The Moral Reasoning of Public Accountants in the Development of a Code of Ethics: the Case of Indonesia.

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Abstract

The objective of this study is to explore the user's perceptions of the role of moral reasoning in influencing the implementation of codes of ethics as standards and guidance for professional audit practice by Indonesian public accountants. The study focuses on two important aspects of influence: (i) the key factors influencing professional public accountants in implementing a code of ethics as a standard for audit practice, and (ii) the key activities performed by public accountants as moral agents for establishing awareness of professional values. Two theoretical approaches/models are used as guides for exploring the influence of moral reasoning of public accountants: first, Kolhberg's model of moral development (Kolhberg 1982) and, secondly, the American Institute of Certified Public Accountants (AICPA)'s Code of Conduct, especially the five principles of the code of ethics (1992, 2004). The study employs a multiple case study model to analyse the data collected from interviewing 15 financial managers of different company categories (as users). The findings indicate that (i) moral development is an important component in influencing the moral reasoning of the individual public accountants, (ii) the degree of professionalism of public accountants is determined by the degree of the development of their moral reasoning, and (iii) moral reasoning of individuals influences both Indonesian public accountants and company financial managers in building and improving the effectiveness of the implementation of codes of conduct. It is concluded that the role of moral reasoning is an important influence on achieving ethical awareness in public accountants and financial managers. The development of a full code of ethics and an effective compliance monitoring system is essential for Indonesia if it is to play a role in the emerging global economy.

Key words: Moral development, role of moral reasoning, institutional ethics, codes of ethics, Indonesia's public accountants; globalisation.

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Introduction

As the world has moved inexorably towards the global economy it has become obvious that there exist many national differences which, if left unchanged, may inhibit progress towards a shared universal awareness. The accounting profession has long realised this and has for some time been striving for the international harmonisation of accounting practices notably through the development of international accounting standards such as International Financial Reporting Standards (IFRS). However, business practices are far from universal and there are many infrastructural differences between individual states that have arisen from different cultural, political and social contexts as well as stages of economic development. There needs to be an effective reconciliation of these differences if global consistency is to be achieved. One example, in respect to the harmonisation of accounting practices, is that accountants must have fairly common perceptions as to their functions. Therefore, it is desirable that there be some commonly accepted standards of behaviour; that is, acceptable behaviour in respect of fulfilling their responsibilities to their clients, their profession and their society in general, a large part of which is generally referred to as their standards of professional ethics.

Differences in the levels of economic development or business sophistication have resulted in some nations seeming to lag in the development of effective ethical codes of practice which would serve as the benchmark for acceptable professional conduct. Thus, despite recent concerns resulting from the spectacular financial disaster at the beginning of this century such as interest in the “Enron effect” or the implications of the WorldCom debacle (and the resultant changes in accounting regulation), the accounting profession in the USA has long had codes of professional ethics with which its members are required to comply. However, the accounting profession in Indonesia is far less “developed”. But, as Grace and Cohen have clearly stated, codes of practice “have long been used to establish standards in the professions” and, despite “a certain degree of scepticism about the self-seeking nature of codes” a “profession without one would be an impossibility these days” (1995, p 187). Consistent with this sentiment the International Federation of Accountants (IFAC) some time ago issued a Code of Ethics for Professional Accountants which was recently reissued in a revised form (June 2005, effective June 2006) in the belief that "[A] distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest". This, they hold is (amongst other things) in order to "contribute to the development of strong international economies by establishing and promoting adherence to high-quality professional standards".

Nevertheless, until very recently such a code for public accountants did not exist in Indonesia. This study was undertaken prior to the development of a code and is a preliminary investigation into some of the difficulties faced by the accounting profession in Indonesia in developing an (internationally) acceptable code of ethics[3]. Specifically, this study sought to determine the perceptions of the ethical behaviour of Indonesian auditors as major members of the professional accounting community. In so doing it proceeded on the assumption that two approaches to assessing ethical behaviour can provide useful guidelines for determining the need for ethical standards, namely, Lawrence Kohlberg’s stages of moral development and the AICPA Code of Conduct.

[3] The Indonesian Accountants Association (IAI) established a code of ethics in October 2008 which was to take effect from 1 January 2010. This code only covers public accountants and not accountants in private industry or the public sector.

The Auditor (as Public Accountant)

An auditor is an accounting professional, who supposedly performs his/her duties in a professional manner. This can be achieved by applying standards or principles of accounting and auditing correctly, and abiding by ethical codes. These regulations and guidelines have been specifically prepared for and enforced by professional bodies on their members. They are intended to avoid any fraudulent or inappropriate conduct and improve professional quality: the ability to cope with difficult situations in a manner beneficial to clients is a reflection of professionalism (Nixon 1994, p.2). Since the spectacular company failures early in this century considerable attention has been directed to the functions and performance of the auditor.

At present, there are many debatable issues relating to the extent to which public accountants appropriately render their services – such as providing information in the form of financial reports. In fact, as economic agents, public accountants frequently face complicated situations and are faced with choosing between their self-interest (the client's benefit) and the public interest (observing rules of conduct). This is a moral dilemma that often poses great difficulties for professional accountants. Consequently, regulations, standards, principles and ethical codes are devised by professional bodies as guidelines to ensure that all public accounting practitioners serve society (users).

In principle, professional accounting body ethical codes have seven aspects, which need to be considered. In the USA, the AICPA has listed these as independence, objectivity and integrity, public interest, responsibility, due care and scope and nature of services (AICPA 1992). Therefore, such codes of ethics are more than just instruments for the maintenance of a moral, ethical and honest image among the public: professional bodies need to ensure that the trust of society is upheld. The maintenance of high professional ethical standards relies on an understanding of the moral reasoning process. This moral reasoning process forms part of the entire moral consciousness of an individual's belief system from which a decision is made when an individual is facing a difficult dilemma (Au & Wong 2000). Hence, in this study, the moral reasoning process of professional accountants is investigated by utilising the theory of ethical development.

