Solutions manual

to accompany

Accounting: business reporting for decision making

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Chapter 2: Accounting in society

Apply your knowledge

Financial acumen may not be every director's strength but ignorance is no excuse when it comes to understanding company accounts. The former directors of property group Centro found this out the hard way when the Federal Court brought down its landmark decision against them regarding their lack of due diligence in the lead-up to the company's near collapse in 2007.

The eight former directors and executives were found to have breached the Corporations Act by signing off on financial reports that failed to disclose billions of dollars of short-term debt. The case was watched closely by boards of directors across Australia, although the recently announced penalties were considered lenient. Declarations of contravention were made against all defendants.

Regardless of the lightness of the penalties, the case will continue to hold important lessons for Australian company directors. In his ruling, Federal Court judge John Middleton commented that the omission of more than A$2 billion of debt from the accounts could have been identified 'without difficulty'. What was required of the directors was 'critical and detailed attention', rather than relying on the information presented to them by management and Centro's auditors PricewaterhouseCoopers 'no matter how competent or trustworthy they may appear to be'.

The Centro case will continue to be upheld as a prime example of what can go wrong when directors rely on others for information rather than make it their business to read the financial statements and check them.

'The judgement is more of a wake-up call to say "don't skim the accounts and don't rely on the assurances of others. You need to exercise judgement and use an inquiring mind". Which is consistent with the legal principles that directors have to be pro-active when it comes to understanding company affairs including its financial affairs,' he (Anil Hargovan) says.

Leigh Warnick, a partner with Lavan Legal in Perth, says there are two key messages company directors and their advisers should take home from the Centro judgement: directors are the last line of defence on financial reporting; and information overload is no excuse — directors must take control.

Directors across Australia would be entitled to react to the Centro case with alarm if it obliged them to read financial statements with the eyes of an expert, but this is not the case, Warnick says. The requirements outlined by Justice Middleton were to have enough financial literacy to understand basic accounting conventions, and to exercise proper diligence in reading financial statements.

John Colvin, managing director and chief executive of the Australian Institute of Company Directors (AICD), says the judgement against the Centro directors

highlights important issues and provides some timely reminders of the significant responsibilities that come with a board seat and just how difficult being a director can be. 'It is important for all company directors to have an understanding of the business they oversee, as well as a basic understanding of the financial position of the company,' says Colvin. However, in an environment where the complexity of financial reporting standards and their application continues to increase, the role of company directors continues to become even more onerous.

The Centro judgment reminds directors that they are entitled to rely on specialist knowledge and advice provided by management and external advisors, but cautions directors that there are limits to that reliance, according to Colvin. 'Board members should apply their individual, considered judgment to matters that are highly significant to the company before approving financial statements, and while we (at the AICD) agree that "directors are an essential component of corporate governance", we are of the view, that it is not the role of non-executive directors to be involved in the day-to-day management of the company,' says Colvin.

'You may find that some directors are not confident about their ability to understand the basic accounting concepts in the financial statements,' says Warnick. 'The only safe option for directors in this position is to take an appropriate course to improve their skills.'

Source: **BusinessThink 2011, Directors' notes post Centro: How to avoid barking up the wrong tree, UNSW Australian School of Business, 13 September, www.businessthink.unsw.edu.au.**

Required:
a. Discuss the main issues for directors that are evident in the extracts above. (4 marks)
b. Critique the judgement made in the case regarding the level of financial knowledge required of directors. (4 marks)
c. Suggest the consequence of the Centro decision for the diversity of Australian boardrooms. (4 marks)
d. A continuing controversial topic relating to management and the board is remuneration. Given the decision in the Centro case, predict the consequences for the remuneration of board members and the effect this would have on other stakeholders. (4 marks)

a. Discuss the main issues for directors that are evident in the extracts above.

i. Be able to read financial statements.
ii. Reliance on experts.
iii. Duty of care required under the corporations act (directors under corporation act need to act with care and diligence).
iv. Skills such as assertiveness, inquiring mind, confidence to speak and ask questions are necessary. As is the time needed to understand complex reports. (complexity, thick board papers and little time is no excuse).
v. Delegation (what can and can't be delegated).

b. Critique the judgement made in the case regarding the level of financial knowledge required of directors.

