

Solution Manual

to accompany

Accounting: Business Reporting for Decision Making 4e

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WILEY

John Wiley & Sons Australia, Ltd 2012

CHAPTER 2 Business Sustainability

Comprehension Questions

2.1 Describe the structure of corporate governance as put forward by Farrar.

Farrar (2005) sees the corporate governance structure as a relationship between the legal regulation, the stock exchange listing requirements and statement of accounting practice, codes of conduct, guidelines and statement of best practice and business ethics. The legal regulation sits at the core, with the factors emanating outwards depending on their obligatory nature.

2.2 Compare and contrast the views of Hobbes with those of Smith and Friedman.

Hobbes viewed regulation as essential whereas Smith and Friedman advocated little regulation and the promotion of self interest thereby creating market efficiencies and wealthy nations by free entrepreneurial trade.

Thomas Hobbes (1588 – 1679) famous' position is that if everyone acted in their own self interest then anarchy would rein and it would lead to a shallow, anxious and short life. He argued that most people would rationally recognize that it was in their best interest to form a government to regulate behavior. In so doing they would accept the laws of the state and agree to abide by their moral obligations (Honderich, 1995).

However, maximising self-interest became a theme in classical economic theory. Adam Smith (1723-1790) was an advocate of this philosophy and believed that competitive self interests were necessary in the commercial world to achieve overall public benefit. Basically, if people were free to venture into activities that promoted their own self interest then the process would guide them not to war on each other (as believed by Hobbes) but to a utilitarian state. Economist Milton Friedman also believed in limited government intervention and in the self interest principle as long as it was done in accordance with the “rules of the game”. He states

“there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profit so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.” (Friedman, 1970, p.126).

Friedman's laissez-faire economy in which profit is the ultimate goal and there is very little regulation is based on the idea that a firm taking on social costs makes them less efficient and therefore in the long run will do more harm to society than good. So Smith and Friedman's view of little regulation is in contrast to Hobbes's position of a government ruled society. Although at seemingly opposing ends, the Smith and Friedman view is premised on an acceptance that some regulatory controls are needed. However, the question remains as to what extent regulation is needed to protect the interest of the community while not stifling the risk taking ventures of

entrepreneurs that provide the impetus for wealthy nations. In other words, what are the rules of the game and how and who decides upon them?

2.3 Outline the major maxims of Kantianism and describe what they mean.

“I ought never to act except in such a way that I can also will that my maxim should become a universal law.

Act in such a way that you always treat humanity ... never simply as a means, but always at the same time as an end.”ⁱ

The first of these maxims is similar to the ‘do unto others as you would have them do unto you’ If you take out credit knowing that you couldn’t pay it back, would you like a universal law that dictates that this is acceptable practice. The second maxim is that the end does not justify the means or to put it another way you should not take advantage of people to achieve a certain end.

2.4 What is meant by business sustainability?

Business sustainability is considering the long term (multi-generational) in business decisions. It is about thinking of solutions to the world’s problems and in trying to change business practices and processes to ensure a respect for the environment and people. It is about integrating sustainability into the business and about being transparent and accountable via business sustainability reporting.

An often cited definition of sustainability was that put forward by Brundtland (1987): “Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs. It contains within it two key concepts: the concept of needs, in particular the essential needs of the world’s poor, to which overriding priority should be given; and the idea of limitations imposed by the state of technology and social organisation on the environment’s ability to meet present and future needs.”

2.5 Distinguish between morality and prudence.

A distinction between acting in one’s self interest (prudence) or acting as one ought to by taking into account the interests of other people (morality) is central to the theory of ethics. For example, a child is taught to eat vegetables, not to run across the road or to touch a hot cup of tea. These are instructions of self interest. However, when a child is taught not to hit, share or be kind to others that is instruction on morality. So rules of morality and rules of prudence are taught together with no distinguishable differences (Beauchamp, Bowie and Arnold, 2009). In fact, most people in business are unconcerned about the motivations of the decision maker as long as the action is the right thing to do. Generally acting morally is prudent. However, the distinction is important because in business there are numerous cases where decisions have been made to act morally but it isn’t prudent. Such as, the many examples of businesses that kept staff employed throughout the global financial crisis despite a downturn in their trade or hiring of disabled people despite in some circumstances their lower

productivity. There are also examples where acting prudently was not moral, such as withholding information, stalling wage negotiations with unions to delay the increase in labour costs or misleading advertising.

2.6 What are the three pillars of sustainability?

The three pillars are economics, social and environment.

Economic performance is the traditional profit and return on capital performance. More recently economic performance has been defined as the economic value created by the entity over a particular period of time. This is the profit minus the cost of the capital employed. All entities must turn a profit and deliver an adequate return on the capital employed to remain sustainable. It is this bottom line that captures the conventional concept of performance and the focus on the owners of the entity.

Environmental performance refers to an entity's activities relating to natural capital and whether their activities are environmentally sustainable. Natural capital falls into two main areas: "critical natural capital and renewable, replaceable, or substitutable natural capital" (Elkington, 1998, p.79). So the environmental bottom line captures the affect an entity's operations have on the natural capital and whether this is sustainable.

Social performance refers to both the human capital (the employee/community's health, skills and education) and society's wealth creation potential (Elkington, 1998). Fukuyama (1995) describes social capital as "the ability of people to work together for common purposes in groups and organizations". He argues that 'trust' in one another is a central element in social prosperity and that those organisations that trust one another and accept a common set of ethical norms will do business more efficiently and gather a greater variety of positive social relationships than those organisations that do not trust. The result being that doing business will be cheaper and the synergies from more positive social relations will help create sustained wealth. Examples of social capital are paying fair salaries to workers, not exploiting supplier relationships, providing safe working conditions and ensuring the product/service is safe for the consumer.

2.7 Discuss whether an accountant should take on an appointment outside his or her area of expertise.

The APES 110: *Code of Ethics for Professional Accountants* requires an accountant to perform professional services with due care, competence and diligence. This includes ensuring that they possess a level of technical and professional skills to take on appointments. It is clear, therefore, that an accountant should not take on an appointment outside his/her area of expertise.

2.8 Outline the principles of business sustainability performance as put forward by Epstein & Roy (2003).

Table 2.1: Principles of Business Sustainability Performance

1	Ethics	The company establishes, promotes, monitors and maintains ethical standards and practices in dealings with all company stakeholders.
2	Governance	The company manages all of its resources conscientiously and effectively, recognizing the fiduciary duty of corporate boards and managers to focus on the interest of all company stakeholders.
3	Transparency	The company provides timely disclosure of information about its products and services, and activities, thus permitting stakeholders to make informed decisions.
4	Business relationships	The company engages in fair trading practices with supplier's distributors, and partners.
5	Financial return	The company compensates providers of capital with a competitive return on investment and the protection of company assets.
6	Community involvement/economic development	The company fosters a mutually beneficial relationship between the corporation and the community in which it is sensitive to the culture, context and needs of the community.
7	Value of products and services	The company respects the needs, desires and rights of its customers and strives to provide the highest levels of product and service values.
8	Employment practices	The company engages in human resource management practices that promote personal and professional employee development, diversity, and empowerment.
9	Protection of the environment	The company strives to protect and promote sustainable development with products, processes, services and activities.

Source: Epstein and Roy (2003) "Improving Sustainability Performance" as cited in Epstein (2008) p. 37.

2.9 Imagine that you are a manager in a large entity, and need to make a recommendation to the CEO on which tender to accept. The job being put out to tender by the entity is worth millions of dollars, and you have a significant ownership share in one of the companies tendering. Outline the ethical issues to be considered.

The issues to consider are independence, conflict of interest, objectivity and integrity. In your position as manager, you need to act in the best interests of the company and make an independent and objective assessment as to which of the tendering companies should be given the tender. If the company in which the manager had an interest won the tender, there may be doubts from others as to whether it was because it was the best tender or because there was bias in the decision-making process. It would be best for the manager to declare his interest and to step back from the decision.

2.10 What are the four key responsibilities of business? Do you think an entity should consider discretionary responsibilities? Why?

According to Carroll, there are four key responsibilities of business which are economic, legal, ethical and discretionary. Organisations have an economic responsibility to provide goods and services at a fair price, to repay their creditors and to seek a reasonable return for their shareholders. Legally, they are required to uphold the laws of government and are ethically responsible to act the way society would expect. Discretionary responsibilities are carried out voluntarily. For instance, there may be no laws relating to the maximum volume of effluent discharge, but a company may choose to monitor and limit its discharge because society expects it to. It is an ethical responsibility. However, the firm may also choose to change equipment and processes so that there is no discharge at all and this would be classed as a discretionary responsibility. Over time, discretionary responsibilities may become ethical responsibilities or even legal responsibilities. If organisations don't address their pollution problems then the government will step in and regulate it.