Theoretical Development

Most public accountants would not expect their actions to adversely affect the interests of a client. However, it is possible that as a result of strictly following a professional code of conduct a public accountant could damage a client's interests. Hence, most public accountants who desire to protect a client from harm may find that following the code could lead to a moral conflict. On the one hand, taking care of a client's interests disregarding existing ethical rules or values ethics can be considered as prioritising self-interest (improving the financial benefit of the public accountant). On the other hand placing a higher priority on public interest (users) by upholding the ethical rules and values might damage a client's interests. Consequently, these different conditions will create a moral conflict of interest for public accountants.

The actions chosen by professional accountants are determined by the extent to which they understand the meaning of and utilise codes of conduct and the principles underlying them. Moral reasoning as a development process of the moral levels of public accountants (from cognition-judgment to moral action) will influence decision making of public accountants in action.

Moral reasoning can be defined in terms of the arguments about how people should act or in terms of providing reasons to justify or criticise behaviour. The reasoning is offered to show why an action is believed to be wrong or why that judgment is thought to be correct. Thus, moral reasoning involves offering reasons for or against moral beliefs in an attempt to show that those beliefs are either correct or mistaken (Fox & DeMarco 1990, p.4). Furthermore, the definition of moral reasoning is an argument that means a reason or a series of reasons that aims to support a particular claim, which is called the conclusion. Hence, these arguments consist of reason and conclusion (Thompson 1998, p.5). For example, in respect of particular ethical issues, moral reasoning arises from demonstrating an action or behaviour, which is a response to the question "what ought I to do", not "what shall I do"? It also involves several issues such as, considering the consequences of various courses of action, or some weighting of the conflicting responsibilities, and attempting to come to a conclusion on the issues (Thompson 1998, p.6). From the definition above, it can be concluded that reasoning consists of three points of view, namely: (a) thinking about what people should do and why people should do it; (b) forming ideas to describe and evaluate actions, and (c) judging a particular action by means of a general rule.

In addition, moral reasoning is an argument (of an individual) that has the objectives of explaining the process of that individual's ethical decision making, or describing a process of establishing behaviour or action based on individual moral judgment (cognition-judgment-action process). Thus, the moral reasoning process of an individual can also be understood by examining how individuals internalise moral standards (Adams, Malone & James, 1995, p.3).

Lawrence Kohlberg (1969) developed a theory of moral development with roots in the work of Swiss psychologist Jean Piaget which he intended to be applied to moral education. His ideas have since been applied to analysis of moral development in many areas and disciplines. For example, Velasquez (2002) uses it as a basis for evaluating virtue and particularist theories (of ethics in business). Despite it having its critics[4] it was felt to be an appropriate basis for this study as it is concerned with determining the degree of moral consciousness or awareness which can serve as the foundations for a (regulated) code of professional ethics. In addition, as Thomas (2004) has suggested, it deals with the extent to which ethics "can develop in later stages of life" (p 32). According to Kohlberg (1976), moral development occurs at three levels with each level having two distinct stages. These stages determine the level of moral reasoning used by individuals in distinguishing right actions from wrong actions. Level 1: *Preconventional*, contains stage 1 – physical consequences of actions, avoidance of punishment, and stage 2 – satisfaction of one's own needs. Level 2: *Conventional*, involves stage 3 – desire to please others and stage 4 – respecting authority and preserving the rules of society. Level 3: *Post-conventional* embraces stage 5 – morality of contracts, individual rights and democratically accepted law and stage 6 – universal moral and ethical principles (Kohlberg 1976). Furthermore, Kohlberg maintains that these stages are sequential such that a person does not enter into a later stage until they have passed through each of the previous stages.

Based on statements of the objectivity of moral reasoning it can be stressed that moral reasoning is influenced by levels of an individual's moral development. Thus, the higher the individual moral development is the higher her/his level of moral reasoning (this is consistent with the work of Rest, as described by Thomas 2004, p 32). Consequently, the higher level of moral reasoning will influence an individual's ethical decision making behaviour or actions and hence supports an individual's choice of whether or not to apply rules of a code of conduct with full awareness. Thus, the process of moral reasoning is specifically the process of an individual's moral reasoning in respect of conscious ethical decision-making.

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[4] Subsequent to its publication in the early 1980s there was considerable interest in Kohlberg's work and it attracted support and criticism. There were many studies in many disciplines employing his analytical framework published in the last decades of the 20th century. While interest seems to have waned we believe it was still a useful basis for our analysis. (cf Dellaportas 2005, chapter 2)

Moral Reasoning as the Basis for a Code of Ethics

In this study, moral reasoning in the context of a moral argument is defined as the arguments about how people should act or give a reason to justify or criticise specific behaviour. Suggestions are made to show why one kind of action is believed to be wrong or why a judgment is thought to be correct (Fox & DeMarco 1990). There are several presuppositions in this study including the following.

1. Consciousness of public accountants is defined as the extent to which the moral reasoning of public accountants influences ethical decision-making (judgments of good or bad and of right or wrong behaviour) towards the upholding of a principal code of conduct.
2. The principles of a code of conduct contains seven ethical "standards" for professional accountants that address moral and ethical behaviour regarding activities, attitudes, and procedures involved in most aspects of professional conduct.
3. The attributes of codes of conduct will be designed in such a way as to monitor and measure performance of public accountants.
4. The key factors of the level of moral reasoning of professional public accountants are defined in respect of the increase in the level of individual moral development of public accountants.
5. Key effectiveness is defined as the adherence of public accountants to appropriate codes of conduct, and consequently, the improvement in the implementation of codes of conduct is achieved.

Research Design

The research comprised interviews of fifteen financial managers of three classes of companies in Indonesia. The company classes were "family owned companies" (FOC), "state owned companies" (SOC) and multinationals, or "foreign owned companies" (FrOC). Because of issues of access and availability the companies were not randomly chosen. The financial managers of the companies were selected for interview because they are in effect the chief financial officers and as such would have been involved in appointing the external auditors as well as working sufficiently closely with them to be able to assess their performance. In addition some internal auditors were interviewed as they too would have worked closely with the external auditors and have had some opportunity to observe their performance. The same questions were addressed to all financial managers but were supplemented by informal discussion.

