ACCA
P1 Governance, Risk & Ethics
Revision Classes
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Key Corporate Governance Concepts

- Honesty
- Transparency
- Independence
- Accountability
- Responsibility
- Fairness
- Reputation
- Openness
Openness

Demonstrated by Board Willingness to:
- disclose information timely to the shareholders
- accept constructive criticism from parties who are playing the monitoring role

Honesty

Requires the Board to exercise the duty of loyalty by NOT:
- rewarding themselves with excessive remuneration
- involving in earning management to deceive the shareholders
This concept is characterised by:

- **timely disclosure** which are above the requirement
- the presence of **systems and procedures** to **govern decision making** which can curb malpractices
Independence

Applies to both auditor and non-executive directors who are playing the monitoring role in Corporate Governance.

They are considered independent when they can be expected to express their honest and professional opinion in the best interest of the company.

Thus, their opinion should avoid:

• Biasness
• Conflict of interest
• Influence by others
Accountability

Requires the parties concerned to:
• discharge their respective responsibilities in accordance to the role they hold in corporate governance
• be held responsible for the outcome of their decision

There is no accountability if one does not acknowledge his or hers responsibility towards another party.

Responsibility

This concept is closely related to the accountability concept above. Key issue is to decide who should have responsibility.
Fairness

Requires all shareholders to be accorded equal consideration which means minority shareholders should be treated in the same way as majority shareholders.

Reputation

Company’s reputational risk is measured by the general deterioration of public perception of:

- the company and
- the products or services it sells

Good Corporate Governance emphasises on safeguarding a company’s reputation which is akin to safeguarding the interest of shareholders.
Agency Theory

Applicable for larger sized companies where the separation of ownership and control is the norm.

Directors Delegate the running of the company Shareholders

AGENTS PRINCIPLES

do NOT necessarily make decisions in the best interest of the principal giving rise to agency cost.
**Agency Cost**

Total agency cost comprise of:-

- **Sum of Principal Monitoring Expenditure**
  - Fee payable to both the non-executive directors and the external auditors.
  - Time spent by the shareholders in attending the AGM and dialogues with management.

- **Agent’s Bonding Expenditure**
  - Time spent by the directors in meeting with the institutional shareholders during the dialogues.

- **Residual Loss**
  - Loss resulting from directors misusing their positions.
Solutions to agency problems

**Incentives**

The incentive solution ties an executive’s wealth to the wealth of shareholders as that everyone shares the same goal.

**Monitoring**

The board of directors, auditors and other components of the governance system serve to monitor the executive management.
Fiduciary duty of directors

Directors’ role is similar to that of a trustee in a trust in that they are entrusted by the shareholders to run the company on their behalf.

Directors are expected to demonstrate:

- Uncompromising loyalty to the shareholders
- To exercise due diligence in making decisions
Business cases associated with observing stakeholders’ interest

- Avoidance of negative action by non-governmental organisation against the company.
- Penetration of new markets that value ethical business practices.
- Attract and retain staff who share the same values as the company.
- Ease of raising finance possibly from ethical fund.
- Lower cost of capital due to perceived lower risk by financiers.
UK Corporate Governance Code’s requirements:

(a) Leadership
(b) Effectiveness
(c) Remuneration
(d) Relations with shareholders
(e) Accountability
1) The Board

Every Company

Headed by

Effective Board

Collectively

Responsible for the success of the company

Board should comprise of directors from diversified background to ensure that decisions made are the result of extensive deliberation from different perspectives
2) Chairman & Chief Executive

Clear division of responsibility at the head of the company between

Chairman

Running of the board

CEO

Running of the company business

This is to avoid unfettered power of decisions that can lead to abuse
3) **Board Balance & Independence**

- The board should include a balance of executive director and non-executive director (especially independent non-executive director).
- This balance should be such that no one individual or group of individuals can dominate the board's decision making.

4) **Appointments of The Board**

- Procedure for the appointment of new directors to the board should be formal, rigorous, and transparent.
- This calls for the establishment of a nomination committee to promote meritocracy in the recruitment of directors.
5) Information & Professional Development

- Information should be supplied to the board in a timely manner.
- Information supplied should be of appropriate quality to allow the board to discharge their responsibility.
- All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge to narrow the gap between them created by diversity in experience and knowledge.

6) Performance Evaluation

- Annual evaluation of its own performance should be undertaken in a formal and rigorous manner.
- Evaluation of its committee and individual directors should be undertaken in the same manner.
7) Re-election

All Directors Submit for Re-election at Regular Intervals Subject to Continued Satisfactory Performance

This would not only ensure the independence of the non-executive directors concerned but also allows minority shareholders a chance to vote out a particular director.