Whether or not you feel that firms should consider discretionary responsibilities depends on your view as to the objective of a firm. As discussed in the chapter, some believe that a firm only has a duty to its shareholders, while others believe that a firm has a wider responsibility to all stakeholders. Some reasons put forward why firms consider social and environmental issues are:

- economically in their best interest (has a benefit to the bottom line profit)
- to minimise government interference
- enlightened self interest
- genuinely want to do the right thing.

So, depending on what you believe will determine whether or not a firm has a responsibility to consider discretionary responsibilities.

2.11 Hypothesise what the most important driver of sustainability would be and explain your rationale for its selection.

Sustainability is about meeting today's needs without compromising the ability of future generations to meet their own needs. For business to be sustained over time it needs to be profitable, it needs to maintain customer satisfaction, it needs to maintain product/service quality and it needs to maintain a good relationship with suppliers and to have sustained responsibility for its actions that impact on the environment and community.

Key drivers discussed include the competition for resources, climate change, economic globalization and connectivity and communication. Students may have chosen one of these drivers as the most important driver of sustainability.

**2.12 ‘Complying with the law will always mean that you are acting ethically.’
Discuss this statement.**

Ethics and the law are related but they are not the same thing. Law is about what actions are legal, not particularly what is ethical. Justice may or may not be seen to be done in a court of law.

A good way of thinking about this is by considering Carroll’s four key responsibilities of business (economic, legal, ethical and discretionary). Specifically, consider the legal and ethical responsibilities. Legally, businesses are required to uphold the laws of government and are ethically responsible to act the way society would expect. For instance, there may be no laws relating to the maximum volume of effluent discharge but a company may choose to monitor and limit its discharge because society expects it to. It is an ethical responsibility.

2.13 Are ethics and corporate governance important topics in the study of accounting and the business environment? Why?

Yes. It is necessary to study ethics because ethics is about human behaviour. Business is also about the behaviour of humans, and decisions made in business can alter the fate of individuals, groups, organisations and even countries. Corporate governance is about the ultimate decision making of enterprises. The boards of companies and the top executives make decisions that have far reaching consequences. They are entrusted with billions of dollars of capital, the labour of the world and the futures of not only the current generation but subsequent generations. It is therefore important that people entering the business world understand that responsibility and therefore that guidelines, expectations and an understanding of ethics be incorporated into business studies.

2.14 Comment on the approach put forward by the St James Ethics Centre in deliberations of an ethical issue.

The St James Ethics Centre Approach helps identify the issues to think about in making a decision, rather than a sequential approach. The method is as follows:

- What are the relevant facts?
- Which of my values make these facts significant?
- What assumptions am I making?
- What are the weaknesses in my own position?
- Would I be happy for my actions to be open to public scrutiny?
- Would I be happy if my family knew what I’d done?
- What will doing this do to my character or the character of my organisation?
- What would happen if everybody took this course of action?
- How would I feel if my actions were to impact upon child or parent?
- Have I really thought through the issues?
- Have I considered the possibility that the ends may not justify the means?

2.15 Paul gave Sam a bottle of wine for helping him to prepare his CV for a job he was applying for within Sam's company. Is this bribery? Why?

Generally, this would be classed as a gift. It is small in value and seems to be given after Sam helped Paul, not prior to. That is, the wine doesn't seem to be a condition of Sam helping Paul. Two questions that need to be asked are: (1) Was Sam on the selection panel? and (2) does Paul know the outcome of the selection? If Sam wasn't on the selection panel then it wouldn't be a bribe. He had no authority or influence to alter the decision of the selection panel. If Sam *was* on the selection panel, he should have declined to help Paul or at least made it known to the other panel members that he helped Paul. If the outcome of the selection isn't known and Paul gave the bottle of wine to Sam then it clearly indicates that it was because of the help received rather than the outcome.

2.16 Identify five stakeholders of the business community, and give reasons as to why they would have an interest.

Stakeholders could include (but are not limited to) the following:

- *Investors* — owners of the entity who need to know whether their investment is sound.
- *Creditors* — supply an entity with resources and therefore need to evaluate the entity's ability to pay their debts.
- *Employees (and Trade Unions)* — supply the entity with labour and therefore need to be assured that wages will be paid and that a sound working environment will be provided.
- *Customers* — interested in whether a company will keep supplying a product, honour product warranties, deliver a safe and useable product
- *Government* — such as the ATO, ASIC, ACCC, APRA have an interest to ensure that regulation is being complied with.
- *Special Interest Groups* — have a focus on ensuring that an entity has considered environmental, social or industrial aspects during their operations. The type of interest will depend on the interest of the group.
- *Community* — has an interest in examining whether the entity is contributing positively to the general welfare and economic growth of the local community.

2.17 Outline activities that accountants could take to help corporations discharge their social obligations.

Types of activities include the following.

- Modifying existing systems to incorporate environmental and social revenues and expenditures.
- Rethinking the use of some accounting techniques such as investment and performance appraisal as they ignore the environmental and social elements.
- Having a greater awareness of the future by bringing to account potential contingent liabilities, changing payback periods, costing environmental and social initiatives as well as the cost of not undertaking such initiatives.

- Expanding and developing new information systems to incorporate environmental and social information, e.g. including information on the whole cycle of a product, not just the production cost.
- Including in external reporting environmental and social information. The accountant's role goes beyond providing financial information to satisfy statutory requirements but includes the provision of information that is relevant, reliable, accurate and timely on a number of issues for various stakeholders. It is not enough to leave this to the public relations department.
- Developing systems that not only capture the environmental and social activities but also the extent to which the activities meet the objectives.
- Attempting to measure both the cost of environmental and social activities but and also the benefits. At present, costs can generally be captured in the current system, however, techniques to measure the benefits (both increases in social benefits and decreases in social costs) need to be developed.

2.18 Identify and discuss five fundamental principles of the Code of Ethics for Professional Accountants.

The following are the five fundamental principles for discussion:

Integrity

- Be straightforward, honest and sincere in your approach to professional work.

Objectivity

- Not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others.
- Be fair and do not allow prejudice, conflict of interest or bias to override your objectivity.

Professional Competence and due care

- Perform professional services with due care, competence and diligence.
- Carry out your professional work in accordance with the technical and professional standards relevant to that work.
- Maintain professional knowledge and skill at a level required.
- Refrain from performing any services that you are not competent to carry out unless assistance is obtained.

Confidentiality

- Respect the confidentiality of information acquired in the course of your work and do not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose it.
- Refrain from using confidential information acquired as a result of the professional engagement to your advantage or the advantage of third parties.

Professional behaviour

- Conduct yourself in a manner consistent with the good reputation of the profession and refrain from any conduct that might bring discredit to the profession

2.19 What is stewardship theory and how is it related to corporate governance?

Stewardship theory suggests that motive for serving on a board goes beyond a

purely self interest perspective. This motive may be guided by a code or company purpose or directors may see themselves as stewards of a particular interest. It is generally under this banner that there has been an increase in the number of independent non-executive directors on boards, thus serving the interests of a large number of small shareholders or the community and environment. At times key suppliers or debt providers may take a place on a board to help protect their relevant interests. No matter what the interest they are stewards of some greater good, not just shareholder wealth. However, it may go beyond this as summarised by Peter Weinberg (former Goldman Sachs executive):

“Serving on a board is like taking on a position in public service...It is not (and should not be) a wealth creation opportunity but a chance to play a role in the proper workings of our marketplace.” (p.43, Nordberg, 2008).

2.20 What is risk management and why is it included in the ASXCGC Principles of Good Corporate Governance and Best Practice Recommendations?

Risk management is the systematic process of assessing the probability of something unexpected happening, and the establishment of policies and procedures to manage that risk. It is important for the board and management of enterprises to consider risk in order to properly understand the impact of the environment of their enterprise and to help ensure its survival into the future. It is included in the ASX principles of good corporate governance as it is fundamental for the decision makers in any enterprise to manage risk.

2.21 Give some examples of each of Carroll’s four key responsibilities of business. Have any of these changed from one responsibility grouping to another over the last decade?

The four key responsibilities of business are economic, legal, ethical and discretionary. Many examples could be given.

1. *Economic* — to provide goods at a fair price, to pay creditors on time, to ensure a suitable return to shareholders.
2. *Legal* — to comply with the laws, i.e. submit financial reports on time, adhere to pollution regulation, comply with trade practices act dealing with fair pricing and market exploitation.
3. *Ethical* — to treat employees fairly
4. *Discretionary* — to provide child care facilities for workers.

There would be a number of items that would have gone from the ethical grouping to the legal grouping, especially those issues relating to the environment. Issues such as pollution emission and effluent discharge may not have been regulated to the same extent 50 years ago. Child care facilities are one example that may go from discretionary to ethical over the next decade with pressure on companies to provide such facilities.

