



The Institute of
Chartered Accountants
in Australia



Joint Guidance Notes

GN 1 - Members in Business Guidance Statement

CONTENTS

	Paragraph(s)
Introduction	1
Definitions	2
Guidelines for the Resolution of Ethical Conflicts	3
Resolution of Ethical Conflict	3.1
Ethical Decision Making – A Model	3.2
Assistance from the Accounting Bodies	3.3
Guidance on the Fundamental Principles of Professional Conduct for Members in Business	4
The Public Interest	4.1
Integrity	4.2
Objectivity	4.3
Independence	4.4
Confidentiality	4.5
Technical and Professional Standards	4.6
Competence and Due Care	4.7
Ethical Behaviour	4.8
Examples of Ethical Conflicts	5
Example 1: No Control	5.1
Example 2: Change the Bottom Line	5.2

1. Introduction

The Guidance Statement set out hereunder is jointly issued by The Institute of Chartered Accountants in Australia (Institute) and CPA Australia for the assistance of members in business and are advisory only.

Members are governed in the conduct of their professional relationships with others by the Code of Professional Conduct (Code).

The Code recognises that the objectives of the accountancy profession are to work to the highest standards of professionalism, to attain the highest levels of performance and generally to meet the public interest requirement.

The Code is based upon the following Fundamental Principles of Professional Conduct:

- The Public Interest;
- Integrity;
- Objectivity;
- Independence;
- Confidentiality;
- Technical and Professional Standards;
- Competence and Due Care; and
- Ethical Behaviour.

The Fundamental Principles expected of members in business are the same as those for members in public practice and are equally applicable.

However, given the variety of duties and responsibilities undertaken by members in business, it is sometimes harder for them to relate the Code to many of the commercial situations in which they find themselves involved. It is recognised that some members in practice may also have a role in business.

The business environment in which members work and the decisions that they must make may differ from those of members in public practice. Their day-to-day contact is with people of diverse skills and backgrounds, such as marketing, sales, manufacturing, etc, whose ethical standards may differ from those required of members.

In many cases, members in business are not in regular contact with their peers and have only limited opportunities for objective discussion of contentious issues that may arise during the course of their work.

For these reasons, this Guidance Statement has been developed. It amplifies the meaning of the Fundamental Principles as applicable to a member's role in business and provides examples of business situations involving judgment in the application of the Principles.

Examples given are intended to be illustrative, not prescriptive.

Real life situations will always have elements that differ from the examples and need to be considered from the perspective of an unbiased but informed third party.

The use of an ethical decision making model can provide members with a framework to resolve systematically ethical problems. One such model is included in this Guidance Statement.

Members should also be familiar with any duties, obligations and responsibilities that apply under Common Law, the Corporations Act and other relevant legislation.

In developing this Guidance Statement, reference has been made to material published by other accounting bodies, including the Institute of Chartered Accountants in England & Wales (ICAEW), the Institute of Management Accountants (USA) and the International Federation of Accountants (IFAC).

2. Definitions

For the purposes of this Guidance Statement:

“accounting bodies” means CPA Australia and The Institute of Chartered Accountants in Australia;

“client” means where applicable to the member:

- a) an individual, firm, entity or organisation to which professional services are provided by a member;
- b) an employer of the member; and
- c) a customer of the member or firm, entity or organisation;

“member” means:

- a) member in practice and where applicable includes his firm, company, other entity or any employee thereof; and
- b) member employed in business; and
- c) associates and registered graduates of the accounting bodies;

“members in business” means members in industry, commerce, academia, charities, financial services and the public sector

“public interest” means the collective well being of the community of people and institutions that the members serve.

3. Guidelines for the Resolution of Ethical Conflicts

3.1 Resolution of Ethical Conflicts

In applying the Code, members may encounter problems in identifying unethical behaviour, convincing their colleagues the issue exists and/or in resolving an ethical conflict.

When faced with a significant ethical conflict, members should, if possible, first follow established policies of their employer. If this does not resolve the conflict or if the employer's policies do not extend to the particular problem, members should consider the following courses of action:

- Apply an ethical decision making model. A feature of any decision making model is a systematic approach to dealing with the problem. A description and example of one model is included in paragraph 3.2 ;
- Discuss the problem with their immediate superior, except when it appears that the superior is involved, in which case the problem should be presented to the next higher managerial level. If satisfactory resolution cannot be achieved when the problem is initially presented, then submit the issues to the next higher managerial level.