A planned and progressive refreshing of the board would ensure a smooth taking over of responsibilities by someone being ‘groomed’ for the succession.
People
• Determine the appropriate level of remuneration for executive directors
• To appoint, remove senior management & oversee succession planning

Performance
Scrutinise the performance of management in meeting agreed goals & objectives & monitor the reporting of performance.

Role of non-executive directors in corporate governance

Strategy
Constructively challenge & contribute to the development of strategy

Risk
Satisfy themselves that:
• Financial information is accurate
• Financial controls & system of risk management are robust.
Remuneration committee

The UK Corporate Governance Code requires all members of the committee to be independent non-executive directors.

Establish remuneration policy that is capable of attracting, retaining and motivating executive directors.

DUTIES

Establish targets for any performance-related pay or bonus schemes.

Determine the remuneration package of each individual executive director.

Ensure compliance by the company on disclosure of directors’ remuneration.
Nomination committee

The UK Corporate Governance Code requires a majority of members of the committee to be independent non-executive directors.

Duties

• Recruit new directors after considering the composition of the board in terms of the ratio and number of executive and non-executive directors as well as the diversity in knowledge and experience.

• Establish and review succession plans for the directors.

• Remove incompetent or unsuitable directors.

• Provide new board members with a comprehensive induction to board processes and policies and to their new role.

• Monitor and appraise each individual director’s performance, behaviour, knowledge, effectiveness and values.

• Identify development needs and training opportunities for existing and potential directors.
Risk committee

Duties

• Champion and promoter of enterprise risk management across the group.

• Oversee the implementation of the risk management policy.

• Provide quarterly reporting and update on key risk management issues to the board.

• Review enterprise risk profile for effectiveness of management of risks.

• Evaluate any new risks identified by operating management.

• Ensure that all action plans are acted upon and addressed.

• Establish monetary threshold and nature of proposed investment that require risk committee’s evaluation and endorsement before submitting to the board.
Audit committee

- Oversee financial reporting and internal controls
- Review the scope and outcome of the audit as well as the objectivity of the auditors.
- Provide a useful bridge between both internal and external auditors and the board
- Oversee the arrangements for whistle-blowers
- Assess the systems in place to identify and manage financial and non-financial risks in the company
Issues involving directors’ remuneration

- Remuneration not linked to company’s performance
- Chief executive officer and executive chairman are involved in determining their own remuneration package.
- Failure to attract, retain or motivate the directors.
Components of director’s remuneration

- Short Term
- Long Term
- Severance Payment
Components

**Short-term**

- **Basic Salary**
  - Not related to the performance of the company nor the performance of the individual director.
  - Set with regard to the size of the company, industry sector, experience of the individual director and level of base salary in similar company.

- **Bonus**
  - Tied perhaps to the annual financial performance of the company.
• Various perks such as membership of the company’s health insurance scheme, private use of the company’s aircraft or boats, and so on are offered to directors to reflect directors’ status as senior management of the company.
Components

**Long-term**

- **Share Option**
  - Grant directors the right to purchase shares at a specified exercise price over a specified time period.

- **company shares** (also known as ‘restricted stock grant’)
  - Unlike option, directors paid nothing for these grant and therefore has value unless the share price goes down to zero. They are usually awarded with limits on its transferability for a set time but sometimes for the director’s tenure with the company.
Components

Severance Payment

• The service contract of a director sets out the terms and conditions of his or her appointment, including the duration of the appointment and the required minimum period of notice of termination.

• In lieu of notice, the company is committed to giving the individual a minimum severance payment if he or she is forced to leave the company.
Performance related incentives

Pros

Rewards executive directors with one or more cash bonus payments, if actual performance during a review period reaches or exceeds certain predetermined targets. → help promote accountability to the shareholders.

The establishment of performance targets is in line with the concept of transparency.
Performance related incentives

**Cons**

Should the performance targets be for an annual period, short termism practices may be encouraged.

Profit measures which are often used as a basis for a reward system can be manipulated within the accounting rules by adopting more aggressive accounting policies and judgements.
Issues involving share options

- Executive directors treat share options as compensation, they nearly always sell the share for the cash thereby defeating the purpose of making directors the shareholders of the company.

- Stock option is only affected by price appreciation which inevitably encourages directors to forgo increasing dividends in favour of using the cash to try to increase the stock price.

- Directors are motivated to choose a higher risk business strategy that promises higher returns.
Two ways to maintain good relations with the shareholders:

1. Disclosure
   - Refers to mandatory and voluntary information produced by companies aimed at removing information asymmetry caused by separation of ownership and control.

2. Communication
   - Refers to regular and constructive two-way communications between the company and its shareholders in the form of dialogues.
Companies are encouraged to enter into dialogues with its institutional investors based on the mutual understanding of objectives.