2.22 List some of the reasons given to explain why businesses act in a socially responsible manner.

- Enlightened self-interest.
- Economically it makes sense as higher prices and more product sales will be the outcome (good marketing and public relations exercise).
- Limit interference by government.
- Generally believe in doing the right thing.

2.23 Explain the term ‘shareholder value’.

The view that holds that the purpose of the corporation is to maximise shareholder wealth. Shareholders are the owners of the entity and it is through this ownership and their legal standing in relation to their rights and responsibilities that have traditionally seen shareholders as the primary focus in business decision making.

2.24 What is triple bottom line reporting?

Triple bottom line reporting refers to the economic, social and environmental performance of a company. Elkington proposes that a company’s long term viability is a function of how well it can balance the three areas. The concept supports the view that companies have a duty of care to society at large. The movement is developing performance measures to assist the analysis of social and environmental performance.

2.25 What is corporate governance?

Corporate governance refers to the direction, control and management of an enterprise.

2.26 What are stakeholders, and why are they considered in corporate governance?

There is much debate in business literature as to whether an organisation’s sole responsibility is to its shareholders, or whether there is a wider duty of care for organisations to identify all the values and principles at stake. A theory called ‘**stakeholder theory**’ proposes that the purpose of the firm ‘is to serve as a vehicle for coordinating stakeholder interests’, not the narrow view that the purpose is to maximise shareholder wealth. After all, the firm is an artificial entity and the shareholder purpose of the firm is simply based on the shareholder’s right to property. Proponents of stakeholder theory view the purpose of a firm as far greater.

It is related to corporate governance because corporate governance is about the direction, control and management of organisations. Therefore, the management of the nation’s capital and operations rests on the philosophy of the company directors that have the responsibility to govern enterprises. How and to what extent they consider all stakeholder views will have an impact on society in the long term.

2.27 Outline the ASXCGC Principles of Good Corporate Governance and Best Practice Recommendations.

The Australian Stock Exchange (ASX) Corporate Governance principles and recommendations 2nd edition, are:

1. Lay solid foundations for management and oversight
2. Structure the board to add value
3. Promote ethical and responsible decision making
4. Safeguard integrity in financial reporting
5. Make timely and balanced disclosure
6. Respect the rights of shareholders
7. Recognise and manage risk
8. Remunerate fairly and responsibly

2.28 What are the arguments for and against a single goal of increasing shareholder value?

Shareholders are the owners of the entity. They risk their capital and take on the responsibility that owning a business entails. Legally, under the corporations act, constitution, partnership agreement, etc they are the party with the rights to make decisions and as such take on the responsibility to run the business. They take on the full risk of not making a profit (losing money), and need to ensure all relevant business legislation is complied with (work place health and safety, product safety, complying with industrial awards and agreements). The corporations law indicates that directors (who are shareholders and have been voted to be on the board of directors) have to act in good faith and in the best interests of the company. Therefore, arguably to put another group's best interests first may conflict with this direction. Further, it may be that some decisions need to be made where there is a direct conflict between one stakeholder group compared to another. An example would be where a company decides to source their raw material from a non-local firm due to their processes being more environmentally friendly. In a number of circumstances what is good for shareholders may indeed be good for other groups. For example, treating employees with respect and offering good employment conditions (although at extra cost to the entity and therefore shareholder in the short term) may be good for the entity in the long term as employees will want to stay and productivity may increase.

However, it has been argued that other stakeholders invest (not money) in the business as well. There is also growing disillusion with the self interest principle. That is, everyone acting with their own self interest in mind doesn't lead to a society that values the collective or the environment. The self interest principle is very short term. Having a conscious regard for others and the effect of your decisions can lead to a society worth living in.

Further to the above, there is an increased discussion regarding which shareholders the board should be more concerned about. With the increase in and types of trading transactions there is more uncertainty about who owns the company as any point in time. For instance, there is increased 'day traders' traffic. So the board in making a decision regarding say a takeover offer may increase the value for the short term

shareholders (day traders) by accepting the offer but decrease the value for the long term shareholders. There is also increased short selling activity. Does the board have a duty to decrease the value of the shares to benefit the short selling shareholders?

The increased shifting of ownership has heightened the argument that shareholders are not the primary stakeholder. Although legally they have taken the monetary risk, the company structure allows a coming together of all stakeholders whether labour, suppliers, capital and the community.

2.29 Outline the legal duties that directors have to their company.

Generally, directors owe the following legal duties to their company:

- to act in good faith, in the best interests of the company
- to act with care and diligence
- to avoid conflicts between their role as a director and any of their personal interests.

2.30 Identify some social performance aspects on which entities report.

Some social performance aspects that entity's report on are:

- Environmental
- Community involvement
- Treatment of employees
- Treatment of suppliers

See Table 3.2 of the textbook.

2.31 Compare and contrast the professional code of ethics for individuals and the guidelines for corporations.

Both require care and a consideration of the public interest. There are minimum standards expected (technical and professional standards for individuals and best practice standards for corporations) and there is a need for transparency and accountability. Personal attributes of officers of companies referred to in the guidelines and for accountants in the professional code of ethics are competence, integrity and objectivity. Related to these attributes is independence. Independence is an importance element in accounting professional services and contributes enormously to the trust the public have in accountants and their role. It is included in the code of professional ethics. It is therefore not surprising that it is an important element of principle 4 in the guidelines which relates specifically to the accounting function of safeguarding the integrity of the financial reports.

2.32 What is the difference between business ethics and social and environmental responsibility?

Business ethics relate to values and principles used in individual decision making, whilst social and environmental responsibility relates to the consequences of the actions of corporations on society and the environment.

Application and Analysis Exercises

2.35 Fraud

Comment on whether fraud is just part of doing business. Should this cost be passed onto customers? If so, does that make fraud a personal loss or one for the community generally?

This is an opinion-based question. Some discussion points are:

- Some students may feel it is part of normal business activity and others may argue they should have zero tolerance. The point of view will determine whether a business allows for the cost of fraud in pricing or have zero tolerance.
- If they allow it in pricing then it is being passed on to the customer and, ultimately, the community is paying.
- If covered by insurance, the community is still paying.

2.36 Stakeholders

Choose a local business in your area and make a list of its stakeholders. Are some more important than others? List them in order of priority.

Stakeholders could include (but are not limited to) the following: investors, creditors, employees (and trade unions), customers, government, special interest groups, community.

2.37 Corporate governance

Discuss the implications of Sir John Dunlop's statement.

The first part of the statement clearly indicates that he believes a corporation's responsibility is to its shareholders. He indicates that this is a duty in 'perpetuity' or in the long term. The second part then indicates that he believes that to carry out this responsibility, a corporation has to consider all stakeholders. It could be argued that he is professing the 'enlightened self interest' principle.

2.38 Code of Ethics

Members of the two accounting professional bodies, CPA Australia and the Institute of Chartered Accountants have to comply with APES 110: Code of Ethics for Professional Accountants. This code lists several possible threats to the fundamental principles. Look up the APESB website (www.apesb.org.au) and outline some examples of each of the threats.

Those threats include self interest, self-review, advocacy, familiarity and intimidation. Examples from APES 110 are:

Examples of circumstances that may create **self-interest** threats for a Member in Public Practice include, but are not limited to:

- A Financial Interest in a Client.

- Jointly holding a Financial Interest with a Client.
- Undue dependence on total fees from a Client.
- Having a close business relationship with a Client.
- Concern about the possibility of losing a Client.
- Potential employment with a Client.
- Contingent Fees relating to an Assurance Engagement.
- A loan to or from an Assurance Client or any of its Directors or Officers.

Examples of circumstances that may create **self-review** threats include, but are not limited to:

- The discovery of a significant error during a re-evaluation of the work of the Member in Public Practice.
- Reporting on the operation of financial systems after being involved in their design or implementation.
- Having prepared the original data used to generate records that are the subject matter of the Engagement.
- A member of the Assurance Team, being, or having recently been, a Director or Officer of that Client.
- A member of the Assurance Team being, or having recently been, employed by the Client in a position to exert direct and significant influence over the subject matter of the Engagement.
- Performing a service for a Client that directly affects the subject matter of the Assurance Engagement.

Examples of circumstances that may create **advocacy** threats include, but are not limited to:

- Promoting shares in a Listed Entity when that entity is a Financial Statement Audit Client.
- Acting as an advocate on behalf of an Assurance Client in litigation or disputes with third parties.

