i.e. contract enforcement via a trusted, effective, efficient and timely legal system) or by brutal extra-legal systems. However, in the later case, the enforcement system must be both feared and trusted—which may explain why organised-crime groups tend to have codes and neo-feudal systems of inter-locking entitlements and cross-obligations.

While both legal and extra-legal (organised crime) approaches can reduce transaction costs to where transactions are viable even if there is great mistrust, Figures 2 and 3 show that extra-

legal approaches to enforcing contracts in highly corrupt societies tend to be associated with a huge increase in violence and a significant reduction in subjective well being.

Figure 2: Violent Death Rate as a Function of the Corruption Rate

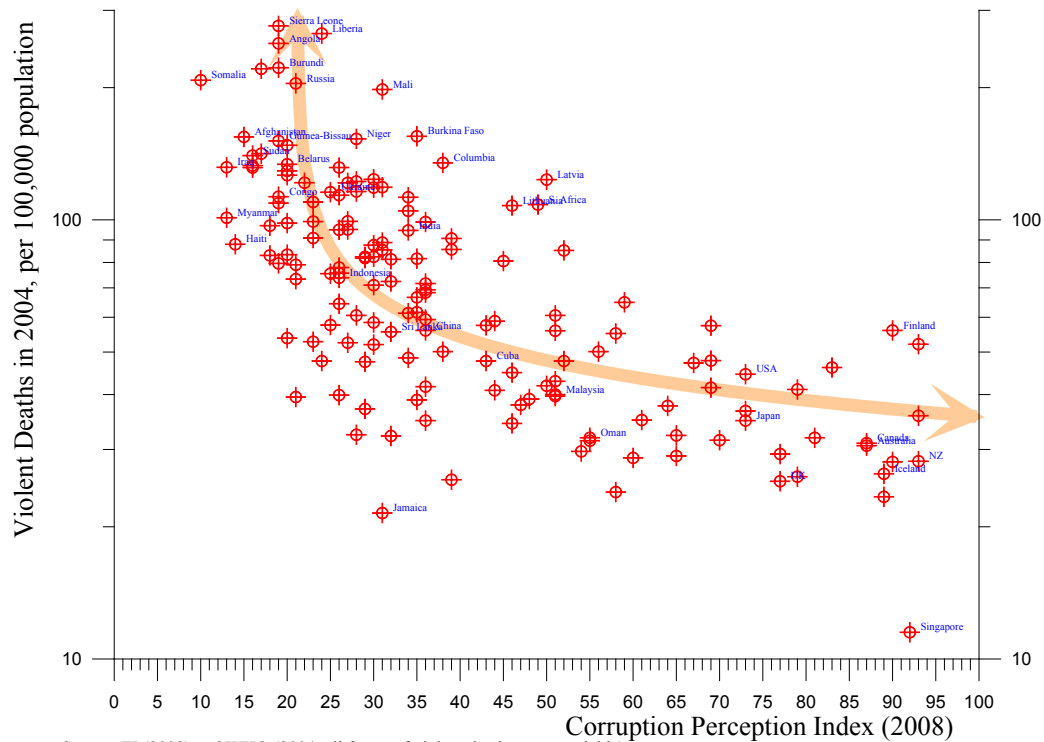
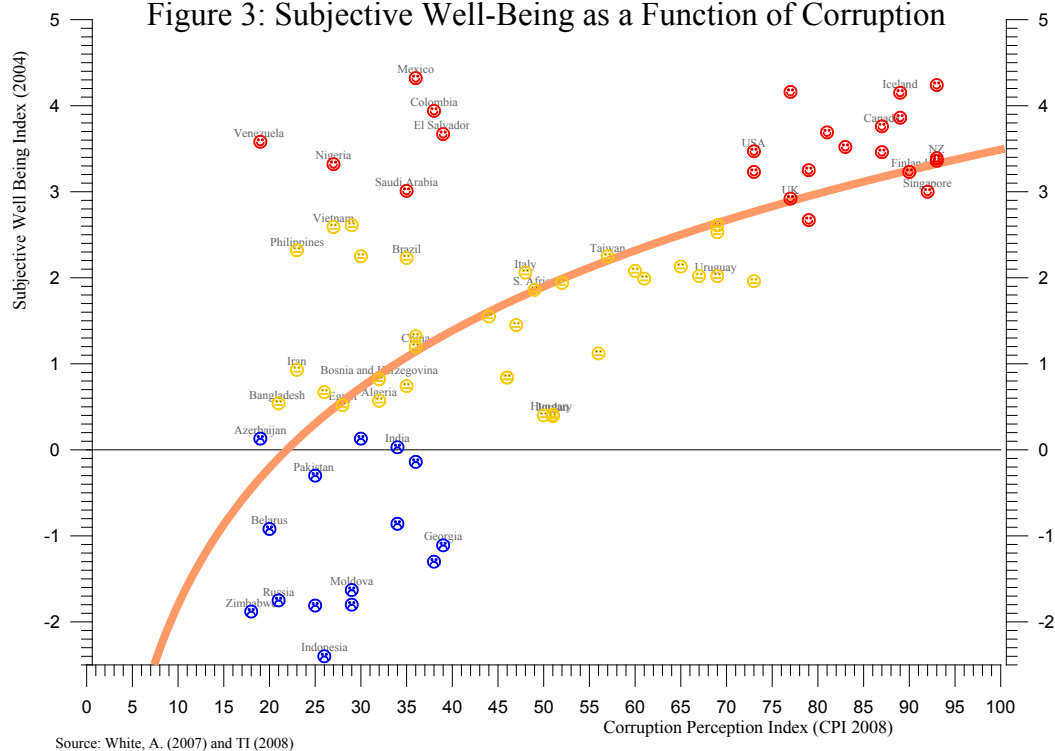