i. Discussion could centre around the comments made in the articles about whether directors need to be skilled in accounting versus that they need to have some minimal knowledge of accounting to ensure that the business dealings that they are aware of are presented and included in the accounts. There is a need to apply themselves to the task at hand and if unsure whether some dealings are included to ask and have it explained.
ii. This issue also dovetails into what can be delegated. Tasks can be delegated but not responsibility/obligations. Therefore can delegate preparation of financial statement and take advice but ultimate decisions to approve is directors' responsibility.

c. Suggest the consequence of the Centro decision for the diversity of Australian board rooms.

i. A central issue here is that of **risk**. The increased risk of directors to be personally liable for honest mistakes, oversights, and/or overreliance may decrease diversity. (The pool of people willing to undertake the position would decrease.) The court's decision sends a message that directors need to be more diligent when approving the financial statements. Some may view this as being expert in the interpretation of accounting standards and their application to the financial statements at hand. This may heighten the risk for some individual directors with the result that they may prefer not to be a director. It may also increase costs if they seek second opinions from experts. This cost will be passed onto the company.
ii. On the other hand, the decision may heighten the consideration of the diversity needed on the board. Obviously, a board needs someone with good financial literacy that can be relied upon to speak openly and independently about the financial statements. Just like the board needs product/service experts (depending on the type of company, for example, BHP would have mining engineers on their board that could understand in-depth technical jargon in relation to their operations), marketing/HR/legal/PR experts may also be desirable. Although the inclusion of various experts does not negate the potential liability of others, it could reduce the risk if individual directors know they are being relied upon more heavily in a particular area. It also doesn't negate the

need for others to read or consider reports but that a particular director will ensure a more thorough reading.

d. A continuing controversial topic relating to management and the board is remuneration. Given the decision in the Centro case, predict the consequences for the remuneration of board members and what effect this would have on other stakeholders.

Risk and reward are linked. Heighten the risk and the reward is expected to increase. This could mean an increase in the remuneration of directors.

Comprehension questions

2.3 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.

2.4 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 behaviour. 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 then 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?

2.5 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.

2.6 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."

2.7 Suggest ways in which suppliers and customers could work together to reduce their overall impact on the environment.

Examples in the chapter include auto manufactures working closely with suppliers to minimise the cost of packaging.

A number of case studies, many of which demonstrate cooperation between suppliers and customers, can be found at: http://www.environment.nsw.gov.au/sustainbus/casestudies.htm. For example, a number of poultry producers got together to find cleaner production processes. Some of the benefits they achieved are as follows:

"Summertime, Cordina and Steggles worked with their suppliers to implement initiatives to reduce packaging. After conducting a trial with a major customer, Summer time replaced non-reusable cardboard cartons used for transporting chicken products with reusable tubs. This has yielded annual savings of over $60,000 and diverted over 38 tonnes of cartons from landfill each year.

Cordina replaced product trays that had to be shrink wrap-sealed with top-seal trays, resulting in a 4.5 tonne reduction in packaging used each year.
Working with chemical suppliers, Cordina and Red Lea optimised chemical use by improving application methods and switched to environmentally preferred alternatives. This has reduced the toxicity of the wastewater from the cleaning process.
Red Lea installed a unit which applies chemicals as foam and controls their application during equipment cleaning, reducing chemicals used in the cleaning process by 20–25%."

Source: http://www.environment.nsw.gov.au/resources/sustainbus/07408Poultry.pdf accessed 8th April, 2010

2.8 Outline the benefits for organisations in considering sustainability.

1. Costs may be reduced
   - less waste
   - less risk of undesirable impacts of poor social or environmental performance.
   - more productive employees.

2. Reputational effects:
   - customers may prefer to purchase from a more sustainable organisation
   - reduced threat of government intervention
   - employees may prefer to work at a sustainable organisation.

3. Competitive advantage from being prepared for future developments.

Also refer to Exhibit 14.10 which illustrates the realisation of returns as companies move from left to right of the CSR curve. Exhibit 14.11 also looks at how an organisation's environmental performance can impact on cash flows.

2.9 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.

2.10 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.

2.11 Outline the principles of business sustainability performance as put forward by Epstein & Roy (2003) as cited in Epstein (2008).

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 managers 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.

2.12 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.

2.13 Outline some ways that accountants could contribute to the sustainability efforts of organisations.

Reporting:

- Accountants are well versed in the application of standards for reporting. Their skills in this area can be applied to the reporting of a firm's sustainability performance. Their systems could also be modified to incorporate environmental and social information. This could be used for both external and internal reporting purposes.