In the study, the discussion regarding implementation of ethics in accounting practices focused more on the specific scope of ethics in ethical codes or principles of conduct for professional public accountants (AICPA 1992; 2004), and utilised qualitative methods to resolve the ethical codes problem. According to Lemon (1996), qualitative methods are several lines of empirical research that enable researchers to examine the behaviour of professional public accountants in relation to culture, social issues, gender issues, environmental issues, employment issues such as downsizing, codes of conduct and cooperative morality. Thus, in this study, a qualitative approach is used to explore the existence of problems. It forms part of what Denzin and Lincoln (2003, p 3) have referred to as the "moral discourse" and results in a (sort of) "sacred textualit(y)" – a professional code. A case study-type analysis is used to explore the factors that influence the consciousness of professional public accountants in performing in accordance with principal codes of conduct, and how professional public accountants improve effectiveness in the implementation of suitable principles codes of conduct.

In so doing, two groups of variable categories are used in this study: independent variables and dependent variables (presented in Table 1 Summary of Variables and Table 2 Overview of Dependent Variables). The independent variable is the levels of moral development of professional public accountants in Indonesia. The dependent variables are five parts of the code of professional conduct of the AICPA, namely; independence and objectivity; integrity; due care; public interest and scope and service of nature.

Table 1
Summary of Variables

Classificatory Variables	- Dependent variables - Independent variables
Independent Variables	The performance of Professional Public Accountants in Indonesia.
Dependent Variables	-Independence & Objectivity. -Integrity. -Due Care -Public Interest. -Scope & Services of nature.
Performance & Measurement Variables	-The code of professional conduct in Indonesia called SPAP (Standard Auditing of Public Accountant) -MID (Moral Individual Development)

Table 2
Overview of Dependent Variables

Variables of independence, objectives and integrity (Rule 101-102)	1. Independence and objectivity 2. Integrity
Variables of Professional Due Care (Rule 201-204)	1. Competence 2. Auditing Standards 3. Accounting Principles 4. Forecasts
Variables of Responsibility to Client (Rule 301 – 302)	1. Confidential client Information 2. Contingent fee
Variables of Responsibility to Colloquies (Rule 401-402)	1. Encroachment 2. Offers of employment
Scope and Nature Service (Rule 501-505)	1. Act discreditably 2. Solicitation and advertising 3. Commission 4. Incompatible Occupations 5. Form of Practice & Name

Source: Adapted from Loeb 1978, pp.114-116

As a result, auditors can make decisions regarding ethics in real professional work. Hence, there are three levels in the model of individual moral development, employed in this study: pre-conventional level; conventional level; and post-conventional level (Kohlberg 1976). Additionally, five variables were analyzed with the use of the data collection in the survey and observation. To answer the research question use of a multiple case study with five cases studies (based on the principles of the code of conduct. AICPA 1996) and three typologies of companies (foreign owned companies, state owned companies and family owned companies) were used. These variables were operationalised in the interview schedules used. To enhance the analysis, process questions pertaining to variables are repeated in interview schedules. Moreover, the interview approach adopted for this phase of the research is that advocated by Emory (1985), Sekaran (1992) and Yin (1989).

Analysis

All the data gathered from the interviews of fifteen companies in Indonesia, (three kinds, viz foreign companies, government/state companies and family business) were analysed according to the methods suggested by Yin (1989). This involved analysis using a cross case study technique, namely pattern matching and explanation building (Yin 1989). Pattern matching involves the comparison of the findings with the predicted pattern of specific variables as defined for the classificatory variable. Lack of precision is a limitation in this method, as interpretive discretion is exercised by the researcher in deciding whether there is a pattern matching by providing theoretical replication. Cross-case results provide more robust explanations. Furthermore, explanation building is the analysis of the case study data presented in narrative form. The explanations attempt to stipulate a set of causal links about some observed phenomena. Limitations of this type of method include the fact that links may be complex and difficult to measure in any precise manner and narratives may tend to drift away from the issues. The study uses the model of the AICPA Code of Professional Conduct and moral reasoning theory and focuses on upholding of the ethics codes, responsibilities and duties by the Indonesian public accountants.

This analysis is organised as follows; first, the data description of five ethics codes, which provide a sketch of the performance of ethics codes in Indonesian companies (case report), then, secondly, a discussion of an ideal measurement, which is in line both with the accounting (IAI – Indonesian Accountants Institute) body's rules and standards and with the measurement results of those three types of companies. The analysis then makes use of two approaches, namely; first, individual analysis using the approach of moral theory (i.e. moral reasoning), and, secondly, a professional approach with special reference to the existing standard rules and ethics code, the IAI's SPAP (Audit Standards of Public Accountants).

DATA DESCRIPTIONS & MEASUREMENT

Various aspects of ethics codes of accountants and auditors will be discussed. The discussion is based on the data collected in various ways from some sources such as in-depth interviews, observations and documents. There are two aspects to the interview results. First, the criteria for the selection of the particular public accountants/auditors by fifteen financial managers in the three categories of companies. Secondly, the interview results explain the perceptions of the five principles of ethics codes for public accountant/auditor by the three categories of companies (users), and which is based on the IAI's SPAP.

The results from the interviews (summarised in the Tables appearing in the appendices to this article) can explain many different perceptions in each of the company categories. These differences in perceptions emerge from the difference in the interpretations of the financial managers of each company about the code of ethics (SPAP-Standards Auditing of Public Accountant) in Indonesia. In addition, the interviews disclosed many interpretations of the users (15 financial managers) of the practices of public accountants/auditors in respect of the application of ethics codes in each level of company. Furthermore, the interviews indicated the extent to which auditors/public accountants will comply with the ethics codes and in which level of company. Therefore, the study will need standard measurements for determining the extent of compliance by public accountants and auditors with the ethics codes, as well as the level of other services they provide to the company or users. These measurements have two aspects. The first, a measurement based on the professionalism of the auditor/public accountant and, the other, the measurement of the individual auditor's level of moral reasoning in accordance with Kohlberg's theory of the development of moral reasoning.

The Professional Approach

The professional approach (measurement of professionalism) used to analyse cases in this study has been guided by the standards implicit in ethical codes. The key factor of the professional approach is the implementation of the standards that consist of the five principles of ethics that the public accounting profession regulates and that guide auditors to achieve high levels of professional performance. The ethical-code standard increases the professionalism of public accountants in respect of a greater awareness of, and compliance with, the modes that have been agreed upon by the accounting bodies (in Indonesia, the IAI). However, as alluded to above, there is a possibility of a conflict of interest in regards to whether to accommodate the interests of the clients, the accountants, or the public.