The board should make constructive use of the annual general meetings to communicate with private investors and encourage their participation.

Shareholders and investors will benefit from timely information, delivered perhaps through the company’s website on a regular basis, about current developments in the company’s affairs.

Financial position of the company and non-financial information such as the direction the company is taking, its strategic objectives, and so on can be found in this report.
Voluntary Disclosure

Characteristic: Disclosures that are over and above the mandated minimum. Examples include operating and financial review, management forecast, environmental or social report.

Benefit: Increased and improved disclosure is likely to reduce agency costs as better information flows from the company to the shareholder helps reduce information asymmetry.
Voluntary Disclosure

Problem

- **Absence of guidance** on the type and form of information that the shareholders and other stakeholders require.

- The **lack of standardisation** in reporting format made comparison between companies difficult.

- Information disclosed are **not subjected to audit** which affect their credibility and thus reliability.
Situations to justify intervention by institutional investors

Instances where institutional shareholders and/or agents may want to intervene include:

- the company’s strategy;
- the company’s operational performance;
- the company’s acquisition/disposal strategy;
- independent directors failing to hold executive management properly to account;
- internal controls failing;
- inadequate succession planning;
Situations to justify intervention by institutional investors

- an unjustifiable failure to comply with the Combined Code;
- inappropriate remuneration levels/incentive packages/severance packages; and
- the company’s approach to corporate social responsibility.
Important Areas

Types and Purposes of Internal Control

The Board’s Roles in Internal Control

Elements of a Sound System of Internal Control
Types of Internal Control

**Financial**
Helps ensure the reliability of internal and external reporting, safeguard the assets including the prevention and detection of fraud.

**Operational**
Facilitates the economical and efficiency of operations thereby helping the company to achieve its goals and objectives (effectiveness).

**Compliance**
Assists compliance with laws and regulations and also with internal policies with respect to the conduct of business.

**Risk Management**
Allows the company to take risks knowingly by managing risks that are significant to the fulfilment of a company’s business objectives.
The Turnbull Report describes a sound system of internal control as comprises of:

- Control Activities
- Communication Process
- Monitoring
- Control Environment
Control Activities

Internal controls put in place by the company in the areas of financial, operational, compliance and risk management

Communication Process

Procedures for timely reporting of control findings to management and establishment of whistle blowing arrangement to enable malpractices involving senior management to be reported.
In the absence of internal audit function, the board should assume the responsibility of monitoring the continued effectiveness of the internal control system so as to be capable of responding quickly to changes in the risks.

Establishment of a positive corporate culture, management style and employee attitudes to control procedures.
Board’s role in Internal Control

- **Establishment** of sound system of internal controls to safeguard shareholders’ interest and investment.
- **Setting up** of audit committee comprising wholly of independent non-executive directors to oversee internal controls and whistle-blowing arrangement.
- **Review** from time to time the benefits of having an internal audit function if the company does not already have one.
- **Undertake** review of the effectiveness of the group’s system of internal controls at least once annually and report to shareholders that they have done so.
- **Preparation** of statement of internal controls that details the control mechanisms, weaknesses found and their associated consequences and measures taken to overcome them.
The Institute of Internal Auditors defined internal auditing as:

- An independent, objective assurance and consulting activity designed to add value and improve an organization's operations.

- Helping an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.
To achieve the said objectives, the following tasks are undertaken by internal auditors:

• Carry out checks on the financial controls possibly in collaboration with the external auditors.

• Undertake special investigation following allegations made by whistle-blower

• Examine financial and operating information for timeliness and accuracy of reporting.

• Investigate into an operation or activity to determine whether it is economical, efficient and effective.
• Review compliance by an organisation with particular laws and regulations.

• Investigate an organisation’s risk management procedures in terms of:
  • comprehensiveness of the risks identified
  • reasonableness of the assessment of risks
  • appropriateness of the measures taken to address the risks
Factors to Consider in Determining the Need for Internal Audit

1) **Scale of operation**
   - The higher volume of transactions increases the likelihood of errors.

2) **Diversity and complexity of the company’s activities**
   - Diversity complicates the company’s operation and thus increases the chances of errors.

3) **Number of employees**
   - Increase in employees’ number makes close monitoring of them difficult and higher chances of recruiting a potential fraudster.

4) **Cost/benefits considerations**
   - Decision should also take account of the qualitative nature of the costs and benefits such as the morale of the staff and prevention of fraud respectively besides the quantitative factors.
Factors that Determine The Internal Auditors’ Independence

1) The level from which the department derives its responsibilities (also known as *organisational status*)

   Internal auditor should report to the highest authority i.e. the board or its designated audit committee to command the respect and cooperation from the auditees.