Examples of circumstances that may create **familiarity** threats include, but are not limited to:

- A member of the Engagement Team having a Close or Immediate Family relationship with a Director or Officer of the Client.
- A member of the Engagement Team having a Close or Immediate Family relationship with an employee of the Client who is in a position to exert direct and significant influence over the subject matter of the Engagement.
- A former Partner of the Firm being a Director or Officer of the Client or an employee in a position to exert direct and significant influence over the subject matter of the Engagement.
- Accepting gifts or preferential treatment from a Client, unless the value is Clearly Insignificant.
- Long association of senior personnel with the Assurance Client.

Examples of circumstances that may create **intimidation** threats include, but are not limited to:

- Being threatened with dismissal or replacement in relation to a Client Engagement.
- Being threatened with litigation.
- Being pressured to reduce inappropriately the extent of work performed in order to reduce fees.

2.39 Corporate governance

If you reckon that I should p— off and get someone who knows nothing about my business (to chair the Harvey Norman board), well I don't think my shareholders will be very impressed. (Gerry Harvey)

This comment by Gerry Harvey was made when the ASXCGC Corporate governance principles and recommendations were released. What principle do you think Mr Harvey was objecting to and why do you think he felt that way?

One of the underlying tenets of principle two is that of independence. There has been some criticism centered on the recommendations in the guidelines regarding the independence principle. The guidelines recommend that the majority of the board be independent directors, including having an independent chair and an independent audit committee. The definition of independence is a non-executive director (i.e. not part of management) and one that it is not a substantial shareholder. Mr Harvey would have been significant at growing the company to the stage it is at now (i.e. from a small business to a large-listed company). He would feel strongly about the development and future of the company. No doubt he feels that shareholders have invested in his company because of his management strength over the years. He is obviously offended at the suggestion that he hand over ultimate power to someone who is a non-executive director and to someone who is not a substantial shareholder.

2.40 Ethical decision-making models

Discuss the effect of the arrangement with you continuing on as the client's auditor. Use the Langenderfer and Rockness model to help with your answer.

What are the facts?

You are the auditor of a company and you have taken on a management advisory service.

What are the ethical issues?

The main issue is that of independence and objectivity. Could you now audit the financial statements which were produced by the very system you installed? It is not only enough that you are of independent mind but that you appear to be independent in the eyes of others. However, if you don't take the audit engagement are you letting down the company who now has to find a new auditor which may result in an increased fee for the client?

What are the norms, principles and values?

Independence, objectivity, conflict of interest, owe a duty to shareholders, community and public as well as to client.

What is the best course of action consistent with the principles of integrity?

Not to take the audit.

What are the consequences of the possible courses of action identified in 4 above?

Option one is to undertake the audit and risk losing respect in the eyes of the shareholders and public with regard to independence and objectivity.

Option two is not to undertake the audit. This may have immediate consequences for the client, especially if there is limited time for the audit to be completed. It may also mean loss of fees for you in the future as you will be giving up a long term engagement.

2.41 Corporate governance

Comment on the following situations in relation to the ASXCGC Principles of Good Corporate Governance and Best Practice Recommendations.

- a. **A member of a board of directors insists on being involved in the employment of personnel.**
 - b. **The auditor of a company is the brother-in-law of one of the company's directors.**
 - c. **The XYZ company ensures that as much information as possible about the operations and financial affairs of the company is made available on the company website.**
 - d. **The chairman of the board puts forward a proposal to remunerate the CEO. A member of the board questions the proposal, giving the opinion that 'in comparison to similar size entities, it seems excessive'.**
 - e. **A board member is a major shareholder of a company that has tendered on a contract worth millions of dollars. When the board meets to consider the tenders received, the board member declares that she has a conflict of interest, and leaves the meeting room while the tenders are being discussed.**
-
- (a) The first principle encourages there to be a clear distinction between the responsibilities of the board and those of management. It would be strongly argued that management should oversee the employment of personnel.
 - (b) Principle 4 recognises the need to safeguard the integrity of the financial reporting system. One safeguard is to ensure that the auditor is independent. If the auditor and a board member has a close personal interest then in the eyes of the public the auditor would not be seen as independent and thus lose credibility.
 - (c) Principle 5 recommends the timely and balanced disclosure to promote accountability and transparency.
 - (d) Principle 8 recommends that remuneration has to be fair and reasonable and in line with performance.
 - (e) Principle 2 states that an effective board is independent and objective.

2.42 Ethics

As the director of a company, you need to make a decision regarding whether to shift the manufacturing operations offshore. Over recent years, the influx of cheap imports has made it harder to compete on a cost basis. However, shifting the operations offshore will create job losses for a large number of local people. Your company is a major employer in the region, and the closure of the factory will have a significant economic effect in the area. Use the St James Ethics Centre method to identify the issues to consider.

What are the relevant facts?

Company is struggling to compete due to cost. It is cheaper to use overseas labour. Would result in large negative economic impact on local community. However, not to shift may result in company failing.

Which of my values make these facts significant?

Integrity, trust, social commitment, reliability.

What assumptions am I making?

That the company may fail if the operations aren't shifted. That the community relies on the business in totality. That there are no other ways of operating that can save the company and still enable its existence in the local community.

What are the weaknesses in my own position?

There could be other avenues for cost saving. Maybe the company does not need to make so much profit. Maybe the local community could be asked for help.

Would I be happy for my actions to be open to public scrutiny?

They would be open to public scrutiny and may feel as if I let the community down if the operations shifted.

Would I be happy if my family knew what I'd done?

Yes, if all avenues were exhausted and the decision to take the operations offshore was the necessary one. It may not only save the business but also some jobs to the community.

What will doing this do to my character or the character of my organisation?

May be seen as chasing the 'dollar' at the expense of the livelihoods of local families. May lead to a backlash of products.

What would happen if everybody took this course of action?

There would be no industry left in the local community and in this country.

Have I really thought through the issues?

Yes

Have I considered the possibility that the ends may not justify the means?

The shifting operations offshore may result in some job losses but some positions may remain. If the operations continue as currently then the business may go bankrupt and all jobs would be lost.

2.43 Ethical decision-making models

You are faced with a number of situations as described. Use the Langenderfer and Rockness model to help determine the course of action you would take.

- a. You are a manager within a large entity and need to make a recommendation to the CEO on which tender to accept. The job being tendered for is worth millions of dollars, and you have a significant share in one of the companies tendering.**
- b. You are a small business owner who wants to enter an overseas market. You arrange to meet with a government official of a country you wish to do business with, to discuss your market entry. To be successful, you really need his support. During the discussion, you realise that he expects a monetary payment in exchange for his help.**

(a)

1. *Determine the facts of the case.*
Need to make a recommendation on tender. You have a material personal interest in a tendering company.
2. *Determine the ethical issues in the case.*
Conflict of interest. Material personal interest
3. *Determine the norms, principles and values related to the case.*
Independence, objectivity, integrity
4. *Determine the alternative courses of action.*
 - (a) Declare an interest and step outside of the decision-making process for this particular tender.
 - (b) Declare an interest and remain part of the decision-making process and complete your recommendation for your company.
 - (c) Don't declare an interest and continue to do your job by making a recommendation.
5. *Determine the best course of action consistent with 3 above.*
Best course of action would be to declare an interest and disqualify yourself from taking part in the decision-making process for this particular tender.
6. *Determine the consequences of each possible course of action identified in 4.*
 - (a) This will communicate to the CEO and all companies dealing with the organisation that you are open and honest in your dealings and that independence is important. Your objectivity and integrity will remain intact.
 - (b) Although it is admirable that you have made your personal interest known, it is not known whether you can truly be objective in the decision-making process, given your interest. It is not only necessary that you are independent, you need to appear to be independent from a third party.
 - (c) This could bring your own character and the reputation of your company into disrepute.
7. *Decide the course of action.*
It is best to declare an interest and step away from the decision making. This will strengthen the confidence in the company's tendering process by showing that you are independent and the company handles fairly all tenders received.

(b)

1. *Determine the facts of the case.*

You need to make a monetary payment to a government official. Your market entry depends on his support. It is against your culture to make such payments but it seems expected in this new country as the way of doing business

2. *Determine the ethical issues in the case.*

Bribery

3. *Determine the norms, principles and values related to the case.*

Honesty, integrity

4. *Determine the alternative courses of action.*

(a) Make the payment

(b) Don't make the payment

5. *Determine the best course of action consistent with 3 above*

It is best not to make the payment as this is consistent with the principles of your own culture. If it was found out that a monetary payment was made, it may jeopardise your integrity at home.

6. *Determine the consequences of each possible course of action identified in 4.*

(a) If you make the payment, it would increase the likelihood of your business venture being successful. However, it would compromise what you believe to be right. It may also mean that further payments would be expected in the future by the government official. That is, once you made a payment you may need to continue to do so.

(b) If you don't make the payment, you may find it hard to do business in that country. However, you may feel that you were uncomfortable doing business that way anyway. You would also feel that you were true to your own character of honesty and integrity by not making the payment.