Cost analysis:

- Comparison of two competing investment projects would require an analysis of economic profits, so to do decisions relating to social and environmental initiatives. For example, a development may require land to be brought back to its original condition, a decision as to what tyres to purchase given the costs and impacts on company maintained roads, or the cost of implementing energy efficient devices compared to the energy consumption costs.

Audit and assurance services:

- The concept, process and practice of audit and assurance services are familiar ground for accountants. This makes them ideal candidates to help provide audit and assurance on the corporate social responsibility reports that are issued by organisations.

2.14 What are the four key responsibilities of business? Do you think an entity should consider discretionary responsibilities? Why or why not?

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.

2.15 Suggest 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.

2.16 '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.

2.17 Are ethics and corporate governance important topics in the study of accounting and the business environment? Why or why not?

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.

2.18 List the qualities needed in providing external audit and assurance services to organisations in relation to CSR reports.

According to GRI (2006, p.41) the qualities needed are:
is conducted by external, competent and independent of the reporting organisation;
is systematic, documented, evidence-based, and characterised by defined procedures;
assesses whether the report provides a reasonable and balanced presentation of performance;
utilizes groups or individuals that are not unduly limited by their relationship with the organisation or its stakeholders (i.e. they're impartial and independent);
assesses the extent of the application of the GRI framework; and
results in an opinion or conclusion that is publicly available along with a statement outlining the relationship of the assurance provider to the report preparer (GRI version 3.1, 2011, p.41).

2.19 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?

2.20 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.

2.21 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 statuary 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.

2.22 Identify and discuss five fundamental principles of the Code of Professional Conduct.

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.

2.23 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).

2.24 What is risk management and why is it included in the ASXCGC corporate governance principles and 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.

2.25 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.

2.26 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.

2.27 What is meant by 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.

2.28 Explain the following:
a. triple bottom line reporting
b. corporate governance
c. the relationship of stakeholders to corporate governance.

a. 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.

b. Corporate governance:

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

c. The relationship of stakeholders to 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.

2.29 Discuss the relevance of legitimacy theory to corporations.

The basic tenant of this theory suggests that entities, to remain legitimate, must operate within the bounds and norms of society. In other words, society allows the entity to operate (pursue their objectives and rewards) so long as the entity agrees to act in a socially acceptable manner. Proponents of legitimacy theory call this the 'social contract'. The 'social contract' represents the explicit and implicit expectations that society has about how the organisation should conduct it operations. An organisation must be responsive to these expectations as they change over time.

2.30 Outline the possible consequences for an entity that breaches its 'social contract'.

Sanctions, a reduced demand for products or a limitation on available resources could be some consequences for breaking the social contract.

2.31 Outline the corporate governance principles and 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

2.32 Discuss 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 corporation's 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.

2.33 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.

2.34 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 GRI website at www.globalreporting.org.

2.35 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.

2.36 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.

2.37 Compare the principles underlying the GRI sustainability reporting framework with the principles underlying the preparation of general purpose financial reports (that were presented in chapter one).

The list below shows that for both sustainability and financial reporting materiality, timeliness and comparability are the same. Given the general purpose financial reports are deliberately limited in scope it is less important to have stakeholder inclusiveness. However, it is vitally important for there to be understandability for widespread stakeholder use. The faithful representation required for the financial reports would capture the context, completeness and balance required in the sustainability reports. Similarly, for financial statement to be verifiable they would need to be accurate, have clarity and be reliable.

GRI principles	**Qualitative characteristics of financial reports**
Defining principles: Materiality Stakeholder inclusiveness Sustainability context and completeness Necessary principles: Balance Comparability Accuracy Timeliness Clarity Reliability	Relevance and materiality Faithful representation Comparability Verifiability Timeliness Understandability

Exercises

2.38 Business sustainability
Consider your personal environmental impact by accessing one of the many websites that has a personal ecological footprint calculator. One such website is www.epa.vic.gov.au/ecologicalfootprint/calculators. Compare your ecological footprint with those of your classmates. List some strategies you could easily undertake to reduce your ecological footprint.

The students may be surprised at the results. The website also suggests strategies for reducing your eco footprint such as not wasting food, eating less processed food and eating what is in season. Cycle or walk. Switch of unused lights and appliances. Wash clothes in cold water. Keep windows shaded. Take shorter showers. Switch to greenpower. Avoid excess packaging.