2) The personality of the senior management and head of department

   Internal auditors should possess an *independent mental attitude* that requires them not to be placed in situations where their objective professional judgements will be threatened.
Threats to Internal Auditors’ Independence

• Undertake assignments where relationship with the auditees exist

• Assume operational and management responsibilities in the company

• Failure to observe a reasonable period of cooling for staff who has been transferred to or temporary engaged by the department.

• Involve in designing, installing and operating systems as well as drafting procedures for them
1) Identification of Risks

2) Assessment of Risks

3) Managing the Risks

4) Communication of the Risks’ Status

5) Monitoring the Risks
1) Identification of Risks

Risks that arise from strategic decision making/external environment and operations are being identified by the board and operating management respectively.

2) Assessment of Risks

Risks identified are then being measured in term of its likelihood of occurrence and impact on the organisation should it occur.

3) Managing the Risks

Depending on the significance of the respective risks, measures under the TARA framework are then implemented to mitigate or reduce the risks to an acceptable level.
4) Communication of the Risks’ Status

The status of the risks are compiled and communicated by the Risk Manager to the Risk Management Committee on regular basis. They will in turn highlight the most significant risks faced by the company and the measures taken to rectify them to the board.

5) Monitoring the Risks

Since risks hardly remain static, they are monitored on a continuous basis to ensure that the company is able to respond to them promptly.
Categorisation of Risk are broadly based on their:

- Severity
- Nature
- Sources
Severity

**Strategic risks**
- Risks that arise from an organisation’s positioning in the environment and the fundamental decisions made by the directors on its objectives.
- Have the effect of threatening the going concern of the company.
- Responsibility for managing these risks lies with the board.

**Operational risks**
- Risks that are connected with the internal resources, systems, processes and employees of the organisation.
- Have the effect of causing temporary hiccups in the smooth running of an organisation’s operations.
- Responsibility for managing these risks lies with the respective line managers.
Operational risks
Risks that threaten the smooth running of an organisation which can arise from breakdown of machineries, high staff turnover or interruption in the supply of raw materials.

Financial risks
Risks that have the effect of threatening a company’s cashflow such as adverse movement in foreign exchange rate, hike in interest rate, default in payment from credit customers or overtrading.

Compliance risks
Risks that the company failed to comply with internal policies and procedures or external laws and regulations.
Sources

Risks are categorised based on **where they originate from**. Should the risk relate to reputation damaged, it will be termed reputation risk or research and development risk if it relates to failure to invest in research and development.
Types of Risk Assessment:

1) Qualitative

Word form or descriptive scales are used to describe the magnitude of potential consequences and the likelihood that those consequences will occur.

Example: Consequences – insignificant, moderate, catastrophic
Likelihood – almost certain, likely, rare
2) Semi-quantitative

*Qualitative scales* such as those described are given *values*. However, they do not have to bear an accurate relationship to the actual magnitude of consequences or likelihood.

3) Quantitative

*Numerical values* rather than the descriptive scales are used for both consequences and likelihood using data from a variety of sources.
TARA Framework:

- **Transfer the Risk**
- **Avoid the Risk**
- **Reduce the Risk**
- **Accept the Risk**
Avoid the risk

- Risk is avoided by **not proceeding** with the activity likely to generate the risk.
- Applicable for risks that have high chances of occurrence and the impacts are significant.
- Risk may also be inappropriately avoided because of an attitude of risk aversion.

Accept the risk

- Risk is accepted if **both** the chances of its occurrence and the impact are **insignificant**.
- Risk can also be retained by default, when there is a failure to identify and/or appropriately transfer otherwise treat risk.
Reduce the risk

- Risk can be reduced via the **reduction in the likelihood** of occurrence or the **impact**.
- Measures taken include preventative maintenance, contract conditions, supervision etc. depending on the circumstances.

Transfer the risk (also know as sharing of risk)

- Risk is transferred if the impact is regarded as **too significant beyond the company’s ability to tolerate**.
- Mechanisms include insurance arrangement, organisational structures such as partnership and joint ventures, outsourcing.
- The organisation to which the risk has been transferred, may not manage the risk effectively.
Related And Correlated Risk

- Related risks are those that often present at the same time in the same organisation because they have a common cause or that one type of risk can give rise to another.

- Correlated risks are those that vary together which can be negatively correlated (one goes up as the other declines) or positively correlated (both go up or down together).
Relativism

- Also known as pragmatic ethical assumptions
- This theory holds that because different societies have different ethical beliefs, there are no ethical standards that are absolutely true that apply or should be applied to the companies and people of all societies.
- An act is deemed ethical if it accords with the moral standards of people and companies in one particular society.
• Also known as dogmatic ethical assumptions and universalism.

• This theory maintains that there are absolute moral truths, not relating to culture, which all entities must obey at all times without exception.