If the next higher superior is the Chief Executive Officer, or equivalent, the acceptable reviewing authority may be a group such as the Audit committee, Executive Committee, Board of Directors, Board of Trustees, or owners. Contact with levels above the immediate superior should normally be initiated only with the superior's knowledge, assuming the superior is not involved; and

- Guidance may also be obtained from the member's relevant professional body.

Members are reminded of the importance of carefully documenting all actions, meetings and discussions that take place in seeking to resolve an ethical conflict.

Where a significant ethical conflict involves possible illegalities, members may wish to obtain appropriate legal advice. If an ethical conflict remains unresolved, members, in order to disassociate from unethical activity, may have no other recourse than to resign from their employer. Before resigning, it is recommended that members submit a memorandum as to the reasons for resignation to an appropriate representative of the employer. Appropriate legal advice may be necessary in drafting such a memorandum.

3.2 Ethical Decision Making – A Model

In many professional situations, there is a need to ensure that one can adequately defend and justify one's decisions (e.g. when evidence is being given to a court or when a particular act or omission is being explained to a superior).

Most people have had to learn to make ethical decisions on an ad hoc basis as their experience develops.

To be defensible, however, a decision must be shown to have been made in a systematic manner, which clearly reflects a consideration of a member's duties and the consequences of different actions in particular circumstances.

Many decision models have been developed over time to provide decision makers with a framework to systematically resolve ethical problems. One such model is the seven-step American Accounting Association (AAA) model that was published in *Ethics in the Accounting Curriculum - Cases and Readings* (May 1990, Sarasota, Florida)¹.

Candidates in the education programs of the accounting bodies use a number of decision-making models. This is a relatively simple but effective model, which is used in practice.

The steps of the AAA model are:

1. Determine the Facts

Who? What? Where? When? How?

What do we know or need to know, if possible, that will help define the problem?

1 The AAA model was adapted from another model by H. Q. Langenderfer and J. W. Rockness, "Integrating Ethics into the Accounting Curriculum - Issues, Problems and Solutions", *Issues in Accounting Education*, Vol. 4, 1989, pp. 58-69.

2. List the Significant Stakeholders and Define the Ethical Issues

Make sure what precisely the ethical issue is (e.g. conflict involving rights, questions over limits of an obligation, etc).

3. Identify the Applicable Fundamental Principles and Any Other Rules or Values

(e.g. integrity, quality, respect for persons)

4. Specify the Alternatives

List the major alternative courses of action, including those that represent some form of compromise or point between simply doing or not doing something.

5. Compare Alternatives - See if a Clear Decision Emerges

Determine if there is one alternative, or combination, which is so compelling that the proper action is clear.

6. Assess the Consequences

Identify the short and long run, positive and negative consequences for the major alternatives. The common short run focus on gain or loss needs to be measured against the long run considerations. This step will often reveal an unanticipated result of major importance.

7. Make a Decision

Balance the consequences against the Fundamental Principles and any other rules or values and select the alternative that best fits. Develop a clear plan of action with specific objectives.

Although following a series of steps such as those described in the model may initially appear to be rather drawn out, experience suggests that these kinds of models are very useful in developing a structured solution to an ethical conflict.

3.3 Assistance from the Accounting bodies

The accounting bodies are strongly supportive of their members facing ethical dilemmas but differ in regard to their policies for practical assistance. Following are brief outlines of the strategies implemented by both accounting bodies.

3.3.1 CPA Australia

CPA members must be aware of the support that can be provided by CPA Australia in situations that place them in an ethical conflict. A member placed in a situation of conflict should, as a matter of course seek guidance from the Divisional Director or Ethics/Professional Conduct Officer who in turn can arrange for confidential discussions with the St James Ethics Centre or such other counselling service nominated by CPA Australia from time to time.

In the event of a complaint being lodged with CPA Australia and the complaint subsequently being referred to the Investigation Committee, the

member must be able to demonstrate that all reasonable action short of resignation was undertaken.

3.3.2 The Institute

To assist members to make the best possible decision in unfamiliar or challenging professional situations, including ethical dilemmas, the Institute has established CA Advisory Groups (CAAGs) in each region.

Each CAAG is a collection of senior Institute members from the local region (NSW/ACT, QLD, VIC/TAS, SA/NT, WA) with a broad cross-section of professional and life experience and unblemished professional records, who have been specially trained to provide confidential counselling and support on an informal basis.