2.39 Fraud
A survey conducted by CPA Australia shows that at least one in four small businesses are affected by fraud. Employee fraud was the most common type reported, with 10 per cent of small entities indicating they had suffered as a result of employee fraud. Other fraud incidences suffered by small entities included loss of funds from bank accounts (7 per cent), credit card fraud (7 per cent), supplier fraud (4 per cent) and internet fraud (3 per cent).

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.

2.40 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.

2.41 Corporate governance and sustainability

I put it to you that the directors are responsible to the shareholders for profit in perpetuity; and that this general expression of a principle permits, indeed requires, directors to pay full regard to their employees, to labour relations generally, to the community, to the country, in all their decisions for and on behalf of shareholders. (Sir John Dunlop, company director)

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.

2.42 Corporate governance

Outline some of the legal constraints in legislating for the consideration of stakeholder interests.

A number of constraints are listed below.

1. It would be difficult for a board to be legally held accountable for all stakeholder interests. At times acting for the benefit of one stakeholder group may clash with another stakeholder group.
2. It could be seen as infringing on the property rights of the shareholders (who own the company).
3. There could be problems with regulating how a board is held accountable in balancing stakeholder interests. Could this be proved in a court of law? What evidence would be needed?
4. Identifying stakeholders that the legislation would protect could be difficult.
5. Processes for stakeholders to enforce their rights under the legislation could be difficult to establish.
6. Allowing a broader group to whom the board is responsible may water down their responsibility to anyone.

Generally, many people may argue that most stakeholders or groups could seek remedy under existing legislation (i.e. employees under workplace health and safety laws and awards) and that expanding the duties of directors would unduly increase their personal risk and liability resulting in a withdrawal of leadership talent, without the commensurate benefits to society.

2.43 Code of ethics

Members of the two accounting professional bodies, CPA Australia and the Chartered Accountants of Australia and New Zealand (CAANZ), have to comply with Compiled 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 five 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.

2.44 Ethical decision-making models
Your client MJM Ltd consults with you in relation to the new financial information system that it wishes to have installed. You are technically competent in this area, and so accept the engagement. You carry out an analysis of software available, and make a recommendation that the client accepts. You continue to be involved while the software is being installed.

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 means loss of fees for you in the future as you will be giving up a long term engagement.

2.45 Corporate governance

Comment on the following situations in relation to the ASXCGC *corporate governance principles and 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.

2.46 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.

2.47 GRI Reporting

You are a CFO is an organisation that is considering reporting on CSR using the GRI Framework. The CEO has asked you to prepare a report for the board supporting such a proposal. In this report you should outline:

1. **the benefits of CSR reporting**
2. **the likely costs of CSR reporting**
3. **to whom the company will be reporting**
4. **what will be covered in the report**
5. **how this process will support the business strategy.**

Benefits:
Benefits would include the actual recognition of environmental and social initiatives; the tracking of an organisation's environmental and social footprint; the increased ability to make a difference to environmental and social outcomes due to the increased awareness from the reporting; and the possible positive public relations that would flow from the reporting process.

Costs:
Costs would include the cost of analysis, preparation and reporting; as well as the costs of setting up systems to gather data, process data and audit outcomes.

Reporting to:
The stakeholders of the business.

Coverage:
The standard coverage of a GRI report would include strategy and analysis, organizational profile, any identified material aspects, stakeholder engagement, profile, governance, ethics and integrity, management approach and economic, environmental and social indicators.

Business Strategy Report:
Through the data capture and reporting process there will be a greater awareness of environmental and social initiatives and impact. This will help an organization with their strategy formulation and implementation.

2.48 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 the country you wish to do business with, in order 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 and material personal interest.

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

2.49 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 society's needs or whether companies would do the 'right thing' anyway. In your answer define regulation and business sustainability. Give your opinion 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 behaviour 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 behaviour. 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.

2.50 Code of ethics for professional accountants
You are an accountant with ABC Ltd and are confronted with the situations described below. State in each case whether there has been a breach of the Compiled 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.

2.51 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?

2.52 Ethics
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. Theological 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.

2.53 GRI and Sustainability
The statement below was extracted from the Amcor website (www.amcor.com):

During the 2011/12 year, Amcor was recognised at the Ethical Investor Sustainability Awards. The judges commended Amcor for 'using the principles of environmental sustainability to reposition its product in customers' and suppliers' minds'.