• An act that is deemed wrong in one country is also wrong in other countries.
Kohlberg’s stages of human moral development

• Divided into 3 levels and 6 stages.

• Conclusion can be reached through interview that consists of a series of dilemmas to judge the respondents reaction to them and the reasoning behind the answer.

• Helps us understand how our moral capacities develop and how we can become increasingly sophisticated and critical in our use and understanding of the moral standards we hold.

• Allows us to manage the relationship with another parties better based on the level of moral development they belong.
LEVEL 1:

Pre-conventional Morality

- Stage 1 people generally will not commit immoral or illegal activities due to their fear of punishment.
- Stage 2 people will not mind doing it if they perceive such an act as a fair deal or it would not be found out.
- At this level, rights and wrongs are always defined in self-centred terms.
LEVEL 2:

Conventional Morality

- Stage 3 people will only **undertake activities** that are **acceptable to his or her social groups.**
  - whereas
- Stage 4 people **perceives that social contract exist** and so would **not undertake activities** that are **against the interest of other members of society.**
- At this level, right and wrong are defined in terms of the conventional norms of their social groups or the laws of their nation or society.
LEVEL 3: Post-conventional Morality

- Stage 5 people define moral right and wrong in terms of moral principles they have chosen for themselves as more reasonable and adequate. Calls for existing laws that do not promote the general welfare to be changed when necessary through majority decision, and inevitable compromise. 

whereas

- Stage 6 people believe that justice carries with it an obligation to disobey unjust laws.

- At this level, rules are seen as not absolute dictates that must be obeyed without question. Individuals may disobey rules inconsistent with their own principles.
Teleological (consequentialist) approach to ethics

- Moral judgments are based on the outcome of a certain action.
- Consequentialist is a relativist.
- Two main theories namely
  - Egoism and
  - Utilitarianism
Egoism

- An action is deemed morally right if the decision maker freely decides in order to pursue either their short-term desires or long-term interests.
- Egoists are at level 1 of Kohlberg’s moral development as their action is motivated by self-interest.
- Egoism based on desire is criticised for rendering patently different approach to life as being equivalent when long-term interest should be the deciding factor.
- This theory works fine only if mechanism exists in society to ensure that no individual egoist pursues his or her own interest at other egoist’s expense.
Utilitarianism

- An action is morally right if it results in the greatest amount of good for the greatest number of people affected by the action.

- Utilitarianists are at Stage 4 of Kohlberg’s moral development as they focus on the collective welfare produced by a certain decision.

- This theory is criticised for the subjectivity involved in assessing and quantifying consequences such as pleasure or pain associated with an action.

- The interest of minorities is overlooked as the focus is on satisfying the greatest number.
Deontological (non-consequentialist) approach to ethics

- Moral judgments are based on the underlying principles of the decision-maker’s motivation.
- Non-consequentialist is an absolutist.
- Two main theories namely
  - Ethics of Duties and
  - Ethics of Rights & Justice
Also known as Kantian Theory or Categorical Imperative Framework

Called for all human to behave ethically in accordance to eternal, abstracts and unchangeable principles all the time.

Ethics are defined in:

- Maxim 1
- Maxim 2
- Maxim 3
Categorical Imperative Framework

Maxim 1

Act only according to that maxim by which you can at the same time view that it should become a universal law.

An action can only be right if everyone could follow the same underlying principle.

Maxim 2

Act so that you treat humanity, whether in your own person or that of another, always as an end and never as a mean only.

An action is right if human dignity is not being ignored.
Maxim 3

Act only so that the will through its maxim could regard itself at the same time as universally lawgiving.

An action is right if it is acceptable for every human being or is endorsed by them.
Ethics of Rights and Justice

• The notion of rights calls for humans to observe the rights accorded to another person and at the same time ensures fair treatment of individuals in a given situation with the result that everybody gets what they deserved.

• The rights approach has been very powerful throughout history and has substantially shaped the constitutions of many modern states and had even led to United Nations declaration of human rights in 1948.
American Accounting Association

- A seven-step ethical decision-making model that professional accountant can adopt for the resolution of ethical dilemmas.
- Encourages the decision maker to fully analyse the problem and to consider the alternatives and consequences from an ethical perspective.
- Provides insight from both non-consequential considerations (step 3 and 5) and consequential considerations (step 6) which is not achievable from a single theory.
Step 1: What are the facts of the case?
Provide a summary of the dilemma experienced by the decision maker in a given scenario.

Step 2: What are the ethical issue in the case?
Highlight the ways in which the relevant stakeholders could be affected by the decisions made.

Step 3: What are the norms, principles and values related to the case?
For decision makers who are professional accountants, fundamental principles such as objectivity and integrity will be relevant.