Consultation in confidence on a relevant member with a CAAG counsellor will not constitute a breach of a member's duty of confidentiality to their employer. Unless members are subject to specific agreements, any duty of confidentiality would be subject to their obligation to comply with the Code and the CAAG counsellors, being members of the Institute are themselves bound by such confidentiality. The counsellors and the Institute manager with whom responsibility for management of the service in the respective region rests will be the only persons aware of the member's identity and the nature of the problem discussed. No information will be disclosed to any other section of the Institute or to third parties.

Meetings to discuss the issues are held at a time and location mutually convenient to the member and counsellor. Alternatively, the discussion could take place over the telephone.

The service is free and available to all Institute members. In the first instance, members in NSW and the ACT should contact their Manager, Member Services NSW & ACT, whilst members in Queensland, Victoria/Tasmania, SA/NT and WA should contact their Regional Manager, during business hours.

4. Guidance on the Fundamental Principles of Professional Conduct for Members in Business

Extracts from Section B of the Code are reproduced in this section and are printed in bold type and commentary in normal type.

4.1 The Public Interest

Members must at all times safeguard the interest of their clients and employers provided that they do not conflict with the duties and loyalties owed to the community and its laws.

A distinguishing mark of a profession is acceptance of its responsibility to the public. The accountancy profession's public consists of clients, providers of credit grantors, governments, employers, employees, investors, the business and financial community, and others who rely on the objectivity and integrity of members to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on members. The public interest is defined as the collective well being of the community of people and institutions that the members serve.

In fulfilling the duties owed to the public, members are bound to observe high standards of conduct that may sometimes appear to be contrary to their personal self-interest.

A member's duty to safeguard the interests of their employer continues throughout the period of working for that employer and it also applies when members wish to change employment.

When acting to safeguard the interests of their employers, members must have regard for the law and any duties and loyalties owed to the community.

4.2 Integrity

Members must be straightforward, honest and sincere in their approach to professional work.

Employed members should observe the terms of their employment, although these cannot require them to be implicated in any dishonest transaction. If they are instructed or encouraged to engage in any activity that is unlawful, they are entitled and required to decline. For example, members should not be party to the falsification of any record or knowingly or recklessly supply any information or make any statement that is misleading, false or deceptive.

When members become aware that their employers have committed an unlawful act, every effort should be made to persuade the employer not to perpetuate the unlawful activity and to rectify the matter.

It is not always clear whether an activity is indeed unlawful and how best to deal with the situation.

Members should take particular care to observe this Guidance Statement in the context of public announcements or statements. For example, any document whether for private or public use should be prepared in accordance with normal professional standards of integrity.

4.3 Objectivity

Members must be fair and must not allow prejudice, conflict of interest or bias to override their objectivity. When reporting on financial statements that come under their review they must maintain an impartial attitude.

The requirement for objectivity is the essence of professionalism and is appropriate to all members in business. The interests of a member's employer should not affect the objectivity of a member's judgment.

Any report for which a member is responsible, whether it bears his or her signature or not, should be prepared with objectivity. This means, for example, that while a report prepared by a member may properly present one side of the case, and may present that case to its best advantage, the report should be accurate, truthful and within its scope, both complete and balanced. It should not rely on ambiguities or half-truths, but should be objectively justifiable and should not be based on unreasonable assumptions.

A member should recognise the problems that may be created by financial involvements or personal relationships that, whether or not sanctioned by a member's contract of employment, could by reason of their nature or degree be perceived by an independent reasonable person to threaten a member's objectivity. Where any doubt exists, the involvement or relationship should be disclosed to the employer.

A member should be aware of the difficulties which may arise from the offer or the acceptance of any gift, favour or hospitality which may be intended to influence the recipient or which could be interpreted by a reasonable person in full possession of the facts as likely to have that effect.

4.4 Independence

Members must be and should be seen to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity.

Members cannot be seen as independent of their employer. They have certain legal duties, such as keeping information confidential, and other obligations that may be incorporated in their contract of employment. However, they also have responsibilities to:

- the directors or other relevant governing group of the employer organisation, who rely on the accuracy, completeness and balance of the information provided in operational and financial reports;
- the shareholders of the organisation;
- other executives and employees of the organisation; and
- third parties, such as suppliers, customers and banks, to whom they may provide information on the organisation's financial position, operating results, projections, investment proposals, etc.

It is important for members to recognise and guard against situations that may affect their independence.

For example, significant remuneration tied to a performance component may bring a member's independence into doubt. Where a member is involved in the measurement of the relevant performance component, the remuneration arrangements may influence or be thought to influence the member's actions in relation to accounting for transactions as part of the measurement of that performance component.