7. *Decide the course of action.*

It is best not to make the payment.

2.44 Ethics

- a. On 11 September 2003, there was an attack on approximately 1000 people (including local villagers) who were protesting outside a Coca-Cola bottling plant in India. The protesters were objecting to the plant using water from two villages near Varanasi in Uttar Pradesh. It is alleged that the attack was made by guards of the Coca-Cola plant, and that the police watched on in silent approval.
- b. Tobacco companies are turning their attention to Third World countries in an attempt to curb a downward sales pattern as western countries decrease their consumption of tobacco.
- c. The OECD claims that governments must do more to improve the job opportunities for women, older workers, people with disabilities and the low skilled. The study warns that, without more and better jobs for such groups (which are underrepresented in the workforce), the prospects for economic growth in many countries will be undermined as the population ages.
- d. In mid 2003, a massive blackout shut down much of the Midwest and northeast of the United States. The immediate cause of the blackout was traced to FirstEnergy, a giant energy company. At 2 pm on 14 August, its Eastlake power plant in Ohio stopped running. As the company started reducing electricity loads elsewhere to compensate, the transmission lines overloaded, causing them to trip. Some commentators argue that since it was FirstEnergy that caused the problem, it should pay the bill for fixing it. The government feels that it is a community issue that should be paid for by public funding. It is claimed that the Bush administration refuses to make FirstEnergy pay the bill because of the large financial support the power company gave to the Bush election campaign.

All of the four situations outlined in the question are from real life. There are no real 'answers' to them. However, they provide good discussion situations. Consideration of the general question 'what would you have done if in that situation' would be a good starting point for discussion. This could be followed up by the ethical philosophy of each person putting forward their point of view. For instance, the rights of the minority groups in question (c) may come face to face with Bentham's 'greatest good for the greatest number' philosophy.

The issue of profit versus a consideration of all stakeholders could be considered. For instance, in question (b) there could be a discussion of whether a company should start marketing a product that medical research shows is harmful in a new market. The new markets may or may not have access to the medical information. Are they well enough informed to make a proper decision about whether or not to smoke? Who will ultimately get hurt? Maybe a discussion of the adage 'do no harm' would be useful.

The issues could also be teased out by using one of the ethical decision making methods outlined in the chapter.

2.45 Business Sustainability

Critique the role that regulation plays in encouraging business sustainability. In other words, assess whether you feel the government should regulate to protect the environment and social needs or would companies in all consciousness do the 'right thing' anyway. In your answer define regulation and business sustainability. You could also hypothesize as to whether existing legislation such as workplace health and safety and industrial relations (such as award wages) are necessary or just an extra burden on business that destroys efficiency and productivity.

Business sustainability is about making decisions for the long term benefit of the business, environment and society. Government regulation helps promote behavior and outcomes deemed valuable by that society. Regulation is used when business and citizens may act differently to what is generally good for society. It is not only useful in trying to promote the good of society as a whole, but also to protect minority rights or aspects of life that could not protect themselves. The environment is a good example of this. No one person or entity owns 'the atmosphere'. Legislation surrounding land ownership and rights to use land have been available in some shape or form for centuries. Water rights have been given greater legislative status over the last century. Given the shortage of water and its flows from one country to another over large continents the debate over water rights will no doubt increase over the next century and international organizations may increase calls for agreement over such rights. However, the atmosphere has not in the past been valued or traded. Yet high polluting entities may affect the lives of others not economically benefiting from the production of the polluting entity. So regulation over carbon emissions in the environment (by taxing it or through carbon trading) is one way the government can help promote acceptable behavior. Some entities may have been concerned about the effect their production processes have on aspects of the environment and some may not. Through regulation the value of the atmosphere to all of society can be promoted.

One aspect of the debate surrounding the issue of regulation is the short and long term horizons. Most entities report on the short term performance of the entity and most people consider their short term wants and needs over the consideration of long term outcomes. In the short term, the cost of implementing workplace, health and safety policies and processes may cause a significant cost to the entity. Many entities may not have implemented some WH&S processes or equipment due to the immediate cost of doing so and have been forced to by legislation. Likewise, the regulation of minimum wages protects the community from entities willing to take advantage of those not in a position to negotiate their own payment.

2.46 APES 110: Code of Ethics for Professional Accountants

- a. You are appointed the auditor of Baba Ltd, a producer of golf equipment. While on the premises carrying out some audit work, you are offered a new set of golf clubs in appreciation of your work to date.
- b. You discover that your client, Black Ltd, has underestimated its income on its tax return. You ask the company to submit an amended return but it refuses.
- c. You approach one of your friends, who works for a lending institution, for an unsecured loan. You have been unable to obtain a loan elsewhere. Your friend approves the loan.
- d. You are on the local council works committee. It is considering a number of tenders for a park upgrade. Your best friend has submitted a tender, and you argue strongly in favour of that tender.
- e. You have been approached to be on the board of directors of a large regional business. Your spouse is employed as a manager within the company.

- (a) The gift of golf clubs may not be seen as normally commensurate with acceptable social/business behaviour and could be construed that you may compromise your integrity, objectivity and independence. The code of ethics requires objectivity and independence. Accepting gifts may be seen to compromise your objectivity and independence. You must not only be independent of mind but also be seen to be independent. Integrity may also be hampered if accepting the gift.
- (b) This raises the issue of a duty to the public and a duty to a client. On the one hand, the code of ethics is based on the premises of credibility, professionalism, quality of service and confidence. The code of ethics states that accountants must maintain a sense of duty to the public interest. The public includes government. To discover an error and not report it may give you a sense that you have let down your responsibility to maintain a professional approach to your work, and a contribution in helping to establish confidence in the accounting profession and a credible and fair application of the tax system. On the other hand, you have a duty to your client. Generally, you may feel that you have done all that you can by requesting that they resubmit the return. It is a hard decision to report a client and you may feel that you prefer to extinguish your relationship to the client. It is probably in your best interest not to deal with such people anyway. Maybe a letter to your client outlining their responsibility, your responsibility and the consequences of their actions would help convince them and put you at ease that you have communicated with them fully and frankly in writing about the situation.
- (c) It is unfortunate that you placed your friend in this position. Given that no other institution approved the loan suggests that you received the loan because you were a friend rather than because you should have received a loan under the lending institution's guidelines. The code states accountants should act with competence and due care. It seems that the person giving the loan has breached this. The person has also breached the public interest, integrity, objectivity and independence.

- (d) In this situation it would have been appropriate to declare a conflict of interest and leave the meeting. By not doing this and arguing in favour of your friend's tender it is unclear as to whether you are arguing for it because you strongly believe it is the best tender or because it is your friend. Your objectivity is impaired. Although you could argue that you are independent in mind, you would not be seen to be independent by third parties. It would seem that integrity, objectivity and independence would be breached.
- (e) The code states that you maintain independence. This means that you not only have to be independent of mind but also independent in the eyes of third parties. You would need to consider whether you could actually remain objective in dealing with the issues and act in the good of the company as a whole. The fact that your partner is a manager in the business may bias your thinking on some or all of the issues put before the board. (You could excuse yourself from those issues that had a direct effect on your partner but overall most issues would have an indirect effect.) Taking on the position may also have a negative effect on your integrity. A further issue is that of confidentiality. It would be necessary to ensure confidential board room documents and discussion remained confidential.

In all of the above situations it could be seen to be a breach of The Public Interest and professional behaviour.

2.47 Corporate social responsibility

In your opinion, should corporations be socially and environmentally responsible? Why?

There is no right or wrong answer.

- Some students may argue that corporations should only be responsible to their owners. They are the ones that are taking the risk and investing their money. If a corporation does not make money then they will not exist.
- Others may argue that corporations should consider the social and environmental issues. If not, their operations would not be sustainable.
- A discussion of 'enlightened self interest' would be useful. That is, it is in the corporations self interest to be socially and environmentally responsible. The community would respond positively to that and it would sustain operations in the longer term.
- A discussion of the Milton Friedman quote in the chapter would prove fruitful.

He states

“there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profit so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.” (Friedman, 1970, p.126).

2.48 Corporations and social responsibility

A corporation is an artificial entity. Discuss whether the rights of this artificial entity should ever take priority over the rights of individuals and communities.

There is not necessarily a 'right' answer to this question. Everyone will have their opinion and arguments to support such opinions. Discussion could include:

- A corporation does not physically exist and cannot think or act without humans acting as agents. They are creations of the state and have evolved over time to the form that they take today. How they should be allowed to evolve is linked to what their role is and this varies depending on one's social stance.
- A corporation's existence comes about because the laws of its jurisdiction allow this. The laws can add rights and responsibilities and take them away.
- Some students may argue that individual rights should take priority over the rights of the corporation and would regard it as objectionable to think otherwise. Others may argue there should be less government regulation and therefore more rights for corporations. The rest may just accept that is the way corporations and business have evolved and that not much can be done to change this.
- To help the discussion maybe an example could be introduced. One from the local area or from current media. For example, should a corporation have a right to use the local water supply before individuals because they can pay more per kilolitre.