For decision makers that are corporations, corporate governance concepts such as transparency and accountability will be relevant.
Step 4: What are the alternative courses of action?

The possible courses of action will depend on the scenario given. Try to keep them to about four as for each course of action, there should be corresponding discussion on its **compliance with the norms, principles and values (step 5)** and consequences (step 6).

Step 5: What is the best course of action that is consistent with the norms, principles and values identified in Step 3?

**Benchmark each course of action** against the identified norms, principles and values and make a conclusion.
Step 6: What are the consequences of each possible course of action?

Consequences can be either positive or negative and should be assessed from the perspective of own self, company or other stakeholders.

Step 7: What is the decision?

Decision can be a combination of options chosen from step 4 above instead of just one.
Tucker 5-question Model

Conceptually slightly different from the AAA model but is nevertheless a powerful tool for determining the most ethical outcome in a given situation.

Not all Tucker’s criteria are relevant to every ethical decision.

More useful for examining corporate rather than professional or individual situation.
Profitable

Consideration is from the perspective of the shareholders to ensure that a proposed decision will maximise the returns to them.

Legal

An ethical decision is one that is in line with the existing laws and regulations.

Fair

Relates to the concept of justice such that no one stakeholder will be inconvenienced or harm by the decision made.
A right decision is one that is in line with the ethical theories.

Requires the outcome of a decision to meet the needs of the present without compromising the ability of the future generation to meet their own needs.
Gray, Owen & Adams’ seven positions on social responsibility

- Pristine Capitalist
- Expedient
- Social Contractarian
  - Social Ecologist
  - Socialist
  - Radical Feminist
  - Deep Ecologist
Pristine Capitalist

Social responsibility is dominated by the need to make money for shareholders, to grow, make profits and seek economic efficiency.

Expedient

Certain (usually minimal) wider social responsibilities are accepted to ensure the long-term economic welfare and stability of a company.
Social Contractarian

Believes that companies and other organisations exist at society’s will and therefore are obliged (to some degree) to society’s wishes.

Social Ecologist

Calls for the change to the existing economic system which is responsible for the resource use, pollution, waste creation and the down grading of the quality of human life.
Socialist

Believes that the present domination of social, economic and political life by capital is unfavourable and promotes the re-adjustment in the ownership and structure of society.

Radical Feminist

Criticises the existing social, economic, political and business systems for being too ‘masculine’ that emphasises on aggression, traditional success which denies a proper voice for compassion, love, cooperation and so on.
Deep Ecologist

Holds that human beings do not have any greater rights to existence than any other forms of life and criticises the common practice of contemplating trade-offs between the habitat of threatened species and economic imperatives.
Johnson, Scholes and Whittington’s four ethical stances

- Short-term Shareholder Interests
- Long-term Shareholder Interests
- Multiple Stakeholder Obligation
- Shaper of Society
Short-term Shareholder Interests

- Takes the view that the only responsibility of business is the short-term interest of shareholders and any form of social responsibility must be prescribed through legislation and regulation.
- This stance is similar to that of pristine capitalist.

Long-term Shareholder Interests

- Recognises the importance of well-managed relationship with other stakeholders for the long-term financial benefits of the shareholders.
- This stance is similar to that of the expedient.
Believes that stakeholder interests and expectations should be more explicitly incorporated in the organisation’s purposes and strategies beyond the minimum obligations of regulation and corporate governance.

This stance is similar to that of a social contractarian.

As the name suggest, the purpose of this group is to shape the society and financial considerations are regarded as of secondary importance or a constraint.

This stance is similar to that of social ecologists, socialist, radical feminist and deep ecologist.
Code of ethics for business conduct

An authoritative statement of values and principles designed to set a minimum standard of acceptable behaviour and guide organisational members in resolving ethical conflicts

Advantages

- Provide a common value system for all divisions to adopt.
- Serves as a moral minimum that helps provide guidance in dealing with anomalies in local customs.
- Helps boost investors’ confidence in the company.
Code of ethics for business conduct

Contents

• Values of the business
• Senior management’s commitment to doing business ethically
• Responsibilities of the respective parties in making the company ethical
• Key stakeholders of the company and the company’s commitments towards them
• Whistle-blowing arrangement within the company
• Means to obtain advice, awareness raising examples (FAQ) and training programmes for all staff
The IFAC Code adopts a conceptual framework approach to complying with the fundamental principles of ethics that requires the professional accountants to identify, evaluate and respond to threats to compliance with those principles.
Integrity

- Requires professional accountant to be straightforward (fair dealing) and honest (truthfulness) in all professional and business relationship.