As a further guide, members should:

- be cautious of undue benefits or preferential treatment;
- not use the employer's property, information or resources for any purpose other than in the employer's interest;
- be aware of and alert to conflicts of interest which can be caused by inappropriate financial involvement and personal relationships; and
- do not "bend the rules" despite any pressure that may be brought to bear by friends or associates within the workplace.

4.5 Confidentiality

Members must respect the confidentiality of information acquired in the course of their work and must not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose it.

It is the nature of a member's work that he or she is frequently entrusted with the private or sensitive information of an employer. This relationship means that an

employer has the right to expect a member to maintain the confidentiality of such information and the member has a corresponding fiduciary duty to do so.

The definition given above of the confidentiality principle stresses the importance of the concept but also indicates that there may be occasions when a member is required to disclose information that would otherwise remain private.

One of these occasions relates to a legal duty where, in the course of his or her work, a member is required by law to disclose an illegal act to an appropriate authority.

Alternatively, the definition indicates that there may be a professional duty to disclose. What constitutes "professional duty" is a matter of professional judgment. The Fundamental Principles will be important inputs into the exercise of such judgment.

For instance, a member may uncover persistent and material breaches in the internal control systems of the member's employer, which will demand disclosure to a higher level in the organisation, even though the member may have been instructed by an immediate superior not to disclose the information.

Alternatively, an organisation may, for example, secretly be causing detriment to an outside party or the environment, which, if generally known, would be universally condemned by the community. Even in the absence of a legal obligation, a member may feel bound in the public interest to disclose this action to a third party.

A member is also required to act in accordance with any applicable obligations relating to privacy legislation in relation to the collection, storage, use and disclosure of personal and sensitive information.

Notwithstanding the above remarks, it is always preferable to seek initially advice from an independent party within the organisation. This may result in any problems being rectified at minimum cost. Only when all internal avenues for disclosure are exhausted, should a member consider disclosure to an external third party.

Professional Statement C5 of the Code contains five items of guidance, as well as examples of points to consider in determining whether confidential information may be disclosed. The items of guidance (with some accompanying commentary) are:

- (a) When requested to sign confidentiality agreements, members must ensure that, other than in exceptional circumstances, the agreements do not preclude the member from disclosing information to the auditor or the audit committee or board of directors.**

A member should ensure that a confidentiality agreement does not constrain the member's ability to make disclosures to third parties when a legal obligation to do so exists.

- (b) Members must be prepared to justify their non-compliance with this requirement in the exceptional circumstances referred to above.**

In making a decision to breach confidentiality, a member may wish to follow a series of steps such as those in the ethical decision making model described in paragraph 3.2 in this Guidance Statement. These steps will allow the member to support his or her decision. Consultation with one of the profession's ethical counselling services may also be advisable in serious cases.

- (c) Information confidential to a client or employer acquired in the course of professional work should not be disclosed except where consent has been obtained from the client, employer or other proper source, or where there is a legal obligation to disclose. The duty of confidentiality continues even**

after the end of the relationship between the member and the client or employer.

When moving to new employment, a member must continue to maintain the confidentiality of any sensitive information relating to the procedures and processes of the previous employer.

(d) Members have an obligation to ensure that staff under their control, and persons from whom advice and assistance is obtained, respect the principle of confidentiality.

Members should ensure that subordinates are properly aware of the confidential nature of information acquired by them in the course of their work, and should supervise them to the extent necessary to make sure that confidentiality is maintained.

(e) A member acquiring or receiving confidential information in the course of professional work should neither use nor appear to use that information for personal advantage or for the advantage of a third party.

One obvious form of advantage is insider trading which, of course, is illegal. Any use of a client or employer's information for the member's advantage (or that of another party) represents a criminal act which brings discredit to the profession and breaches the member's duty to act with integrity.

4.6 Technical and Professional Standards

Members must carry out their professional work in accordance with the technical and professional standards relevant to that work.

Members must not only comply with the relevant accounting standards and other professional pronouncements, but must also follow the policies and procedures laid down by their employer organisation. Such policies and procedures include internal controls and other mechanisms of corporate governance.

Compliance with relevant accounting standards, other professional pronouncements and the organisation's policies and procedures, must be honoured in spirit as well as to the letter.

Members in business face two broad types of potential conflicts in the application of this Fundamental Principle.

The first relates to conflicts between the policies of the member's organisation and those imposed by the accounting profession or other regulatory bodies.