Investigations showed that there are many instances of different perceptions of ethical codes standards held by the FMs (financial managers) in the family owned companies (FOC) and government/state owned companies (SOC). This raises questions regarding the requirements of the code of ethics such as:

1. Have the auditors been truly independent in appearance or independent in performance?
2. Have the auditors implemented their responsibilities in a professional manner, particularly the external responsibilities?
3. Have auditors increased the quality of the audit or are they going to improve knowledge and ability as a part of the professional workers in their area?
4. Have the auditors provided other services under other principles of the ethical codes? And to what extent is the auditor's duty as an auditor to audit the financial report of the company as well as provide other services such as being a consultant in various aspects?
5. Have the auditors in the institution (BPKP- The Supreme Government Audit Department) been independent in appearance and performance (in fact) during the sole time regulation of the maximum of 2 years of auditing?
6. Have the auditors implemented the fifth principle, scope and services, properly?

Responses to the questions indicated that violations of the code of ethics primarily occurred in the FOC category and are caused by a lack of understanding of companies and the extent to which the auditor's practices are confined by the standards (assumption 1). Another cause of non-compliance is the failure of auditors to grasp the purpose of the ethical code standards (assumption 2). More importantly it is apparent that auditors take advantage of the companies that have a lack of knowledge of the code of ethics (assumption 3). The next cause of non-compliance is that the standards might not be appropriate for implementation in Indonesia (assumption 4). Last but not least, collusion, cronyism, and nepotism are wide-spread in Indonesia particularly in the government institutions. This phenomenon is also evident in the government institutions of BPKP (assumption 5) so it is little wonder that they find it difficult to promote healthy practices.

The cases in the companies in the foreign-investing category (FrOCs) were considered to be not significant in the sense that they were found not to have violations of the ethical codes.

It is important to explore the five assumptions mentioned above, in order to find a solution to the problem of non-compliance or an improvement in the rate of compliance with the ethical codes. Regarding the first assumption, it is expected that, first, a financial manager and the people who work in the financial area would have substantial knowledge through continuous improvement in formal and informal education, secondly, the auditors should not choose work based only on the biggest fee, while he/she neglects professionalism and, thirdly, the period of contract between auditors and the companies is not too long, even though it is true that the longer a public accountant stays in a company, the more adaptable he/she becomes to the situation and problems confronting the company. Hopefully, these findings will stimulate the IAI into being more sensitive to the issues, outward looking and able to anticipate the problems as they arise in the world of practice.

The second assumption addresses the issue of the ability of the auditors to understand the meaning of the ethical codes. Any increased understanding of the ethics codes will increase and improve the capacity of the auditors to recognise and confront ethical dilemmas through education and the obtaining of sufficient relevant experience.

The most important recommendation for the IAI (which currently governs all Indonesian accountants) is to determine reliable criteria to determine minimum standards of professional public accounting practice. The third assumption is derived from the insufficient knowledge in the company of ethical (and other) considerations that leads to the auditor violating the ethical codes; this needs to be addressed. This condition cannot be ignored since it will serve as a strong incentive for the auditors to extend dubious practices to other companies. Again, this is the responsibility of the IAI to alleviate this problem by exercising proper sanctions against public accountants violating the ethical code standards.

The fourth assumption is a problem that questions whether the standard fits with the conditions in Indonesia and thus, fits overall the companies in every category. Obviously, this is a matter that needs to be addressed and as the global movement proceeds there will need to be a reconciliation of the specific requirements and conditions to the expectation of the global community.

So far, the five principles are generally described so can only be grasped by companies that have knowledgeable people in the accounting and financial area (foreign-owned companies - FrOC). The last assumption addresses the issue of collusion, cronyism, and nepotism occurring in the BPKP as the institution that governs auditors of government-owned companies. With the changes in the political situation, this phenomenon is no longer a secret for Indonesian society. The majority of Indonesian people question the credibility of accountants. There have been very critical issues since independence and the objectivity of accountants has been questioned. In order to reduce this public cynicism it is important to involve the government in creating regulations associated with guidelines for appropriate professional practice and to execute appropriate punishment for non-compliance with or violations of the ethical codes. Part of the problem here involves the question of auditor (accountant) independence and was an issue of grave concern in the United States in the 1990s and resulted in increased activism by the regulatory bodies, especially the SEC (Securities and Exchange Commission) under its then Chairman, Arthur Levitt. However, collusion, cronyism and nepotism is probably far more evident in Indonesia so there needs to be a concerted joint effort by government and professional regulators to develop regulatory structures that draw attention to the seriousness of winning public confidence in the work of accountants. This will mean that a violation of the ethical code is not only a violation of the profession that will result in punishment from the Indonesian accounting body, the IAI, but also a violation of the country's regulations. Hence, the development and improvement of the regulations, either from the government or the accounting body, is expected to enhance the professionalism of every professional accountant.

The Individual Approach

An individual approach is that which emphasises the genuine ethical behaviour arising from the individual principles of accountants as human beings, members of a society. In other words, the way of thinking is influenced by the values, morals or inner principles of an individual which are influenced by their conscience. In this analysis, based on the interviewees' perceptions, there emerged several assumptions that relate to the auditor's violations of their code of ethics. Below are details of these assumptions that interviewees perceived auditors made.

1. The auditor's assumption is that there would only be light sanctions imposed by accounting bodies on auditors who commit violations.
2. Auditors believe that they can earn more if they are more respectful towards the rights of others.
3. It is believed that auditors have to be responsive to their clients in order to warrant their clients' approval.
4. Auditors need to adopt social rules without further considering the underlying ethical principles involved.

Thus, any violations of the code of ethics are primarily based on the four assumptions above. The first assumption emerges because the accounting body has little disciplinary power in responding to the violations that occur. In addition, there are no clear rules in regard to the mechanism for sentencing and the court processes in regard to violation cases. The individual's process of moral development that emerges from punishment (stage 1) cannot be applied in this case.

The second assumption emerges because auditors assume that if they act respectfully towards the rights of others, such as being loyal to a client, they will get more respect as well as business from the client. In this case the assumption tends to be self-serving. Additionally, the "right" behaviour is the behaviour that can satisfy an individual's needs. Hence, an individual's process of moral development in this stage will result in an awkward situation because on one side auditors have to be loyal towards their client companies and on the other side, auditors also have a responsibility towards the public. Auditors, therefore, often face moral dilemmas and there are many violations of their duty (stage 2).