- Should not be associated with reports, returns, communication or other information where they believe that the information:
  (i) contains a materially false or misleading statement;
  (ii) contains statement of information furnished recklessly; or
  (iii) omits or obscure information required to be included.
Objectivity

Professional accountant should not allow prejudice or bias, conflict of interest or undue influence of others to override professional or business judgments.

Professional competence and due care

Professional accountants are obliged:

✔ to maintain professional knowledge and skill at the level that a client or employer will receive the advantage of competent professional service based on current developments in practice, legislation and techniques; and

✔ to act diligently in accordance with applicable technical and professional standards in all professional and business relationship.
Confidentiality

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<th>Professional accountants should respect the confidentiality of information acquired as a result of professional and business relationships and <strong>should not disclose</strong> any such information to third parties <strong>without proper and specific authority</strong> unless there is a <strong>legal or professional right or duty to disclose</strong>.</th>
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<tr>
<td></td>
<td>The need to comply with the principle of confidentiality <strong>continues even after the end of relationships</strong> between a professional accountant and a client or employer.</td>
</tr>
</tbody>
</table>
Disclosure is required by law:

- Production of documents or other provision of evidence in the course of legal proceedings; or
- Disclosure to the appropriate public authorities of infringements of the law that comes to light.

Disclosure is required by professional duty or right:

- to comply with the quality review of a member body or professional body;
- to respond to an inquiry or investigation by a member body or regulatory body;
- to protect the professional interests of a professional accountant in legal proceedings; or
- to comply with technical standards and ethics requirements.
Professional behaviour

A professional accountant should comply with relevant laws and regulations and should avoid any action that discredits the profession.
Threats to Independence

- Familiarity
- Advocacy
- Self-interest
- Intimidation
- Self-review
## Threats to independence

<table>
<thead>
<tr>
<th>Threat</th>
<th>Definition</th>
<th>Examples</th>
</tr>
</thead>
</table>
| Familiarity | Occurs when, by virtue of a close relationship with an assurance client, its directors, officers or employees, a firm or a member of the assurance team become too sympathetic to the client’s interests | • a member of the assurance team having an immediate family member or close family member who is a director or officer of the assurance client  
• a member of the assurance team having an immediate member or close family member who is an employee of the assurance client, is in a position to exert direct and significant influence over the subject matter of the assurance engagement  
• a former partner of the firm being a director, officer of the assurance client or an employee in a position to exert direct and significant influence over the subject matter of the assurance engagement |
<table>
<thead>
<tr>
<th>Threat</th>
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<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Familiarity</td>
<td>• long association of a senior member of the assurance team with the assurance client&lt;br&gt; • acceptance of gifts or hospitality, unless the value is clearly insignificant, from the assurance client, its directors, officers or employees</td>
<td></td>
</tr>
<tr>
<td>Advocacy</td>
<td>Occurs when a firm, or a member of the assurance team, promotes, or may be perceived to promote, an assurance client’s position or opinion to the point that subsequent objectivity may be compromised</td>
<td>• dealing in, or being a promoter of shares or other securities in an assurance client&lt;br&gt; • acting as an advocate on behalf of an assurance client in litigation or in resolving disputes with third parties</td>
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<tr>
<td>Threat</td>
<td>Definition</td>
<td>Examples</td>
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<tr>
<td>Self-interest</td>
<td>Occurs when the firm or member of the assurance team could benefit from a financial interest in, or other self-interest conflict with, an assurance client.</td>
<td>• a direct financial interest, or material indirect financial interest, in an assurance client</td>
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<td></td>
<td></td>
<td>• a loan or guarantee to or from an assurance client, or any of its directors or officers</td>
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<td>• undue dependence on total fees from an assurance client</td>
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<td></td>
<td></td>
<td>• concern about the possibility of losing the engagement</td>
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<tr>
<td></td>
<td></td>
<td>• having a close business relationship with an assurance client</td>
</tr>
<tr>
<td>Threat</td>
<td>Definition</td>
<td>Examples</td>
</tr>
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<td>--------------</td>
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<tr>
<td>Self-interest</td>
<td></td>
<td>• potential employment with an assurance client</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• contingent fees relating to assurance engagements</td>
</tr>
<tr>
<td>Self-review</td>
<td>Occurs when:</td>
<td>• a member of the assurance team being, or having recently been, a director or officer of the assurance client</td>
</tr>
<tr>
<td></td>
<td>• any product or judgment of a previous engagement needs to be re-evaluated in reaching conclusions on the assurance engagement; or</td>
<td>• a member of the assurance team being, or having recently been, an employee of the assurance client in a position to exert direct and significant influence over the subject matter of the assurance engagement</td>
</tr>
<tr>
<td>Threat</td>
<td>Definition</td>
<td>Examples</td>
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</tbody>
</table>
| Self-review | • a member of the assurance team was *previously* a director or officer of the assurance client or was an employee in position to exert direct and significant influence over the subject matter of the assurance engagement | • performance of services for an assurance client that directly affect the subject matter of the assurance engagement  
• the preparation of original data used to generate a financial report or preparation of other records that are the subject matter of the assurance engagement |
<table>
<thead>
<tr>
<th>Threat</th>
<th>Definition</th>
<th>Examples</th>
</tr>
</thead>
</table>
| Intimidation | Occurs when a member of the assurance team may be deterred from acting objectively and exercising professional skepticism by threats, actual or perceived, from the directors, officers or employees of an assurance client | • threat of replacement over a disagreement with the application of an accounting principle  
• pressure to reduce inappropriately the extent of work performed in order to reduce fees |
Impact of economic activity on the environment and society