2.49 Compare and contrast teleological theories and deontological theories. Discuss whether you think these theories have a place in the modern business society.

Teleological theories are concerned with the consequences of decisions and if the actions result in good consequences then the behaviour is said to be ethical. This raises two issues: (i) what is a desirable consequence and (ii) upon whose judgement is the consequence examined. A number of teleological theories have been proposed the most notable being ethical utilitarianism (also known as consequentialism).

Deontological theories are those concerned with duty. Teleological ethics would fall within this theory as it is concerned with the rules to follow according to religion. Another philosophy under this heading is **Kantianism**.

Teleological theories are to do with consequences whereas Deontological theories are to do with motivation. Both would have a place in the modern business world as examining motivation for action and the consequences of action can help in business decision making.

Synthesis and analysis problems

2.50 The notes to the consolidated financial statements of JB Hi-Fi Ltd appear in appendix A of this book. Examine these notes together with other information from the website to investigate JB-HiFi's compliance with principle 4 (safeguard the integrity of financial reporting) of the ASXCGC Principles of Good Corporate Governance and Best Practice Recommendations.

Form teams to investigate the recommendations under principle 4 as presented in this chapter. The teams should examine one different recommendation each.

The recommendations under principle 4 of the ASX guidelines for good corporate governance are listed below together with the relevant information from the JB Hi Fi Limited Annual Report 2011.

1. The chief executive officer the chief financial officer state in writing to the board that the company's financial reports present a true and fair view, in all material respects, of the company's financial condition and operational results and are in accordance with relevant accounting standards.

Page 7 of the JB HiFi Ltd Annual Report contains information relating to the 'integrity of reporting'. This section states that the CEO and CFO have to make certain statements in writing to the board. The information alludes to this being done.

2. The board establish an audit committee.

Page 9 and 10 of the JB HiFi Ltd Annual Report discusses the Audit and Risk management committee. So JB Hi-Fi have established an audit committee.

*3. The audit committee consist of
Only non-executive directors
A majority of independent directors
An independent chairperson, who is not chairperson of the board
At least three members*

Page 10 of the JB Hi-Fi Annual Report states:
'The Audit and Risk management committee comprises three non-executive directors all of whom are independent with relevant financial, commercial and risk management experience and an independent chairperson who is not the chairperson of the Board.'

4. The audit committee have a formal charter

Page 9 states that the committee has a formal charter.

*5. The entity provide the following information
Details of those on the audit committee, the number of meetings and attendees of the audit committee and explanations of any departures from the recommendations as*

stated above should be included in the corporate governance section of the annual report. It is also recommended that the audit committee charter and the procedures for selection and appointment of external auditors are publicly available.

A copy of the charter and procedures and selection can be obtained from the JB Hi-Fi Limited website. The members of the audit committee are listed on page 10 of the JB HiFi Ltd Annual Report.

The use of audit committees and of the independent external auditor to help promote the integrity of the financial system is key in providing the public with confidence.

2.51 Required

- a. Do you think Mr Smith should take the trip? Outline any ethical concerns involved.**
- b. Do you think the management of Practical Solutions Ltd should allow Mr Smith to go on the trip?**
- c. Do you think that Practical Solutions Ltd should have a code of conduct? What would be the advantages and disadvantages to Practical Solutions Ltd of having a code of conduct?**

(a)

The main ethical concerns are independence, integrity and objectivity. The facts seem to indicate that it is an all expenses paid trip to Los Angeles for Mr Smith and his family. This could give the impression that the trip is a gift that could influence the software chosen. When making the software decision, Mr Smith may feel obligated to Dogto Ltd. because of the trip. From a third party viewpoint, there could appear to be a conflict of interest and a lack of independence. On the other hand, it would be a great opportunity to gather more information about the software. There could be an opportunity to meet users of the software, to hear clearly what the future development plans of the software are and it would save Practical Solutions Ltd money as they wouldn't have to pay for the trip. However, overall, the suggestion of taking family and of having a trip to Disneyland seems to indicate that the trip is more of a gift. The appearance to third parties and the impact on independence, integrity and objectivity may be too great. I would advise Mr Smith not to take the trip.

(b)

The trip would save Practical Solutions Ltd money and it would help gather information that could be useful in making a purchase decision. However, there are the ethical considerations as discussed in part (a) and the effect the trip would have on other employees and other software vendors. Maybe Practical Solutions Ltd could set some conditions to enable an employee to travel to Los Angeles to gather information without having the appearance of favouring Dogto Ltd. Conditions could include:

- the family does not travel
- the time spent in Los Angeles is only dedicated to the task at hand

- an employee other than Mr Smith travel to gather the information so there is a separation of the decision maker from the all expenses paid trip.

Given the conditions above, Practical Solutions could allow the trip to take place without unduly compromising any ethical code.

(c)

Yes, it is probably worthwhile for the company to develop its own code of conduct. The advantages are that it would send a message to employees about acceptable behaviour and help promote an aura of trust and credibility around business dealings. It would strengthen the professionalism of the company and even help the management team to foresee any ethical dilemmas. The disadvantages are that a code can't possibly cover all situations and employees may think that it sets down the minimum standard and it could be costly and time consuming to develop.

2.52 Margo Diamond is the corporate controller for a regional telecommunications company called Speedilink. Although Speedilink is a profit-based company, it has a progressive social-awareness strategy that incorporates the giving of a certain amount of its profits for philanthropic purposes. One company it has been supporting, Family Planning First, runs various activities on family planning. Activities include education in schools, helping your parents cope with new babies, and offering family planning services to low socioeconomic groups. However, when pro-life campaigners discovered that Family Planning First supports abortion, they advertised a boycott of companies that support this entity. In response, pro-choice activists, who believe the products and services of companies who withdraw their support of the entity. Margo has to make a recommendation to the board as to the best course of action to take. Help Margo by outlining the issues she should consider.

Instructors

This is a discussion type case study. Start by asking students to highlight (1) the consequences of continuing to support 'Family Planning First' and (2) the consequences of withdrawing support from 'Family Planning First'.

Note whether there is passionate argument either way and try to bring in people's own value systems surrounding the issue. This is to try to demonstrate that business decisions are never truly objective but biased by the decision maker's own personal view about issues. It will also give students the opportunity of making a case either way and trying to persuade others. This is also a necessary component of decision making.

Finally, ask the question 'What ought one to do?' You could use the Langenderfer and Rockness (1990) or the St. James Ethics Centre models to help with this.

For example: Langenderfer and Rockness Model

1. *Determine the facts of the case.*

You need to decide whether to continue supporting 'Family Planning First'. It seems that whether support is continued or ceased there will be some negative consequences.

2. *Determine the ethical issues in the case.*

The main issue is the rights and wrongs of abortion. The second issue is whether personal bias should affect business decision making.

3. *Determine the norms, principles and values related to the case.*

The firm had a sense of duty to the community that led to the support of the organisation originally.

4. *Determine the alternative courses of action.*

- a. Continue support
- b. Cease support

5. *Determine the best course of action consistent with 3 above.*

Continue support.

6. *Determine the consequences of each possible course of action identified in 4.*

Option one is to continue support. Prior to the dispute Speedlink was happy to support Family Planning First. Continuing the support would ensure that people (generally young or low socio-economic groups) were given the support they needed in education and help with young families and family planning. This would also mean that there may be a campaign against the service Speedlink provides which could have adverse effects on sales and therefore profit.

Option two is to cease support. This may mean that support to those in need may not be provided. This could have dire consequences on those directly and the general community indirectly. However, it does mean that the company isn't linked to abortion in any way. Ceasing to support Family Planning First could also mean some customers don't buy their service which could effect profit.

7. *Decide the course of action.*

It seems that no matter which action is taken there is potential for sales loss and therefore profit loss. The action taken may depend on whether the board of directors themselves are strongly opposed to abortion. Unless, there is strong feelings against abortion it may be that the best course of action is to continue support. It may be worthwhile demonstrating that Speedilink donate unconditionally. Some people argue that donating or giving with conditions isn't really giving at all. Speedilink may feel that the managers of Family Planning First are at the forefront of their profession and understand better then anyone where the need lay and what services to offer.