The third assumption emerges because auditors assume that a "moral situation" occurs because each person has to demonstrate consideration towards others (stage 3). This condition makes auditors less distinct in implementing the code of ethics. For example, auditors as members of the professional body often are placed in a paradoxical situation; they have to balance against two conflicting sides. On the one hand, auditors have to reject every violation of the code of ethics, but on the other hand, they have to permit these violations. Another example would be the reluctance of auditors to report the violations of their peers.

The fourth assumption emerges because auditors, as members of society, have to defend the social rules as well as law and order at their highest value. It is obvious that auditors' morals are developed from the rules and cultures of their society. In other words, auditors have been adopting many social rules as part of their process of moral development. As a matter of fact, auditors sometimes forget the importance of applying the principle of ethics in their practices. For example, an unethical social environment relates to the theory of social psychology, whereby an individual is seeking to conform to the environment and develop trust towards society. In this case, trust means that if there are differences in their individual beliefs, auditors tend to refer to what is "right" in society. Thus, the process of moral development until this fourth stage can be one of the reasons why auditors may sometimes violate the code of ethics.

Hence, after exploring the four assumptions above, several potential solutions can be generated. First, there has to be a clear and distinct statement of the sanctions that the IAI, as the official body of professional accountants, may impose on its members. Moreover, there is a need for a good system of court processes available to the BPP and the DPP. Sanctions could be imposed in several steps, such as a letter of warning, to suspension or dismissal from membership of the IAI (the accounting body).

The existing code of ethics needs to be reviewed. Interpretations of the existing code and the results of cases or complaints against accountants by their peers or the public in general, need to be published. In addition, a hierarchy of needs has to be included in the implementation of ethics. To implement the existing principles of ethics, what is needed is the ability to identify some ethical issues and make some predictions about the effects of some decisions, and also to explain the determination of the ethical issues from different perspectives, in the context of time, place and environment.

An individual practitioner needs to be able to justify the effect of his/her ethical decisions.

The two forms of analysis – professional and individual - are closely related. Both analyses explore violations of and avoidance by auditors in applying the rules (the ethics codes). There are two areas of influence on auditors. There is first their position as a part of a group of professionals (members of a professional accounting body), to which they have to have an obligation to comply with the rules of professionalism (the ethics codes), and, secondly, their position as humans, in which they also have the unwritten rules (way of life) of society and are mostly influenced by their consciousness, culture and religion.

Specific Findings and Contributions

This research revealed several findings which are set out below. The findings have been classified in respect of how they relate to various aspects of the study, namely, the development of moral reasoning generally, the moral reasoning of public accountants, the activities of public accountants and financial managers and in respect of the determination of a code of ethics. These findings are offered as contributions to understanding the issues involved and as suggestions for consideration by the Indonesian policy makers.
First, there are the findings of this study that relate to the moral development on the basis of the moral reasoning process. These include the conclusions that moral behaviour depends on:

- the prospect of any punishment and the desires of the individual.
- the social norms and the rights of others
- the law and responding to the obligation of duty (in a deontological sense)
- a social contract orientation such as, equality and human dignity, and also respect for universal principles such as values, truth, honour and integrity (in a virtue theory sense).

Secondly are the findings of this study that relate to the level of the public accountant's moral reasoning as a moral agent. The public accountant, as a member of society, has the ability as a professional to be involved in the four processes of the development of moral reasoning as an ethical decision maker. As was mentioned earlier, Kohlberg (1969) states that the theory of moral development is one of the most widely used approaches in the examination of moral reasoning. According to him the level of moral reasoning development is influenced by:

- the age level
- the education level
- the environment or situational level

Thirdly are the findings of this study that relate to the key activities performed by both the Indonesian public accountants (members of IAI) and the financial managers and which can be used to build and improve the effectiveness in the implementation of the principles of a code of conduct for professional practice. They have sufficient knowledge, especially in understanding the meaning of the ethics codes to make continuous improvement through education and obtaining relevant experience in this area.

It is advisable that the period of contract between the public accountant and the companies is not too long. This conclusion is consistent with many recent recommendations of regulatory bodies in many parts of the world (eg. Sarbanes Oxley requirements).

Codes of ethics are appropriate to be followed by accountants dealing with all categories of companies in Indonesia. There should be no exceptions as the ethical principles are relevant to activities of all Indonesian companies despite the variation in form and function, that is, family owned or state owned or other ownership structure.

Given the current "stage of development" of Indonesian business organisation it is advisable that the government be involved in creating regulations in respect of ethical guidelines or more formal pronouncements. Once again this conclusion is consistent with current developments in many other countries post-Enron.

Fourthly, there are the findings of this study that relate to the establishment and improvement of ethics codes. Control of public accountants by BPKP, BPP, DPP, and the Public Accountant Compartment should be increased and properly managed. Meaningful punishment or sanctions against violators of the codes should be implemented and enforced. Less negative steps could also be implemented such as greater communication to public accountants advising them of the importance of respecting professional practice. This should also include encouragement to partners and senior management to educate their staff about the need to avoid ethical code violations. Obviously leading by example would be beneficial but there is also the need to make staff aware that the firm values ethical professional conduct. Systems of monitoring and control of staff behaviour could supplement the education programs. Most importantly the IAI, as the major responsible professional body, would need to clearly demonstrate continuous upgrading of its required standards of professional behaviour. Many professional bodies around the world have mandatory continuing professional development. As part of such a program the IAI could have regular courses on what constitutes best professional ethical behaviour. In addition it would be necessary to have effective monitoring of compliance with the ethics code.

General Contributions

In addition to the specific findings above there are some more general inferences that can be drawn from this study. These also relate to Indonesian audit theory and practice and are grouped under similar headings to the specific findings. Although many are similar to the specific findings it is felt they are of a more general nature.

First, in respect to a code of ethics there needs to be far greater general awareness of its purpose and the intentions behind it; the need for and the importance of compliance with a code. This awareness should not be restricted to public accountants but should extend to the business community and probably the public at large as potential stakeholders. However, any code has to be properly drawn up and subject to continual improvement and relevance to the practice of accounting. Perhaps there needs to be a validation of the five standards/principles for every category of company – the relevance question. As indicated above, there needs to be effective and efficient assurance of application of the code and compliance with it.