Figure 3: Subjective Well-Being as a Function of Corruption



Thus, extra-legal approaches to managing corruption do not resolve it, but merely change its form and shift its costs to different victims. Ultimately, extra-legal approaches to corruption

compound the problem and can eventually destabilise a country, by undermining its social institutions and allowing violently-corrupt individuals to usurp wealth, power, and authority.

4.0 A SOLUTION TO CORRUPTION THAT INTEGRATES ECONOMIC, LEGAL AND ACCOUNTING DIMENSIONS

In a high-trust environment transaction cost are considerably lower, because trust reduces the perceived need for validation, cross-checks, and documentation. Dyer & Chu (2003) support this notion in their study on the role of trust in transactions. As previously noted, transaction costs rise dramatically as trust declines and trade eventually becomes non-viable unless trust can either be re-established, or complemented, or replaced by other factors.

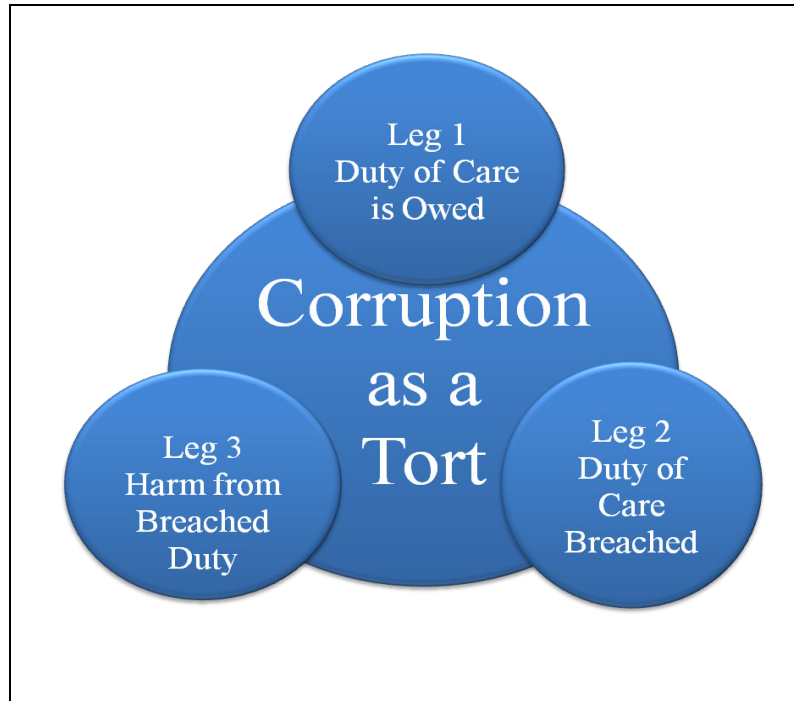
The operating and enforcement of a trustworthy legal system are negligible, in comparison to the rise in transaction costs imposed by a lack of trust or the violence and socially corrupting effects of extra-legal approaches to resolving a lack of trust. As Williamson (1979) notes: “...agreements and contracts can be best and almost costlessly enforced within the legal system”. However, the main issue regarding the legal system is only rarely its existence or its cost—most nations have a legal system, however, many are ineffective because they are seen as corrupt, less-than competent, too slow, and/or generally untrustworthy. Thus, the legal systems of many countries have become so entangled in corruption that they are no longer a viable solution. Such legal systems need to be reformed and made cost-effective, impartial, timely and trustworthy. Tyler (1990) argues that people respect the law because they believe that the justice system is fair and that they have been and will be treated fairly. The key to less corruption (and more trust) then, is an effective system of property rights and the rule of law (Lambsdorff, 1999; Leite and Weidmann, 1999; Treisman, 2000). It is an interesting issue—are trusting societies, as Uslaner (2004, p.2) concludes, less corrupt or are less corrupt societies more able to trust?

4.1 Defining Corruption to Facilitate Control, Exit, and Voice

Corruption, despite many earlier definitions, is not about private gain. Specifically: “There is nothing wrong in making partial decisions in return for favours on the grounds that *it harms nobody*” (Amos, 1982). Corruption tends to be so twisted, convoluted, and confused that the struggle against it needs to be clearly focused around a definition that is general and unambiguous. As noted previously, this study suggests that the notion of a tort provides such a definition. Corruption, as a tort, balances on three legs where all three must all stand, for a situation or action to be deemed corrupt. Specifically, as illustrated in Figure 4, an accusation of corruption requires proof that:

- a) A *duty of care* existed,
- b) The *duty of care* was breached, and
- c) Harm arose from the breached *duty of care*.

Figure 4: Illustration of Corruption as a Tort Standing on Three Legs



The first two legs, in Figure 4, involve proving or disproving simple questions of fact (i.e. a duty either exists or does not and, if a duty exists, it was either honoured or breached). A few researchers suggest that small levels of corruption are harmless and may even benefit society by working around bureaucratic blockages to economic growth (Yoshihara, 1988). However, such claims are hotly disputed by most researchers and are irrelevant to the tort approach to corruption. Specifically, the third leg of the corruption tort is proof of harm. Thus, proof of corruption requires that all three legs be present and those three legs identify the perpetrator of corruption, the victim and the *quantum* of harm (i.e. the estimated of the amount of harm). If any of these items is unproven, there is no corruption. Essentially, the focus in corruption is all about *harm occurring where there was reason to expect care* and while unwarranted gain may be the intent of corruption, it is neither necessary nor sufficient to prove corruption.

The violated duty of care is what emotes the perception of corruption as being heinous and such outrage often fuels strident demands for legal action and retribution. However, defining corruption as a criminal offence is a *red herring*—all corruption is a social wrong that needs redress, but only a few variants of corruption are legislated into being criminal acts and proof of criminal corruption requires (in countries with an English-based jurisprudence) evidence *beyond a reasonable doubt* (usually seen as ≥ 95 percent confidence) of criminal intent—a

claim of stupidity is often a low-cost but sufficient defence against charges of criminal corruption. A tort civil-lawsuit requires only a probable level of evidence (usually seen as 50 plus percent confidence) and (except for prison) offers a wider array of remedies. Thus, a tort approach to resolving corruption offers retribution and restitution in the form of damages and it is important to note that damages from corruption often exceed what the perpetrator gained, by a factor of five—so civil convictions for corruption will be easier to achieve, be cost-effective, and may bankrupt those who are convicted. As a side benefit, in a situation like that of the Enron fraud, hundreds of employees could be tried, convicted, and punished—rather than only the top few. Thus, the cost of participating in organizations committing fraud would rise to a point of being an untenable risk.