- 2.53 Go to the Shell website and examine the sustainability report. Examine the report and other information on the website and comment on the following:**
- a. What approach did Shell take in undertaking its sustainability report?**
 - b. List some of the key performance indicators that Shell used to measure financial, environmental and social factors.**
 - c. What are some of the key challenges facing Shell in its quest for sustainability?**
 - d. Given that Shell's core business relies on fossil fuel, which itself is a limited resource and a major cause of global warming, how can Shell ever expect to have sustainable development? (See 'Sustainable development and business strategy' in the Shell report to help with your answer).**

(a)

Shell has voluntarily reported on social and environmental performance. They indicate that they want to be transparent and honest because sustainability matters to their stakeholders. Page 36 of the sustainability report outlines its approach to reporting.

(b)

Pages 28-33 contain tables that summaries the performance data across both environmental and social issues that were discussed throughout the report.

(c)

Generally the three main challenges are

1. to provide the massive amount of extra energy needed to fuel development and reduce poverty;
2. to keep supplies secure from disruptions and
3. to do the above in socially and environmentally responsible ways.

However, the report discusses the challenges of the difficult economic conditions and its impact on energy needs and provision in the future.

(d)

In the 2010 report page 2 it states '*Sustainable development underpins our strategy. Our production of cleanerburning natural gas is growing. We are also investing in biofuels that are more sustainable, in technology to capture and store CO₂, and in ways to improve the energy efficiency of our operations.*

So Shell is investing in cleaner energy alternatives. The report indicates a general move to renewable energy. The report indicates that 'wind' is currently their largest business area. Note also that the report indicated a major review in 2009.

In the 2008 report it describes two ways of tackling the rising energy needs.

‘Scramble’ is described as:

“ a headlong rush by individual countries to secure more energy for themselves, whatever the consequences for others, or the planet. In this scenario, government responses to energy and climate problems are short-term and reactive. This leads to more economic volatility and brings wilder swings in energy price.” The other scenario, ‘Blueprints’, *“starts with a disorderly patchwork of local and national initiatives, but quickly settles down into a more orderly, co-operative transition. In this scenario, a global policy framework emerges for managing greenhouse gases within a decade. This encourages technologies like CO2 capture and storage (CCS), biofuels, wind and solar power and, after 2020, a mix of plug-in hybrid, fully electric and hydrogen-powered vehicles to come on stream faster.”* p.4

Hobbes advocates a governed state, so this view would require regulation if a blueprint rather than scramble approach is desirable. The Shell report clearly calls for governments to take a longer-term view and expects them to help reduce carbon emissions through regulation and help in the development of renewable energy by encouraging investment in their development.

The pure utilitarian view would consider consequences. What would be the consequences of each scenario? If you are purely self interested then maybe the scramble approach would be favourable as the consequences of a government or business not securing enough energy for their nation would be severe. It may bring economic volatility but it will be up to individual governments and businesses to manage and harness that volatility for the benefit of those they are responsible for. In fact some may argue that it is only through this economic viability that business and governments will move towards the most efficient means of using the limited resource. However, some may argue that utilitarianism would drive you to the blueprint approach. In fact it is in a company and government’s best interest to take that approach. If they do, and they are first to the market with some of their initiatives then that may benefit the company or nation in the longer term. The maxim ‘do no harm’ may move government and businesses to the blueprint approach.

Kantianism would study the decision from an obligation or duty point of view. What obligation does big business and government have to each other, society and the environment? Given the greenhouse crisis, at a minimum it would seem big business and government have an obligation to make some initiatives in this area.

- 2.54 Search the Johnson & Johnson website for their famous Credo http://www.johnsonandjohnson.com.au/about_credos.aspx. Given that it was written nearly 60 years ago, comment on its appropriateness in today's business world. Further, reflect on the early philosophical writings and comment on its relevance to these philosophies.**

The Johnson & Johnson credo lists all stakeholders as important to the mission of the enterprise. This reflects well with today's stakeholder philosophy. Further, it has been discussed that the philosophies of companies such as Johnson & Johnson, Cadbury, Du Pont, and other companies that started in the early twentieth century were such that they considered and believed in community and the benevolence of people. It was only in the latter part of the twentieth century that the management of firms took the self interest principle to the next level. Even Friedman and Smith, advocates of this principle believed that there were 'rules to the game'. With credos such as Johnson & Johnson there may not be a need for excessive regulation.

- 2.55 Some fund managers invested and lost client's money in the Bernie Madoff Ponzi scheme. One example was that of the Fairfield Greenwich Group that directed \$US7.3 billion of client money into the fund over a 5 year period.**

- (a) **If you were a client of Fairfield Greenwich Group would you expect that your fund manager should do minimum checks on recommended investments?**
- (b) **As a client, do you think you should be made aware if your fund manager or financial planner would gain a commission from your investment?**
- (c) **If you on the advice of your financial planner, invested your money in the Bernard Madoff Investment Scheme and then subsequently lost it, would you blame your financial advisor given that it was a well orchestrated fraud?**
- (d) **Would your answer in 3 be different, if you new that the Fairfield Greenwich Group earned \$US500 million in commissions by directing the \$US7.3 million capital into the fund?**

(a)

As a client you go to financial advisors for expertise in the financial area. You may not understand some of the complexity of the market but at a minimum you would expect that your advisor to do fundamental checks on investments and assess for themselves the level of risk.

(b)

Yes you should be made aware of all fees and charges that your fund manager or financial planner would gain from your investments. The confidence that you place in your financial advisor is based on trust. Trust in their knowledge, trust in their integrity and trust in their honesty.

(c)

Despite the checks and balances that your financial advisor performed, if there is a well orchestrated fraud then it may be impossible for anyone to be aware of it. Bernie Madoff had started his investment scheme in the 1960, he held numerous positions on government bodies and committees, he had consistent performance - never high or low and most others in the investment world rated his scheme low risk. So as a client is that enough? You may feel that despite all this your advisor should have understood the type of investment and the risk that it carried.

(d)

Given the level of fees, the clients should have expected their advisors to vouch for the legitimacy of the investment. Further, to take fees for investing signals some independence issues.

2.56 Investigate the relationship of human rights to business sustainability. In your answer examine the relationship from various angles such as:

- (a) Are human beings a resource to be used as a means to an end?**
- (b) Individual human beings should be able to negotiate their own pay without the need for industrial laws.**
- (c) If some people have more than others then they must have worked harder and deserved it. The system is based on opportunities and everyone has to look out for themselves.**

The triple bottom line approach to sustainability includes three pillars: economic, environment and social. Human rights would fall under the social dimension. It is accepted that all human beings need to be treated with respect and dignity. It has also been argued that the world's production should first ensure that every person has access to basic human needs. Once these needs are met then the surplus can be divided based on the success of individual opportunities taken. However, there is growing awareness that some people do not have their basic human rights covered while others live in luxury.

(a)

If human beings are used as a means it degrades them to the level of 'resources' or 'commodities' to be used and manipulated at will. It does not encourage respect or dignity.

(b)

The capital versus labor debate is one of the longest in history. The capital providers (business owners) hire labor to help produce their goods and services. The union movement was born out of the inequality of wage rates and of the need for laborers to form groups to help negotiate better wages and conditions. Benefits to the capital providers would be happier staff and a minimization of the costs to negotiate with one or a few parties compared to large numbers of individuals. Market rates of pay could be successful in a buoyant economy with minimally education job seekers. However, it is accepted that minimum rates of pay need to be regulated.

(c)

Certainly the capitalist system is based on opportunities and those willing to take advantage of them and work hard. It becomes unfair when those opportunities may not be available to all. Specifically, if political favours are involved.

Analysis of business cases

2.57

After being trained by former US vice-president Al Gore, Mike Sewell FCPA is convinced that the weight of scientific evidence behind climate change and the global effects we're seeing today should be enough to push businesses and individuals to take action.

Sewell is the general manager and company secretary for the Nossal Institute for Global Health, which is actively involved in research, education and inclusive development health practices in developing countries. In July this year, he underwent an intensive climate change course, along with a group of other volunteers under the Australian Conservation Foundation's Climate Project. The training was led by Nobel Prize winner Al Gore, whose Oscar award winning documentary *An Inconvenient Truth* helped bring mass international attention to climate change . . .

His interest in climate change grew earlier this year when he read an article in the medical journal *The Lancet* drawing the link between the developing world where his work is focused, and the magnified effects of climate change in these areas. He says that it's only in understanding the massive impact of climate change that organisations and individuals will start to take action.

'Climate change affects all of us but it affects developing countries more,' says Sewell. He notes that a lack of resources and already poor infrastructure amplifies the devastation caused by climate change. In acknowledging these global incidences Sewell puts aside the debate over whether the scientific arguments of global warming are valid. It's a separate argument he says. 'We have to acknowledge that things are happening to the world and that we need to change things if we want to protect the next generation.'

'I'd say the majority of small businesses haven't addressed the issues because they don't acknowledge the problems and they aren't aware of the effects,' Sewell says. The effects, however, are becoming more tangible for organisations around the globe, as their carbon footprints begin to appear on their balance sheets with the introduction of carbon emissions trading schemes.