Amcor was also recognised in a report released by the Association of Chartered Certified Accountants (Australia) for our overall integration of material non-financial concerns into company vision and strategy, management systems and risk management framework. The report also ranked Amcor the best amongst the ASX50 companies for demonstrating the interdependencies between environmental and social matters, and financial performance.

Amcor continues to be listed on global and regional market indices, including the Dow Jones Sustainability Asia Pacific Index; the Carbon Disclosure Leadership Index, Materials Sector, Australia and New Zealand region; and, the FTSE4Good index.

Suggest why organisations would use resources to apply for sustainability awards and would be concerned about their rating on sustainability market indices.

Reasons why entities may invest resources on awards and upholding sustainability ratings could be:

- They want to uphold their 'social contract' under legitimacy theory;
- They are self-interested (agency theory) and link the awards and sustainability indices to great marketing and public relations.
- They genuinely believe in addressing issues to all stakeholders.

2.54 Ethics, corporate governance and sustainability
Underlying the professional code of ethics is an obligation to act in the public interest. Utilitarianism espouses the need to act and make decisions with consequences in mind. Practically, business decisions are often made based on a consideration of the decision's effect on the business. How can any business manager merge the principles of utilitarianism - acting in the public interest - while ensuring growth and prosperity to the organization they are managing? Discuss.

To discuss this, a good article is *Counting the consequences* by Eva Tsahuridu, from IntheBlack Magazine, March, 2013, p.71. The article discuses outcomes that help guide behaviour when difficult choices must be made.

2.55 Corporate governance
Corporate governance relates only to large public enterprises and is therefore irrelevant for small business. Discuss this statement.

All businesses need good governance. Governance is about the distribution of authority within an organization to make decisions relating to its resources and the use of policies and procedures to ensure proper control and decision making for the accomplishment of aims, goals and strategies as effectively and efficiently as possible.

So governance is as much relevant for a small business as it is for a large one.

Instructors note: A paper written by Sir Adrian Cadbury (author of the Cadbury Report on corporate governance) wrote a paper entitled '*Family Firms and their Governance: Creating tomorrow's company from today's*' (Egon Zehnder International, Great Britain, 2000). This may be worth discussing if interest warrants. Generally the Cadbury recommended that a family firm establish a board (through a family council), which should focus on strategic business issues, that there be clear lines of authority, stability and continuity with respect to policy and values. He also recommended including an independent person on the board.

Problems

2.56 Corporate governance

The notes to the 2015 consolidated financial statements of JB Hi-Fi Ltd appear in appendix of this book. Examine these notes together with other information from the website (www.jbhifi.com.au) to investigate JB-HiFi Ltd's compliance with principle 4 (safeguard the integrity of financial reporting) of the ASXCGC *Corporate governance principles and 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 2015.

Recommendation 4.1

The board of a listed entity should:
(a) have an audit committee which:
(1) has at least three members, all of whom are non-executive directors and a majority of whom are independent directors; and
(2) is chaired by an independent director, who is not the chair of the board,
and disclose:
(3) the charter of the committee;
(4) the relevant qualifications and experience of the members of the committee; and
(5) in relation to each reporting period the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or
(b) if it does not have an audit committee, disclose that fact and the processes it employs that independently verify and safeguard the integrity of its corporate reporting, including the processes for the appointment and removal of the external auditor and the rotation of the audit engagement partner.

Pages 3 and 13 of the JB Hi-Fi Ltd Preliminary Annual Report discusses the Audit and Risk management committee. So JB Hi-Fi have established an audit committee.

Page 3 of the JB Hi-Fi Annual Report indicates that The Audit and Risk management committee comprises 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.

Page 3 states that the committee has a formal charter. This can be found on their website.

Pages 11 and 13 contain information about the audit committee members' qualifications and the number of meetings held and attendance.

Recommendation 4.2

The board of a listed entity should, before it approves the entity's financial statements for a financial period, receive from its CEO and CFO a declaration that, in their opinion, the financial records of the entity have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the *entity and that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively.*

Page 55 of the JB Hi-Fi Ltd Annual Report contains the CEO and CFO declaration that in their opinion the financial records have been properly maintained, comply with reporting standards and present a true and fair view of the financial position.

Recommendation 4.3
A listed entity that has an AGM should ensure that its external auditor attends its AGM and is available to answer questions from security holders relevant to the audit.