The aim would be to significantly influence the practices of public accountants and internal auditors without inhibiting the free flow of appropriate market forces. This is, of course, a difficult question but a balance needs to be derived in order to instil confidence of prospective investors – internal and international – in the practices of accounting and auditing in Indonesia. While to some this may seem obvious it is important to stress this to accounting practitioners. The professional dilemma – the balance between the interests of the client and the public – are ever present but often not so obvious to those within organisations, in this case, those involved with the internal audit function.

Secondly, an awareness of moral development theory would create a formal morality, and hence contribute to the adherence to principles of conscience of the individual, comprehensive and universal. It bestows a higher value in the degree and equality of rank to an individual's life. It would enhance public interest through expressing ethics to the public in order to increase public care, public alertness, and public awareness. Not only would it influence the public accountant's professional behaviour it would create a greater consciousness of the importance of ethics in his/her personal life.

Thirdly, there are implications for audit practices in Indonesia's companies. For example, it would require increased co-ordination and control of public accountants by the Ministry of Finance, BPKP, BPP, DPP and the Public Accountants Department which, in turn, would necessitate cooperation between these regulatory bodies. The imposition of severe sanctions by the IAI and the government for ethics codes offences would first require government regulation or intervention and an explicit statement of likely sanctions from the courts of law if there was to be a violation[5].

With the increased cooperation of the regulatory bodies there would be an improvement in the public accountants' professional practice; the emphasis on the importance of codes of ethics would result in (written) documentation of statements of "acceptable" professional behaviour. If this was to be continually updated it would make accountants more aware of the need for ethical behaviour and the importance of encouraging their staff to provide solutions to ethical problems.

A Preliminary Study

The research reported here was a modest study yet it deals with problems of global concern. We acknowledge there are some limitations in the study that arise from the fact that the research relates to an Indonesia case study selection. Audit regulations in Indonesia are few and at the time of the study were contained in the one general standard, SPAP. The research did not canvas all public accountant audit activities but only those related to issues connected with ethics. Secondly, in Indonesia, the relationship between the public accountant and the financial manager of a company is very specific and arises from many factors too difficult to fully categorise. A major characteristic of most public accountants in Indonesia is their lack of knowledge of ethics codes and a lack of awareness in implementing audit practices that in more developed economies would be regarded as standard practice. Moreover, a major characteristic of most financial managers of companies in Indonesia is that they have little knowledge and experience in understanding and preparing company financial reports. Thirdly, there were demographic limitations to the data collection. Due to time (and resource)

[5] As indicated earlier there is now an Indonesian code but to date its application is to public accountants only. To date there is no evidence - no study has been undertaken - of the impact of the code on the practices of public accountants.

constraints, data was gathered only from interviews of fifteen companies (in the different categories) situated in major cities on the island of Java, viz Jakarta, Surabaya and Malang.

Conclusion

Despite these limitations this research was involved with an issue of global concern and is one of the very few studies to examine the concern in the context of a developing economy. There have been some studies generally related to this subject of this study. For example, Tsui and Windsor (2001) compared ethical reasoning of Chinese and Australian accountants. Endicott, Bock and Navarez (2003) examined moral reasoning in a cultural context. However, neither work addresses moral reasoning, ethics and accounting in the developing economy context. Similarly, while Clements, Neill and Stovall (2009) investigate the impact of cultural differences on international accounting codes of ethics they too do not specifically address the case of developing countries (nor moral reasoning).

In the study, two elements of analysis were used to examine the problem of non-compliance with codes of ethics and unethical business behaviour - professional analysis and individual analysis. They complement each other. Individual analysis is used to assess an individual's level of moral development which will determine their awareness of ethical issues. An auditor/public accountant is an individual who has membership of a professional body which expects members to behave professionally and in accordance with its rules and codes of conduct. The level of moral development is an indicator of the accountant's awareness of the significance of a code of ethics and the likelihood of compliance with it. The professional approach is concerned with the degree of compliance with professional codes; in this instance the code of ethics. Thus, the two approaches are the two side of the same coin: moral development indicates awareness of the significance of professional ethics and determines the extent of compliance. Conversely, non-compliance may not necessarily indicate poor moral development as the code of ethics needs to be constructed in such a manner as to be appropriate and relevant to professional conduct.

The results of this study suggest that there is both a low level of moral development in Indonesian accountants and a lack of an appropriate code of ethics to guide accountants' actions. Thus, if Indonesia is to participate fully in the global economy with its attendant free flow of capital and investment the profession and the government have much work to do to establish an infrastructure that will provide international investors with the confidence to make investments. In so far as this study is concerned, an important element of this infrastructure is an appropriate code of ethics and a system for ensuring compliance with it. The US is a major player in the global economy so the code of ethics it has established for its accountants is a good model with which to start. Therefore, the elements of that code were used in this study.

However, there are major ontological and epistemological questions not addressed in this study. These involve issues surrounding the desirability and the implications of globalisation; the determination of appropriate professional behaviour across different cultures; the usefulness of professional codes of ethics especially in a global environment; the ideological bases of differing economic systems; the relationship between the regulatory bodies within an economy; and other factors.

Graham and Neu (2003, p 449) tell us that "The age of globalisation is upon us". However, they caution that despite the attention paid to globalisation "gaps still exist in our understanding" (p 449) of it. Also, "detailed research is required into the concrete and specific mechanisms that constitute globalization" (p 450). This study is one such attempt. Political change in Indonesia has ushered in greater political freedoms. A desired consequence is that responsible economic management will lead to increased economic development to allow Indonesia to become part of the global economy. As indicated above, this necessitates greater assurance to global investors in the quality of the accountability – the financial information provided them. The age of "crony capitalism" must be seen to have died if investors are to have full confidence in any investment in the country.