For example, a member's organisation may wish to adopt an accounting policy, which is not in accordance with a relevant accounting standard.

Paragraph 11 of APS 1, *Conformity with Accounting Standards and UIG Consensus Views*, makes it clear that, in the context of a general purpose financial report, members must do all in their power to ensure conformity with the relevant accounting standard. As such, a member must seek to persuade the management of the organisation that non-compliance with an accounting standard will mean that the financial statements will not be of the required quality and that readers of the report may be misled.

It should be pointed out that such non-compliance may result in legal and other disciplinary action. Where the member is unable to convince management to comply with the standard, then paragraph 12 of APS 1 requires the member to attempt to ensure that the non-compliance is disclosed in the financial report.

The second type of potential conflict relates to the application of the organisation's own operating policies and procedures. A member has a fiduciary duty to ensure that the organisation's policies and procedures are followed.

An employer may require prior authorisation for the purchase of assets above a certain limit. Employees may seek to circumvent this requirement by buying an asset (e.g. computing equipment) on the basis of separate transactions for each component, none of which individually would exceed the authorisation limit.

Although such a practice may be in accordance with the letter of the purchasing policy, in substance it is clearly designed to subvert the controls, thus increasing the risks of the employer. Members should not condone non-compliance with an employer's policies unless express written permission has been obtained from an appropriate authority within the organisation.

Members may find that they face pressure from within their workplace to "bend the rules" for friends or associates. Such pleas are usually based upon references to "mateship" and "loyalty" but they represent threats to a member's integrity, objectivity, and technical and professional standards.

As above, the member should seek to persuade the friend or associate that the proposed action is inappropriate and seek other means of achieving the desired outcome if it is in the organisation's interest. For instance, the member may be able to assist in the preparation of a detailed justification that could be used as a case for authorisation by senior management of a proposed acquisition.

In keeping with the principle of competence and due care, members have a duty to ensure that they inform themselves, and any staff with whom they work, of all relevant professional, legal and organisational policies and procedures. This will require members to maintain their own continuing professional development and to ensure the continuing education of professional staff they supervise and that appropriate training is provided to support staff. Where necessary, members should communicate any relevant professional and legal requirements to senior management for their decision making.

Members working overseas are reminded of Section C1 of the Code which requires the member to comply with the professional requirements of the country which has the stricter set of requirements. Section E of the Code contains a list of other relevant professional regulations and by-laws relating to professional conduct.

4.7 Competence and Due Care

Members must perform professional services with due care, competence and diligence. A member has a continuing duty to maintain professional knowledge and skill at a level required to ensure that a client or employer receives the advantage of competent professional service based on up-to-date developments in practice, legislation and techniques. In agreeing to provide professional services it is implied that there is a level of competence necessary to perform professional services and that the knowledge, skill and experience of the professional accountant will be applied with reasonable care and diligence. Professional accountants should therefore refrain from performing any services that they are not competent to carry out unless advice and assistance is obtained to ensure that the services are performed satisfactorily.

Competence involves both academic and professional training and learning from experience, which should be of a sufficient standard to ensure an ability to undertake the task at hand. Maintenance of competence requires a commitment by members to ongoing participation in continuing professional education in areas appropriate to their work.

While members are frequently specialists in a complex area of the profession and spend most of their working hours developing and applying that expertise, other members may not be able to specialise to the same extent. However, they are expected to know when and where to obtain competent advice and assistance when their responsibilities take them into areas for which they are not qualified by training or experience.

Skills required of members are dynamic, and require constant upgrading to remain abreast of changes in technical and statutory matters, as well as issues affecting the general business environment.

It is not enough that members maintain a sufficient level of competence throughout their professional career, as they must also exercise due care in the application of their knowledge, skill and experience. In agreeing to provide professional services, a member implies that there is a level of competence necessary to perform those services and furthermore that their knowledge, skill and experience will be applied with reasonable care and diligence.

To bring due care to bear to a task members are required to exercise professional judgment in the allocation of appropriate resources to that task.

Members are also required to ensure that staff working under their control are competent to undertake the work for which they are responsible and are adequately supervised, having regard to their knowledge, skill and experience.

Members should endeavour to avoid undertaking tasks where their knowledge, skill and experience are not sufficient to undertake that task with competence and due care and insufficient guidance and supervision are provided. When such a task cannot be avoided, members should communicate their lack of expertise in writing to his or her superiors.

4.8 Ethical Behaviour

Members must conduct themselves in a manner consistent with the good reputation of their profession and refrain from any conduct that might bring discredit to their profession.