The preliminary report does not state whether the auditor will attend the AGM. There is no indication that the auditor will not be available. The audit report is presented on pages 52-54. An independent external auditor helps promote the integrity of the financial system and is key in providing the public with confidence.

2.57 Ethics

Erle Smith is a financial controller with Practical Solutions Ltd, an entity that sells software products to accounting firms and small businesses. At present, Mr Smith is analysing a number of software packages that focus on job costing. He needs to pick one package that he can recommend to his clients. Each software vendor is keen to have their software selected as it will result in a significant increase in sales for their company.

Anitah Loh is a salesperson for software company Dogto Ltd. She has told Mr Smith that he should go to Los Angeles to analyse her company's software package properly, because the programming experts there could give him a thorough demonstration. Ms Loh has also suggested that he take his family, so that he feels relaxed in a foreign country and is in the right frame of mind to undertake his analysis. She also suggests that Disneyland is worth visiting while Mr Smith is over there. Dogto Ltd would pick up the expenses for the trip.

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.

2.58 Business sustainability and ethics
Search the Johnson & Johnson website for their famous credo http://www.johnsonandjohnson.com.au. *Hint:* Access the credo from the drop-down menu called 'Our Company'). Given that the credo was written nearly 60 years ago, comment on its appropriateness in today's business world. Further, reflect on the early philosophical writings (such as utilitarianism and Kantianism) and comment on the credo's 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 Freidman 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.

2.59 Ethics

The downturn in the economy during 2008 revealed one of the biggest cases of fraud in history. The fraud was masterminded by Bernie Madoff, a well-known American finance executive. The $65 billion Ponzi scheme called the Bernard L Madoff Investment Securities resulted in a number of institutional and high-wealth individuals losing their money. Clients affected included Steven Spielberg, HSBC, Fortis, RBS, Baroness Thyssen-Bornemisza, Yeshiva University, top Merrill Lynch executives and Eliot Spitzer, the New York governor. Many charities and organisations have had to shut down due to losing their money. There were also various fund managers who channelled their clients' money into the Madoff Investment. One French fund manager committed suicide when the extent of the disaster became known.

It seems that there were warning signals and general rumours over the years that Bernie's investment performance was too good to be true. The performance of the investment fund was never over the top but was consistently good. One investor even tried to re-engineer the investment strategy by calculating each individual trade but couldn't get the same investment return. He decided it just didn't add up and that something had to be wrong. The fact that there was never a down month, that he had his own broker-dealer clearing trades, that a relative was his finance person, that the regulatory audit was performed by a too-small audit firm (it employed three people, including an 80-year-old), that he didn't welcome questions and returned funds to investors who probed too much were all signs that something may be too good to be true. The market's collapse in 2008 exposed the truth that the consistently good 6.8 per cent returns were being funded by fresh investments from new clients.

It seems people invested because Bernie was a good bloke. They trusted him. He wasn't a loudmouth, he belonged to the right clubs, he had the right connections and he seemed to perform consistently. Despite complaints and concerns about the business since 2000, and a number of discrepancies found by a Securities Exchange Commission (SEC) lawyer and inspector in 2004, the SEC did nothing.

On 29 June 2009, Bernard Madoff was sentenced to 150 years in prison. His statement: 'I have left a legacy of shame, as some of my victims have pointed out, to my family and my grandchildren. This is something I will live in for the rest of my life. I'm sorry.'

Source: Compiled from various Clusterstock.com, nydailynews.com and Cityfile New York articles.

Some fund managers invested and lost clients' money in the Bernard L Madoff Investment Securities scheme. One example was that of the Fairfield Greenwich Group that directed US$7.3 billion of client money into the fund over a five-year period.

Required

(a) If you were a client of Fairfield Greenwich Group, what minimum checks on recommended investments would you have expected your fund management to undertake?

(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? Why or why not?

(c) If you on the advice of your financial planner, invested your money in the Bernard L Madoff Investment Securities scheme and then subsequently lost it, would you blame your financial advisor given that it was a well-orchestrated fraud? Why or why not?

(d) Would your answer in (c) be different, if you knew 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.

2.60 Business sustainability

Human rights are rights inherent to all human beings, whatever our nationality, place of residence, sex, national or ethnic origin, colour, religion, language, or any other status. We are all equally entitled to our human rights without discrimination. These rights are all interrelated, interdependent and indivisible. (United Nations Office of the High Commissioner for Human Rights 2010, 'What are human rights', paragraph 1).