This begs the question of the efficacy of codes of ethics but that is beyond the scope of this study. Black (2004) has suggested that "fundamentalist believers in the efficient markets hypothesis consider all accounting irrelevant". However, he continues that many recent debacles (he cites the Savings and Loans case) should have put an end to extreme views and "the current crisis in which control frauds have deceived investors for years to the tune of billions of dollars of fictional capital has shattered the remaining hubris". Thus, the use in this study of the US ethical codes as a desirable model may well be questioned. However, it is not the codes that are defective so much as the operation of them and these frauds in the US have resulted in greater regulation of accountants. Indonesia could do well to have tight regulations before such a situation arises. Cultural factors are an important consideration as the collusion, nepotism and cronyism, referred to earlier, have been in existence for some time and may well be entrenched in some business behaviour. Analysis of moral development and the development of a professional code of ethics will hopefully remedy such a situation.

There is a dilemma for the accountant in deciding between the client's interest or the public interest. Black (2004) has suggested this may be a bigger problem in smaller firms as the need for bringing in and maintaining clients is less in the public sphere. This could lead to what he sees as a variation in Gresham's law: "bad accounting can drive good accounting out of circulation".

The research findings of this study provide useful information for the principal professional accounting regulator, the IAI, to encourage the development of sound ethical regulations and surveillance. It also provides useful information for the financial managers who need to build and improve knowledge of accounting practices. And, finally, it provides useful information for public accountants who will increase professionalism in their practices. As Black says:

"Audit partners have to rediscover the professional and ethical restraints that once made them symbols of rectitude"(2004).

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Appendices

Table 3.
Auditor Selection Criteria of Interviewees from FOCS

The five Financial Managers of "Family-Owned Companies"	Key reasons: • *Good services by public accountant (auditor firm)* • *Loyalties, care and independent* • *Cheaper fees* • *Confidential*

Table 4.
Auditor Selection Criteria of Interviewees from SOCS

The five Financial managers of "State-owned Companies"	Key reasons: • *Professional skill* • *High integrity* • *Independence* • *Loyalties* • *Time limitation* • *Confidential* • *Objective*

Table 5.
Auditor Selection Criteria of Interviewees from FROCS

The five Financial managers of "Foreign-owned Companies"	Key reasons: • *Independence* • *Objectivity* • *Integrity* • *Professional skill* • *Confidential* • *Responsibility to user*

Table 6.
Auditor Selection Criteria of the Interviewees from Three Categories Companies (Summary)

• Good services	5 interviewees = 33.3%
• Loyalty	15 interviewees = 100%
• Independence	15 interviewees = 100%
• Care	5 interviewees = 33.3%
• Cheaper fees	5 interviewees = 33.3%
• Integrity	10 interviewees = 66.6%
• Objectivity	10 interviewees = 66.6%
• Professional skill	10 interviewees = 66.6%
• Limitation time	5 interviewees = 33.3%
• Confidential	15 interviewees = 100%
• Responsibility	15 interviewees = 100%

Table 7.
Reasons for Auditors Implementing the First Ethics Code (Independence and Objectivity) by FOCS, SOCS and FROCS (User Perceptions)

The five Financial Managers of "Family – owned Companies	Key reasons: • *Fairness* • *Avoiding the relations that can lead to bias and negative impact on audit result.*
The five Financial Mangers of "State-owned Companies"	Key reasons: • *Fairness* • *Objectivity* • *Independence* • *No family relations, financial and any personal interest* • *Auditor has limitation time max 2 years to change regularly.*
The five Financial Managers of "Foreign-owned Companies"	Key reasons: • *Fairness* • *Objectivity* • *Independence* • *No family relations, financial and any personal interest* • *No priority towards self-interest and groups* • *Free from conflict of interest.*

Table 8.
Independence and Objectivity (Summary)

Fairness	15 interviewees = 100%
Free from bias and other negative impact	15 interviewees = 100%
Independence	10 interviewees = 66.6%
Objectivity	10 interviewees = 66.6%
No relationships; family, business, financial and personal	10 interviewees = 66.6%
No priority towards self-interest and groups	10 interviewees = 66.6%
Time limitation to change regularly max 2years	8 interviewees = 50%
Free from personality and conflict of interest	5 interviewees = 33.3%

Table 9.
Reasons for Auditors Implementing the Second Ethics Code (Integrity) by FOCS, SOCS and FROCS (User Perception)

The five financial Managers of "Family-owned Companies"	Key reasons: • *Honesty* • *Clarity* • *Fittingness of Financial Report* • *Client confidentiality*
The five Financial Managers of "State-owned Companies"	Key reasons: • *Honesty* • *Clarity* • *Confidentiality* • *Trustworthy* • *High loyalty*
The five financial Managers of "Foreign-Based Companies"	Key reasons: • *Honesty* • *Clarity* • *Trustworthy* • *Adhere to the rule of the standard auditing* • *High loyalty to profession*

Table 10.
Integrity (Summary)

Honesty	15 interviewees = 100%
Clarity	15 interviewees = 100%
Client confidentiality	15 interviewees = 100%
High loyalty to profession	10 interviewees = 66.6%
Fittingness of Financial Report	5 interviewees = 33.3%
Trustworthy	7 interviewees = 45%
Follow the rule of auditing standards	5 interviewees = 33.3%

Table 11.
Reasons for Auditors Implementing the Third Ethics Code (Responsibility) by FOCS, SOCS and FROCS (User Perception)

The five financial Managers of "Family-owned Companies"	Key reasons: • *Responsibility to user (company)* • *On time* • *Responsibility to all services*
The five Financial Managers of "State-owned Companies"	Key reasons: • *Responsible for punctual audit practices* • *Responsible for user to understanding of financial report* • *Responsible for objectivity of financial report information ot public and user* • *Responsible for result of financial report*
The five Financial Mangers of "Foreign-owned Companies"	Key reasons: • *Responsible for maintenance of public trust.* • *Responsible for work relationship with others auditor* • *Responsible for increase of public interest* • *Responsible to give objective information to all users of the Financial report*

Table 12.
Responsibility (Summary)

• Responsible for user (company)	15 interviewees = 100%
• Responsible for other user of financial report	10 interviewees = 66.6%
• Responsible for all services	5 interviewees = 33.3%
• Responsible for punctual audit practices	10 interviewees = 66.6%
• Responsible for maintenance of public trust	5 interviewees = 33.3%
• Responsible for work relationship with others auditor	5 interviewees = 33.3%
• Responsible for increase of public interest	5 interviewees = 33.3%
• Responsible to give objective information to all users of the financial report	10 interviewees = 66.6%