An organisation does not exist in isolation; it depends on and is depended upon by its clients, providers of credit, governments, employees, investors, the business and financial community, and other stakeholders. It is important that all of these parties, who may regard members as representatives of both the employer and the profession, be satisfied that members are acting honestly and in good faith.

The principal, and in many cases the only basis clients and other stakeholders may assess a member's character is by his or her conduct – real or apparent.

Members have a fiduciary duty to their clients to neither use nor disclose non-public information acquired by virtue of their employment. Furthermore, members shall take special care to protect the proprietary nature of any information belonging to their client or provided to the member as part of a fiduciary relationship or on the basis of some other special relationship.

5. Examples of Ethical Conflicts

The following two examples of ethical conflict make use of the AAA model of ethical decision-making outlined in paragraph 3.2.

5.1 Example 1: No Control

This example is taken from the Institute video *Ethics in Business* (1996).

Participants

John Lim	Internal Auditor
Adam Smith	Internal Audit Manager

Facts of the Case

John, a young accountant and one of a number of internal auditors working for a large organisation, has been assigned a range of specific projects in the last twelve months. John's role in these projects has been to complete a specific work program and draft a report for review by Adam.

In completing the work program, John finds a number of items that concern him. The audit programs do not require follow up or investigation of these items; however John cannot help himself. He believes in his role as an internal auditor and proceeds to investigate the items. The items of concern relate to inventory controls and cash. John aims to find out the facts before raising the matter further with Adam.

John documents his findings. At a workshop inspection, he notices that controls over inventory requisitions are poor, leading to serious concerns over the accuracy of financial records. The potential for material differences concerns John.

During another audit, he finds cash records are incomplete and funds missing. John raises his findings with the individual responsible who is unable to provide a satisfactory explanation.

John completes his draft report ready for Adam's review. Adam is disturbed by John's findings and is unhappy with John for pursuing items outside of the audit program.

Adam tells John not to concern himself further with the matters he found and that he (Adam) will take the appropriate action.

In the draft monthly management report, John notices that Adam has not raised his findings at all. Concerned at the omission, John confronts Adam who reminds him of the earlier discussion. John is uncertain of what his next steps should be.

Application of an Ethical Decision Making Model

1. Determine the Facts

Who? What? Where? When? How?
What do we know or need to know, if possible, that will help define the problem?

- John, a young accountant, is an internal auditor responsible for specific projects.
- John discovers matters of concern that relate to inventory and cash controls. John aims to find out the facts before raising the matter with Adam (Internal Audit Manager).

- John documents his findings, noting inventory controls were poor, cash records incomplete and funds missing.
- John raises the issue of cash controls with the individual responsible and gets an unsatisfactory explanation.
- John completes his report for Adam's review. Adam is angry that John has conducted reviews beyond his brief. However, he advises John that he will take appropriate action.
- John subsequently discovers that Adam has not included his findings in the monthly management report.

2. List the Significant Stakeholders and Define the Ethical Issues

Make sure what precisely the ethical issue is (e.g. conflict involving rights, questions over limits of an obligation, etc).

a) List stakeholders

- John Lim
- Adam Smith
- Directors of the organisation
- Shareholders of the organisation
- Creditors of the organisation
- Individual responsible for cash

b) Define the ethical issues

- John's responsibility to Adam vs. his own integrity
- John's responsibility to the organisation/shareholders vs. his responsibility to Adam
- John's relationship to the individual responsible for cash vs. his duty to the organisation

Overall, John's problem is what further action to take regarding the information he has gathered.

3. Identify the Applicable Fundamental Principles and Any Other Rules or Values

(E.g. integrity, quality, respect for persons)

- Integrity (Adam should be straightforward)
- Technical and professional standards (John and Adam should carry out their work in accordance with technical and professional standards relevant to that work)
- Competence and due care (John's responsibility as an accountant)

4. Specify the Alternatives

List the major alternative courses of action, including those that represent some form of compromise or point between simply doing or not doing something.

- John can do nothing
- John can try to raise his concerns with management, peers, the audit committee, etc
- John can resign
- John can raise his concerns informally with the external auditors
- John can try once more to convince Adam to report John's findings

5. Compare Alternatives - See if a Clear Decision Emerges

Determine if there is one alternative, or combination, which is so compelling that the proper action is clear.