A weakness common to both criminal and civil systems of law is that victims need to become aware they have been harmed before they can argue for restitution and then evidence must be gathered on the nature and extent of the harm. Thus, anti-corruption legislation needs to be written so as to make substantiation of the offence, perpetrator, and harm easy to perform.

A new class of legislation and declarations of fundamental human, social, and environmental rights, appear to be seeking to explicitly induce a general acknowledgment that most social harm associated with business arises via corporate breach-of-a-duty-of-care torts. And, (as part of this acknowledgment) venues are being created for those harmed by such torts to seek redress from those benefiting from that harm. In the absence of a rigorous system of Social Responsibility Accounting, (e.g. an unambiguous statement of obligations, clear performance criteria, effective means of validation, and harsh and certain consequences for defalcation), Corporate and Individual Social Responsibility merely add another venue for corruption.

Social Responsibility Accounting can be ordered into what Everett et al. (2007) have called: control, exit, and voice—where:

- **Control** involves traditional accounting methods and approaches to prevent or detect defalcations like corruption—this stage provides a statement of responsibility and evidence of due diligence in completing a duty of care,
- **Exit** involves gathering and providing information so that individuals and organisations can identify situations that are corrupt or risky and either avoid them or exit from them before harm occurs, and
- **Voice** involves providing individuals and organisations with the information they need to give voice to either the harm that they or other have experienced from those who have failed in their duty of care or to prove that they have completed their duty of care with due diligence.

The beauty of the tort approach to corruption is that it makes intent irrelevant—what counts are obligations, outcomes, and a defendant having to prove due diligence if a contracted intent was not achieved (NB: a contract in this case might be an actual contract, a social contract or a legislated contract inferred by social norms or legislated corporate and individual social responsibility). Thus, the onus of proof for harm and that there was a breach of a duty of care should rest with the plaintiff and the onus of proving a due diligence should rest with the defendant.

Accountants are well positioned to develop appropriate reporting and controls for Corporate and Individual Social Responsibility—the accounting professional associations provide a clear statement and guideline of the responsibility and ethics of accountants, accountants are required to report annually on how they have kept their knowledge current via professional development, and accounting clients can file a complaint with and/or ask for arbitration from the association if they feel that an accountant has not been professional and/or otherwise failed to diligently discharge their duties.

CONCLUSION

Corruption has plagued and impoverished humanity since time immemorial. Mountains of research and sermons have been written and presented to condemn corruption and to seek a solution, but have changed little. Accounting has for millennia sought to contain and control corruption, but the corrupt gather wealth, power and authority and use those means to corrupt and subvert the systems and processes setup to fight corruption. Corruption is an enormous drag on society that destroys far more wealth than what is gathered by the corrupt. This study found that, while corruption can be soundly condemned on moral and ethical grounds, those grounds are too culturally and context sensitive to provide an unambiguous paradigm from which to fight corruption.

This study suggests that tort law be used in civil courts to fight corruption. After legislation firmly establishes the nature and context of a *duty of care*—precedence in case law will soon fill in the details of who owes what to whom and will keep that process up-to-date. The risk of lawsuits is likely to have a salutary effect on those who might be tempted to seek benefit from corruption. Accounting will need to develop Social Responsibility Accounting to keep the system fair, reasonable, and relatively free from frivolous and vexatious tort lawsuits.

Social Responsibility Accounting will require a clear accounting of who owes what duty to whom and what constitutes due diligence in fulfilling those duties. That accounting will be

arise from the activities of control, exit, and voice—voice is the most important of those activities, because it enables and empowers victims of corruption to denounce and to seek restitution from those who betrayed their trust. However, this process will not work unless the courts are seen as cost-effective, impartial, timely and trustworthy.

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