Table 13.
Reasons for Auditors' Implementing the Fourth Ethics Code (Due Care) by FOCS, SOCS and FROCS (User Perception)

The five financial Managers of "Family-owned Companies"	Key reasons: • *Care* • *Diligence* • *Consistency* • *High dedication*
The five Financial Managers of "State-owned Companies"	Key reasons: • *Care* • *Diligence* • *Consistency* • *More professional* • *High dedication*
The five Financial Mangers of "Foreign-owned Companies"	Key reasons: • *Care* • *Diligence* • *Competence* • *Consistency* • *High dedication* • *Professionalism* • *Greater knowledge of ability*

Table 14.
Due Care (Summary)

• Care	15 interviewees = 100%
• Diligence	15 interviewees = 100%
• Consistency	15 interviewees = 100%
• High dedication	15 interviewees = 100%
• Professional	10 interviewees = 66.6%
• Competence	5 interviewees = 33.3%
• More knowledge of ability	5 interviewees = 33.3%

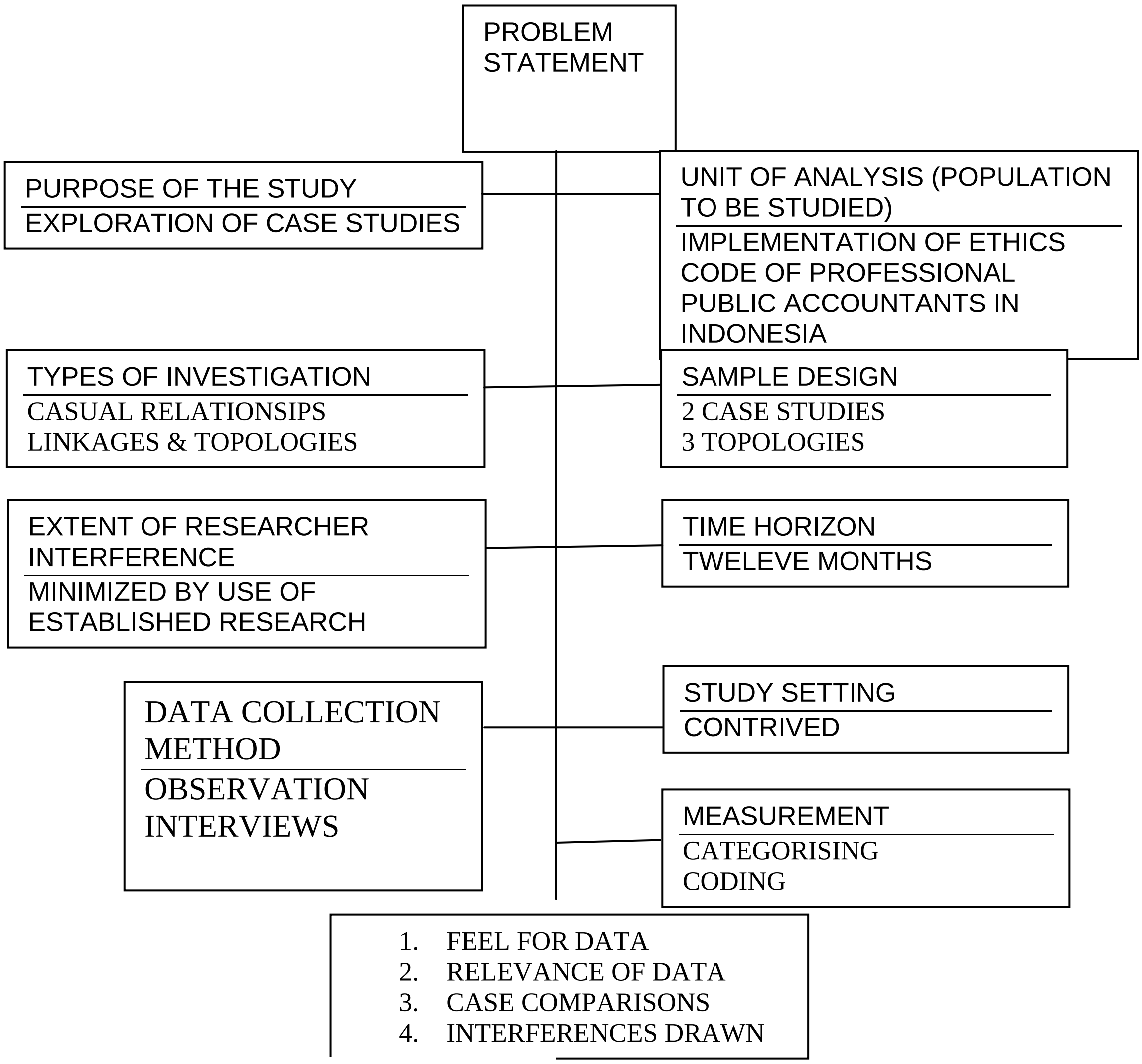
Table 15.
Reasons for Auditor Implementing the Fifth Ethics Code (Scope and Service) by FOCS, SOCS and FROCS (User Perception)

The five financial Managers of "Family-owned Companies"	Key reasons: • *Tax consultation* • *Correction of accounting system* • *Consultation about expansion company*
The five Financial Managers of "State-owned Companies"	Key reasons: • *Resolve the problem of taxation* • *Consultation for accounting system* • *To give guidelines about standards of financial report.*
The five Financial Mangers of "Foreign-owned Companies"	Key reasons: • *Consultation for taxation* • *Consultation for accounting system* • *Consultation for expansion/go public company* • *Consultation for make financial report with right direction standards*

Table 16.
Scope of Services (Summary)

• Consultation for Taxation	15 interviewees = 100%
• Consultation for accounting system	10 interviewees = 66.6%
• Correction of accounting system	5 interviewees = 33.3%
• Consultation for expansion of company	10 interviewees = 66.6%
• Consultation for financial report with right direction standards	5 interviewees = 33.3%
• Consultation for guidelines of standards financial report	5 interviewees = 33.3%

Diagram 1
THE RESEARCH DESIGN



Sources: Adapted from Sekaran (1992, p.67)

Diagram 2
Flow Chart of the Relationship Between the Professional Approach and the Individual Approach