'It's important for CPAs to understand what the carbon emissions trading scheme is about, and what drives it. What we as accountants need to do is to understand the fundamentals that are driving the scheme and make sure that the desired result comes through. These are exciting times for us because as accountants we can drive significant global change,' says Sewell, who's president of CPA Australia's Victoria division.

'There's no doubt that it will increase costs,' he notes. 'But we were always going to pay a price for carbon reduction. In the short term we'll pay a price, but in the long term we'll learn to develop a model that's more sustainable . . .'

Source: Excerpts from Grimard, C 2009, 'Turning the heat on', *InTheBlack*, vol._79, no._11, p. 19.

Required

- a. **Outline how climate change is likely to affect Sewell's business operations in developing countries.**
- b. **Evaluate the social issues likely to impact on a business operating in a developing country.**
- c. **Evaluate the role accountants can play in addressing climate change in a business environment.**

a.

Climate change in developing countries would exacerbate the difference between developing and developed countries. They would have fewer resources to deal with the consequences and would not be as developed in their systems to prevent or minimise such effects. In fact, the climate change itself was probably not a direct consequence of any action of the inhabitants of the developing countries.

Sewell is the general manager for the Nossal Institute for Global Health. This Institute is part of the University of Melbourne's research and education activities. So climate change in developing countries would affect their business operations by increasing their opportunity/need for research and education in all aspects of environmental and social life. Given the Institute is focused on health research it would include examining the climate change impacts on items such as water quality and sanitary issues and its affect on the health and well being of the residents.

b.

Social issues in developing countries that are likely to impact on business operations include (but not limited to):

- Lower cost of living means lower wages expected thus decreasing operating costs. This brings with it responsibility to not take advantage of the community and to help improve the standard of living over time.
- Lower education and understanding may increase the cost of training and bring with it a responsibility to train and educate the community.
- Undeveloped infrastructure (roads, sewerage, water) may increase some operating costs and heighten the expectation that business would take responsibility to develop the infrastructure over time.
- Undeveloped countries have a greater probability of political unrest so the protection of assets, and the protection of jobs for the people is a high priority and resources would need to be committed to this.

c.

Accountants can:

- Modifying existing systems to incorporate environmental and social revenues and expenditures.
- Rethinking the use of some accounting techniques (such as investment and performance appraisal) because they ignore the environmental and social elements.
- Having a greater awareness of the future by bringing to account potential contingent liabilities, changing payback periods, and determining the cost of

environmental and social initiatives as well as the cost of not undertaking such initiatives.

- Expanding and developing new information systems to incorporate environmental and social information (for example, by including information on the whole lifecycle of a product and not just the production cost).
- Including environmental and social information in external reporting. The accountant's role goes beyond providing financial information to satisfy statutory requirements. It includes the provision of information — relevant, reliable, accurate and timely — on a number of issues for various stakeholders. It is not enough to leave this to the public relations department.
- Developing systems that not only capture the environmental and social activities but also evaluate the extent to which the activities meet the objectives.
- Attempting to measure both the cost of environmental and social activities as well as the benefits. Costs can generally be captured in the current system, but techniques to measure the benefits (both increases in social benefits and decreases in social costs) need to be developed.

- 2.58 Orica issues a sustainability report using the GRI reporting framework.**
- a. Access the report on-line at <http://www.orica.com.au/sustainability/index.asp> Comment on its appearance, structure and informativeness from a user's perspective.**
 - b. The GRI reporting framework includes application levels (A, B or C), declaring the extent that they have applied the GRI framework. What level did Orica indicate they had applied the framework? Would you agree?**
 - c. Sustainability reports can be independently assured. What does this mean? Did Orica have their report independently assured? If so, in your opinion how credible were the assurers and how does this affect your reliance on the sustainability report?**
 - d. Above is a typical newspaper article surrounding the chemical hazard at Kooragang Island in August, 2011. Is Kooragang Island mentioned in the sustainability report? If so, are the risks of such an incident occurring/reoccurring mentioned. What other activities environmental or social are mentioned in the Kooragang Island section of the sustainability report? Given the incident mentioned in the newspaper article, have you reassessed your reliability on the report? Do you feel that the regulation and government response to this particular incident was excessive or not enough in relation to protecting the interests of the community and the environment.**

(a)

The appearance is that expected of a large company's sustainability report. Its presentation is professional and glossy and this gives weight to its credibility. The

structure is easy to follow and appears to contain the three main parts suggested by the GRI Reporting Framework. That is strategy and profile, management approach and performance indicators.

(b)

Orica has indicated that the application level of their sustainability reporting is level B. (This is in the sustainability report for 2010 and on the website under GRI Index.) The website contains a GRI Index which lists the criteria and links to where the Orica Sustainability Report addresses this. This gives some assurance that the level B is appropriate.

(c)

Independent assurance means that that a person or group of people with appropriate expertise and knowledge from outside the entity are contracted to assess whether what the sustainability reports as an entity's processes are actually their processes. There is no mention in the report of external assurance. The credibility of the report is normally enhanced with independent external assurance.

(d)

The CEO message in the report is clear "Orica aims to be a business that does no harm to people and the environment". Given the issues with chemical releases the local community may feel that this is simply lip service. Realistically Orica deals in chemicals. Reading through the sustainability report may give you some assurance that the aims of the CEO and company are credible. The spills may be just unfortunate accidents. Kooragang Island is mentioned in the 2010 sustainability report. The report mentions the operations but does not elaborate on any risks. The company however, donated significant sums to help the community build a playing field. This promotes good will with the community. The company would also be employing local people. The newspaper reports may give rise to some students rethinking the credibility of the Orica report and the whole concept of sustainability reporting.

2.59 Required

- a) Explain the 'self-interest' principle.
- b) Debate the use of the 'self-interest' principle in practical terms in the business environment.
- c) Taibbi accuses Greenspan (a past US Federal Reserve Chairman) of protecting his wealthy patrons. Make some conclusions as to why he would think that way.
- d) Hypothesise what the effect on an economy would be when the free market principle is practiced together with the government protection of some interests.

(a)

The self-interest principle is when decisions are made that maximize the benefit to the person making the decision. Jeremy Bentham derived the principle from the utilitarian idea that individuals maximizing their own utility will ensure the maximization of society's utility. He did not practically believe that each individual should only worry about maximizing their own utility. It should be the greatest good for the greatest number.

(b)

In economic theory, it is meant to encourage a productive society where individuals can make choices to maximize the wealth creation not only of that individual but for society as a whole. Entrepreneurs who take risks create wealth for all by hiring labor and by producing goods and services that society wants and needs. Further, the principle is used in salary packages to try to tie pay or bonuses to the good performance of the company. If individuals are self interested then they will want to maximize their pay and bonus and this will ensure they are working to maximize the performance of the entity.

Unfortunately, the self interest principle tends to be more short term driven. So the maximization of the individual outcome in the short term may be at the expense of society in the long term.

(c)

Economically the US has not performed well. Accusations of the relaxing of financial regulations to allow some fancy financial instruments to be traded was part of the cause of the credit crisis. The US Federal Reserve injected money into the economy twice (known as QE1 and QE2) to help ease the financial stress in the economy and to try to stop it sliding into recession. In this process, it bailed out large private banks. So the free market (relaxed regulation) let investment banks trade as they will and yet when it all came tumbling down they went to the government for help. Remember government money is taxpayers money. Most of the government tax revenue is collected from middle income earners paying income tax, small business paying payroll tax and everyone (including the very poor) paying sales tax.

Recall that investing money and forming corporations to help make money is a risk. So theoretically in the free market the big investment banks should have been allowed to collapse with the owners losing their money. Instead, public money was used to bail them out.

So the private debt was transferred to the public.

There have also been criticisms that the bail out money was never going to be successful unless the retail banking sector was separated from the investment banking sector. The government money was supposed to be used for loans to small business to encourage entrepreneurial activity and promote employment and loans to the housing sector that would try to help the drowning property sector. Instead the banks took the money into their investment divisions and used it to invest in the world economic market thus earning big bonuses for their managers and large increases for their shareholders.

So the people on the street (with no job, no home and a government encumbered with debt) feel greater animosity towards those that took advantage of the opportunity. Obviously, if the government is playing favorites then this puts some people at a greater advantage to others.

(d)

The above is a good example of what might happen.

ⁱ Kant, I. 1964. *Groundwork of the Metaphysics of Morals*; transl Paton, H. J., Harper and Row, London as cited in Chryssides, G. D. & Kaler, J. H. 1995, Ethical theory, chapter 3, *An introduction to business ethics*, Chapman & Hall, London, pp. 80-107.