- John can do nothing - would breach all three Principles identified in step 3
- John can try to raise his concerns with management, peers, the audit committee - may be consistent with the Principles but does not give Adam an opportunity to explain himself
- John can resign - does not satisfy any of the Principles and abrogates responsibility
- John can raise his concerns informally with the external auditors - may be consistent with the Principles but does not give Adam an opportunity to explain himself
- John can try once more to convince Adam to report John's findings - is consistent with integrity and allows Adam the opportunity to explain himself (e.g., it may be that the matter is part of a broader but confidential investigation that Adam is conducting)

6. Assess the Consequences

Identify the short and long run, positive and negative consequences for the major alternatives. The common short run focus on gain or loss needs to be measured against the long run considerations. This step will often reveal an unanticipated result of major importance.

- John can do nothing:
 - will pacify Adam
 - could have detrimental financial consequences for the organisation if there are continual losses of inventory and cash
 - would cause John to breach his ethical standards as outlined in the Code
- John could raise his concerns with management/peers/audit committee, etc
 - may highlight problems within the organisation and lead to their rectification
 - may result in action being taken against the employee who has failed to keep adequate cash records
 - could have a negative impact on John's career aspirations if he has to continue working with Adam. Alternatively, John may be rewarded for identifying the problems
- John can resign
 - may not result in problem being identified, which may have detrimental effects on the organisation
 - has a personal cost
- John can talk informally to the external auditors
 - may preserve John's integrity
 - may lead to an independent investigation
 - could have a negative impact on John's career aspirations if he is identified as the source
- John can try once more to convince Adam to report John's findings
 - may cause Adam to refuse and take disciplinary action against John

- may cause Adam to explain his actions to John's satisfaction and so settle the matter

7. Make a Decision

Balance the consequences against the Fundamental Principles and any other rules or values and select the alternative that best fits. Develop a clear plan of action with specific objectives.

In the light of the analysis, John could adopt the following plan:

First, John can try once more to convince Adam to report John's findings and if this is not successful, John could raise his concerns with management/his peers/the audit committee, etc. This allows Adam the opportunity to resolve the matter but, if unsuccessful, means that the issue will probably be resolved internally.

5.2 Example 2: Change the Bottom Line

Participants

Susan Martinazzo
Harry Fitzsimmons

Management Accountant, Plastics
Divisional Manager, Plastics

Facts of the Case

Susan is the Management Accountant working in the plastics division of a large multinational conglomerate. In accordance with the organisation's decentralised operating model, Susan works for Harry. Harry is the Divisional Manager for plastics and has a background in engineering.

Susan's responsibilities include the preparation of a monthly management pack that is provided to the Divisional Manager and forwarded to the organisation's national office together with the Divisional Manager's monthly review.

The plastics market has reached a mature stage and the division's results have been stable for a number of years. In addition, the industry is under threat from increasing competition as a result of lower barriers to entry and changes in technology. Susan's latest monthly management pack reflects the continuation in the decline in the division's profit margins and no growth in sales.

Harry is anxious about the plastics division's future. For a number of months, the division has failed to meet the organisation's benchmark rate of return. Harry has heard from a reliable source that the national office is seeking to divest the plastics division or in the absence of a sale, abandon the division. The division employs 35 people.

Harry has reviewed the monthly management pack and instructed Susan to change the accounting treatment of unearned income to bring forward the recognition of sales income, and to increase the useful life of depreciable assets.

Susan has tried to explain to Harry that the national office determines the accounting policies for income recognition and asset depreciation. Harry replies that he is too busy to delve into the accounting "mumbo jumbo"; Susan is again instructed to make the changes or she may be fired.

Application of an Ethical Decision Making Model

1. Determine the Facts

Who? What? Where? When? How?

What do we know or need to know, if possible, that will help define the problem?

- Susan, a Management Accountant in the plastics division is responsible for the preparation of a monthly management pack that is provided to the Divisional Manager and the national office.
- The plastics division has failed to meet the organisation's benchmark rate of return for a number of months.
- The plastics division employs 35 people. The division is up for sale failing which, the division will be abandoned.
- Harry has instructed Susan to change the accounting treatment for unearned income and to lower depreciation expense.
- The national office sets the accounting policies for income recognition and asset depreciation.
- Susan reports directly to Harry. Harry does not have an accounting background. He has threatened to fire Susan if she fails to change the numbers.