Required

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 labour debate is one of the longest in history. The capital providers (business owners) hire labour to help produce their goods and services. The union movement was born out of the inequality of wage rates and of the need for labourers 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.

Decision-making activities

2.61 Triple bottom line

Download the report *Triple bottom line reporting in Australia* at www.environment.gov.au/archive/settlements/industry/finance/publications/indicators/pubs/indicators.pdf.

This guide puts forward a methodology to help entities report on their environmental impact. The environment is one of the three pillars of TBL. From the report:

a. Outline the five environmental indicators stated in the guidelines.

b. For each of the environmental issues listed in the report give two examples of an environmental measure of environmental performance.

c. Discuss how accountants could help an entity develop a TBL report.

a. Outline the five environmental indicators stated in the guidelines.

The report outlines the five environmental indicators as:

1. Environmental System Conformance
2. Environmental Performance Improvement Process
3. Integration of Environment with other Business Management Systems
4. Due Diligence Process
5. Environmental Liabilities.

b. For each of the environmental issues listed in the report give two examples of an environmental measure of environmental performance.

Energy:
- Direct energy use.
- Indirect energy use.
- Initiatives to use renewable energy and increase energy efficiency.

Greenhouse:
- Total greenhouse gas emissions.
- Initiatives aimed at reducing greenhouse gas emissions.

Water:
- Total water use.
- Total water reused.
- Initiatives to decrease water consumption or increase water reuse.

Materials:

- Total material use.
- Initiatives aimed at using post-consumer recycled materials and waste from industrial sources.

Waste Emissions and discharges to air, land and water:

- Significant emissions to air and land.
- Significant discharges to water by discharge type.
- Initiatives to reduce emissions and discharges.

Biodiversity:

- Location and size of land and water owned, leased or managed in biodiversity-rich or ecologically significant habitat areas.
- Major impacts on land, water and biodiversity associated with an organisation's activities, products and services.

Ozone-depleting substances:

- Ozone depleting substances emissions.
- Suppliers.
- Initiatives to encourage.

Products and services:

- Describe where relevant, major environmental impacts at each stage of the life cycle of principal products and services.
- Product and service stewardship initiatives including efforts to improve product design and lessen impacts associate with manufacturing, use and disposal.

Compliance:

- Incidences or and penalties for non-compliance with applicable laws.
- Significant spills of chemicals, oils and fuels in terms of total number and total volume.

c. Discuss how accountants could help an entity develop a TBL report.

The role of the accountant in promoting and reporting sustainability is very broad. They can use their skills of aggregating data into useful information, help with cost analysis of environmental decisions and be involved with the audit and assurance of corporate social reports.

Reporting:
Accountants are well versed in the application of standards for reporting, and their skills in this area can be applied to the reporting of an entity's sustainability performance. Their systems could also be modified to incorporate environmental and social information, which could be used for both external and internal reporting purposes.

Cost analysis:
Comparison of two competing investment projects would require an analysis of economic profits in order to make decisions relating to social and environmental initiatives. For example, a development may require land to be brought back to its original condition; a decision may be needed as to what tyres to purchase given their costs and impacts on company maintained roads; or the cost of implementing energy-efficient devices may need to be compared to the energy consumption costs. This could then be extended to the collection, analysis and reporting of non-qualitative

information.

Audit and assurance services:
The integrity of the information and its collection can be safeguarded by putting in place clear processes and procedures known as internal control. This is familiar ground for accountants and makes them ideal candidates to help provide audit and assurance on the corporate social responsibility reports that are issued by entities. Apart from internal control, the systems in place and reports produced can be audited by external independent groups or individuals. The GRI guidelines identify external assurance as important to the reporting process and list its key qualities. External assurance:

- is conducted by groups or individuals who are external, competent and independent of the reporting organisation.
- is systematic, documented, evidence-based, and characterised by defined procedures.
- assesses whether the report provides a reasonable and balanced presentation of performance.
- utilises groups or individuals that are not unduly limited by their relationship with the organisation or its stakeholders (that is, they are impartial and independent).
- assesses the extent of the application of the GRI framework.