Environmental footprint

The impact that a business’s activities have upon the environment including its resource environment and pollution emission. Examples include the depletion of natural resources that are not renewable, rising temperature etc.

Social footprint

The social impact that a business activities have through the provision of products and services, the employment of workers, or some other corporate activity. Examples include the closure of plant on individuals and communities, erosion of local culture and environment etc.
The typical contents of social and environmental report

• A description of the company’s activities at the site considered
• An assessment of all the significant environmental issues of relevance to the activities concerned
• A presentation of the company’s environmental policy, programme and management system implemented at the site concerned
• A summary on the figures on pollutant emissions, waste generation, consumption of raw material, energy, water, noise
The typical contents of social and environmental report

- Other significant environmental aspects as appropriate, as well as other factors regarding environmental performance
- **Significant changes since the previous statement**
- The name of the accredited environmental verifier
- The deadline set for submission of the next statement.
An environmental audit typically contains three elements:

- **Agreed metrics (what should be measured and how)**
  Typical measures include measures of emissions and consumption which are essentially the organisation’s environmental footprint.

- **Performance measured against those metrics**
  Target may be set for each of the metrics which then allows a variance to be calculated against the target.

- **Reporting on the levels of compliance or variance.**
  The data gathered from the audit enables metrics to be reported against target or trend (or both). It is generally agreed that this level of detail in the report helps readers better understand the environmental performance of organisations.
## Public sector governance

<table>
<thead>
<tr>
<th>Differences</th>
<th>Private Sector</th>
<th>Public Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership</td>
<td>Private</td>
<td>Country / State</td>
</tr>
<tr>
<td>Control</td>
<td>Private Owners / Directors, and Managers working on their behalf</td>
<td>National Government or local authority</td>
</tr>
<tr>
<td>Capital</td>
<td>Raised by private owners</td>
<td>From Treasury</td>
</tr>
<tr>
<td>Use of Profit</td>
<td>Distributed to owners</td>
<td>Handed to Government or local authority</td>
</tr>
<tr>
<td>Aim</td>
<td>Profit – oriented</td>
<td>Service provision</td>
</tr>
</tbody>
</table>
Good governance in the public sector

The Chartered Institute of Public Finance and Accountancy (CIPFA) and the International Federation of Accountants (IFAC) had jointly developed the International Public Sector Governance Framework (International Framework) which outlined the following key principles of good governance in public sector.

- Strong commitment to integrity, ethical values, and the rule of law

The public sector is normally responsible for using a significant proportion of national resources raised through taxation to provide services to citizens. Public sector entities are therefore accountable not only for how much they spend but also for the ways they use the resources with which they have been entrusted.
• Openness and comprehensive stakeholder engagement

Public sector entities are run for the public good, so there is a need for openness about their activities and clear, trusted channels of communication and consultation to engage effectively with individual citizens and service users, as well as institutional stakeholders.

• Defining outcomes in terms of sustainable economic, social, and environmental benefits

The long-term nature and impact of many of the public sector’s responsibilities mean that it should define its planned outcomes, which must be sustainable.
• Determining the interventions necessary to optimize the achievement of intended outcomes

Determining the right mix of interventions is a critically important strategic choice that governing bodies of public sector entities have to make in order to ensure they achieve their intended outcomes.

• Developing the capacity of the entity, including the capability of its leadership and the individuals within it

Public sector entities should develop its capacity as well as the skills and experience of its leadership and individual staff members to ensure that it operates efficiently and effectively and achieve its intended outcomes within the specified periods.
• Managing risks and performance through robust internal control and strong public financial management

Risk management and internal control are significant and integral parts of a performance management system and crucial to the achievement of outcomes while a strong system of financial management is essential for enforcing financial discipline, strategic allocation of resources, efficient service delivery, and accountability.

• Implementing good practices in transparency and reporting to deliver effective accountability

Effective accountability is concerned not only with reporting on actions completed but ensuring stakeholders are able to understand and respond as the entity plans and carries out its activities in an open manner.