2. List the Significant Stakeholders and Define the Ethical Issues

Make sure what precisely the ethical issue is (e.g. conflict involving rights, questions over limits of an obligation, etc).

a) List stakeholders

- Susan Martinazzo
- Harry Fitzsimmons
- Directors of the organisation
- Shareholders of the organisation
- Creditors of the organisation
- Plastics division employees

b) Identify the ethical issues

- Susan's responsibility to Harry vs. her independence and objectivity
- Susan's responsibility to protect the interests of the company and shareholders vs. her responsibility to Harry
- Susan's wish to help protect the employment of the division's employees vs. her duty to protect the interests of the organisation and shareholders

Overall, Susan's problem is how to respond to Harry's instructions.

3. Identify the Applicable Fundamental Principles and Any Other Rules or Values

(e.g. integrity, quality, respect for persons)

- Integrity (Susan may not supply information that is misleading or false)
- Objectivity (the interests of Susan's employer should not affect her judgment)
- Independence (Susan may not bend the rules despite the pressure applied by her superior)
- Technical and professional standards (Susan should carry out her work in accordance with technical and professional standards relevant to that work, including the national office accounting policies)

4. Specify the Alternatives

List the major alternative courses of action, including those that represent some form of compromise or point between simply doing or not doing something.

- Susan can do nothing
- Susan can try to raise the issue with the accounting staff at the national office as an accounting issue
- Susan can try to raise the issue with management at the national office as an unresolved issue between Harry and herself
- Susan can resign
- Susan can try once more to explain to Harry that accounting policies cannot be changed at a division level
- Susan can follow Harry's instructions

5. Compare Alternatives - See if a Clear Decision Emerges

Determine if there is one alternative, or combination, which is so compelling that the proper action is clear.

- Susan can do nothing – may lead to her dismissal even though to do nothing is consistent with the Principles
- Susan can try to raise the issue with the accounting staff at the national office as an accounting issue – may be consistent with the Principles but it may not resolve the issue with Harry and may lead to her dismissal
- Susan can try to raise the issue with management at national office as an unresolved issue between Harry and herself – may be consistent with the Principles but may have a detrimental impact on Susan's or Harry's career aspirations
- Susan can resign – may lead to the required changes being made to the pack to the detriment of the organisation and shareholders
- Susan can try once more to explain to Harry that accounting policies cannot be changed at a division level – consistent with the Principles and affords the opportunity for resolution with Harry (e.g. it may be that the income recognition for sales should be brought forward)
- Susan can follow Harry's instructions – is a failure to comply with the Principles

6. Assess the Consequences

Identify the short and long run, positive and negative consequences for the major alternatives. The common short run focus on gain or loss needs to be measured against the long run considerations. This step will often reveal an unanticipated result of major importance.

- Susan can do nothing
 - may lead to personal costs due to Susan's dismissal. In the interim, Harry's recommended changes may be made to the pack, to the detriment of the organisation and shareholders
 - will result in Susan complying with the Fundamental Principles and with her responsibility to the organisation and shareholders
 - if the pack remains unchanged, may lead to the redundancy of staff in the division
- Susan can try to raise the issue with the accounting staff at national office as an accounting issue
 - likely to confirm that Susan can only change the accounting treatment of income and depreciation where there are appropriate grounds to do so

- will not resolve the issue between Harry and Susan
- Susan can try to raise the issue with management at the national office as an unresolved issue between Harry and herself
 - may have a detrimental effect on Harry's career aspirations
 - may result in Susan being rewarded for her objectivity and independence
 - alternatively, may have a detrimental effect on Susan's career aspirations with the organisation
- Susan can resign
 - has a personal cost
 - may result in Harry's recommended changes being made to the pack, to the detriment of the organisation and shareholders
- Susan can try once more to explain to Harry that accounting policies cannot be changed at a division level
 - may resolve the issue between Harry and Susan
 - may cause Harry to refuse to withdraw the instruction and instigate disciplinary action against Susan
- Susan can follow Harry's instructions
 - may cause the pack to be false and misleading
 - may diminish the usefulness of the pack if it is no longer comparable to previous results and the results of other divisions
 - may result in a reduction in organisation and shareholder wealth

7. Make a Decision

Balance the consequences against the Fundamental Principles and any other rules or values and select the alternative that best fits. Develop a clear plan of action with specific objectives.

In the light of the analysis, Susan could adopt the following plan:

First, Susan can try once more to explain to Harry that the national office determines accounting policies and that a change in accounting policy must be disclosed in the statutory accounts.

If this fails to resolve the issue, then Susan could explain to Harry that she would need to raise the matter as an accounting issue with the accounting department in the national office.

If this fails to resolve the issue and if Harry commences disciplinary action against Susan, then Susan should explain the basis of her actions in writing to Harry and to management at the national office.