2.62 Business sustainability

The production of a washing machine, either low-end or high-end, uses about 30–40 kilos of steel (0.625 tonnes of CO^2). A low-range user (single person) may use 110 wash cycles a year, while a high-end user (commercial) may use 3000 wash cycles per year. One average private consumer uses 250 wash cycles per year. A low-end machine on average operates for 2000 wash cycles, while a high-end machine on average operates for 10 000 wash cycles. Most washing machine providers give a warranty of 1–2 years. Commonly malfunctioning are the motor, the pump or the plumbing. Despite a washing cycle costing 27 cents in a low-end machine and 12 cents in a high-end machine, most users opt to purchase a low-end machine.

Required

a. Hypothesise why consumers would prefer to purchase a low-end machine.

b. Outline the information that would help a consumer make a decision that would be economically beneficial in the long term (20 years).

c. Outline the information that would help a consumer make a decision that would be ecologically beneficial in the long term.

d. Figure 2.6 suggests that the economic and ecological correct decision would be to lease a high-end washing machine (value approximately $970, 5-year lease period and 11 per cent interest rate for a family using 500 cycles per annum) rather than purchase a low-end washing machine. Outline the economic and ecological pros and cons of this suggestion.

e. Discuss the accountant's role in helping businesses and individuals to promote sustainable practice.

f. Explain why some people feel there is a need to move beyond sustainability.

a. Hypothesise why consumers would prefer to purchase a low-end machine.

Students could come up with various reasons. The most obvious being that it is cheaper initially.

A low-end machine will be less capital cost upfront and probably most people would not do the calculation to compute what the extra operating cost would be over the life of the washing machine. Further, with any capital investment decision the longer time frame has a greater risk element. So a saving now, upon purchase is a sure thing compared to projections of likely operating savings in the future.

b. Outline the information that would help a consumer make a decision that would be economically beneficial in the long term (20 years).

Information that would help a consumer would be:

1. Capital cost of each washing machine option.
2. The projected operating costs of each washing machine.
3. The life of each washing machine.
4. The probability of breakdown and warranty information.
5. The finance rate available to the consumer that could be used as the discounted rate of return for future cash flows.

c. Outline the information that would help a consumer make a decision that would be ecologically beneficial in the long term.

1. The materials that were used to make the product and the effect on the environment of its extraction and use.
2. The ongoing energy and water use of each model of washing machine.
3. The likely breakdown of each model and likely parts replacement.
4. The disposal of the washing machine and whether the materials and components could be reused.

d. The figure accompanying the activity suggests that the economic and ecological correct decision would be to lease a high-end washing machine (value approximately $970, 5-year lease period and 11 per cent interest rate for a family using 500 cycles per annum) rather than purchase a low-end washing machine. Outline the economic and ecological pros and cons of this suggestion.

Economically more money has to be paid up front. However, there are savings in operating costs over the life of the asset.

Ecologically, a machine that uses less ongoing energy and water is better for the environment. Also, a machine that lasts longer means that over a human lifetime less machines will be needed thus saving the environment from the extraction and processing of extra material.

e. Discuss the accountant's role in helping businesses and individuals to promote sustainable practice.

Accountants can help businesses and individuals to promote sustainability by helping cost practices and by reporting appropriate quantitative and qualitative information for the benefit of the decision makers.

f. Explain why some people feel there is a need to move beyond sustainability.

Some argue that the concept of sustainability locks thinking into the existing way of operations and business models. They argue that operations and business models need to embrace abundance and the idea that operations should improve the planet not simply to sustain our existing way of life.

2.63 Sustainability, ethics and regulation

Greenspan is that one-in-a-billion [expletive deleted] that made America the dissembling mess it is today … laying the intellectual foundations for a generation of orgiastic greed and overconsumption and turning the Federal Reserve into a permanent bailout mechanism for the super-rich. (His) rise to the top is one of the great scams of our time. Greenspan pompously preached ruthless free-market orthodoxy every chance he got while simultaneously using all the powers of the state to protect his wealthy patrons from those same market forces. He was a member of the Ayn Rand 'Collective' that believed in 'objective reality', which boiled down to a belief in self-interest as an ethical ideal and pure capitalism as the model for society's political structure.

Source: **Taibbi, M 2010, 'Griftopia', as cited in Kohler 2011, 'Week in review', Eureka Report, 8 October.**

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 labour 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 were 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 taxpayer's 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 favourites then this puts some people at a greater advantage to others.

d. The above is a good example of what might happen.

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[i] Kant, I. 1964. *Groundwork of the Metaphysic of Morals*; trasl 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.

