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Ethical Dilemma: A BANKER SHOULDN'T ALLOW PROMOTION PROSPECTS TO CLOUD HIS JUDGEMENT, SAYS TIINA-LIISA SEXTON

Helping clients make an informed decision

Dilemma: You have been employed by a merchant bank for a number of years and are eager to secure a promotion. You have a long-standing friendship with the chair of the finance committee of a city council and you become aware that the council has substantial surplus cash to invest. You are also aware that your bank has in its inventory certain "esoteric financial instruments" that it would like to dispose of. You see this as a perfect opportunity to gain a promotion and proceed to contact the finance committee chair to discuss a possible investment. The chair makes you aware of the city council's policy of only investing in "safe" financial instruments that would protect the city's principal. The chair, who has complete faith in your competence in advising on investments, provides you with authority to proceed. What are the ethical issues to be considered if you propose to recommend financial products from your bank's inventory?

There are a number of issues that need to be addressed and resolved before investing the city council's surplus funds:

1. Recommending appropriate investments

It is important to fully understand the city council's investment strategy in relation to its surplus cash. You have already been made aware of the need for "safe" investments. Therefore in recommending one financial product in preference to another, it is necessary that the recommendation clearly explains the appropriateness of the investment in achieving the city council's identified needs and objectives as required by APS 12 *Statement of Financial Advisory Service Standards*. It is important to assess the complexity and any associated risk associated with the proposed investment and whether it is suitable for the city council. Financial products from your bank's inventory may not provide the conservative, principal-protected investment required by the city council.

2. Conflict of interest

As a member of the accounting profession you are required to identify and manage real and potential conflicts of interest. APS 12 requires that the conflict is disclosed to the council together with a detailed explanation of the circumstances and details of any safeguards that will be adopted to control the conflict.

This allows the council to make an informed decision as to whether to continue with your service. If the conflict cannot be adequately managed through controls and disclosure, you must avoid the conflict by declining to provide the financial service or by referring the city council to another financial adviser. In this situation, you may argue that there is no conflict of interest as there is no guarantee that you will gain a promotion from the sale of your bank's financial instruments. This argument may hold in terms of any real conflicts of interest but does not resolve the issue of a potential conflict which still remains. Therefore, it is necessary to disclose this issue, together with the fact that the financial instruments being considered are owned by your bank and employer.

As a member of the accounting profession you have a responsibility to increase community confidence in financial advice

Paragraph 9.5 of APS 12 further reminds those providing financial advisory services to recognise the potential threats created by personal and business relationships; the acceptance of commission or other benefits; and financial involvements, which by reason of their nature or degree, might threaten their objectivity.

3. Public interest

As a member of the accounting profession you have a responsibility to increase community confidence in financial advice. Advice must be of a high quality, objective, ethical and in the best interests of the client. The aim is confident and informed decision making by clients. It is therefore incumbent on members that services are executed at the highest level of performance and in accordance with ethical standards that ensure that public confidence is firmly founded. It is important that all stakeholders are satisfied that members are acting honestly and in good faith. ■

Tiina-Liisa Sexton is CPA Australia's ethical adviser.

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Ethical dilemma: A CFO BECOMES CENTRAL TO A COVERT MANAGEMENT BUY-OUT.

Personal gain vs integrity

Dilemma: **You have recently been appointed interim CFO for an organisation. A few months into the contract you are approached by a group of senior managers to discuss a covert management buyout (MBO). They explain that the MBO must be covert at this stage to allow information to be gathered before approaching private equity companies. In exchange for your assistance, you will be offered a position on the board of the new MBO organisation. The current chairman and CEO of the business are unaware of these developments, so at this stage it is not clear if this will turn into a friendly or hostile MBO. You seek guidance on any possible ethical issues in relation to the proposed MBO.**

MBOs that occur when investors, led by incumbent managers, remove an organisation from public trading by acquiring all issued shares do raise ethical issues. In considering the range of ethical issues, it is important to note that ethical decision-making is not limited to ensuring that no laws have been contravened. The ethical requirements for members of the accounting profession are contained in *APES 110 Code of Ethics for Professional Accountants*. The main principles that need to be considered are as follows:

1. Objectivity

Perhaps the most difficult ethical issue is that of conflict of interest, which is contained in the principle of objectivity. This principle imposes an obligation on all members not to compromise their professional or business judgment because of bias, conflict of interest, or the undue influence of others.

Therefore, as CFO of the organisation targeted for an MBO, and with the offer to become a director of the new MBO organisation in return for your cooperation, there is at least a perceived, and more likely, a real conflict of interest. As interim CFO you have acquired a great amount of knowledge, information and understanding of the organisation's current value and, of course, its potential value. The perception, therefore, may be that while acting as interim CFO this paid "employment" is being used to advance personal interests, perhaps to the disadvantage of the organisation and its stakeholders.

Further, it is expected that members who hold senior positions promote ethical behaviour. Paragraph 300.5 of APES 110 states that a "member in business often holds a senior position within an organisation. The more senior the position, the greater will be the ability and opportunity to influence events, practices and attitudes. A member in business is expected, therefore, to encourage an ethics-based culture in an employing organisation that emphasises the importance that senior management places on ethical behaviour". So, it is important to manage real and potential conflicts of interest as they arise.

2. Integrity

The principle of integrity imposes an obligation on all members to be straightforward and honest in professional and business relationships. Integrity also implies fair dealing and truthfulness.

This implies that participation in the MBO is with the informed consent of the CEO and board of directors. It is assumed that if it was a hostile MBO, those proposing the MBO would not be allowed to continue to have access to company information and records.

3. Confidentiality

The principle of confidentiality imposes an obligation on members to refrain from disclosing information acquired as a result of professional and business relationships without proper and specific authority. Using such information for personal advantage, or the advantage of third parties, is prohibited.

The principle of confidentiality does not rely on a signed confidentiality agreement. Unless there is consent or authorisation to use or disclose this information, the fundamental principle of confidentiality would be breached. ■

Dilemma answered by Tiina-Liisa Sexton, CPA Australia's ethics adviser.

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Ethical dilemma: TIINA-LIISA SEXTON EXAMINES HOW TO DEAL WITH INCENTIVES AND INDUCEMENTS OFFERED BY SUPPLIERS OF GOODS AND SERVICES.

A gift list

Dilemma: As state manager of a professional member organisation you are charged with improving the professional lives of your members, as well as promoting the organisation's value to members. Having ultimate control of the state budget you are persuaded to enter into a preferential agreement with a supplier of services. This decision is not only based on the level of service provided but the added incentive of you personally receiving gifts in exchange for using the preferred supplier services. The size of the gift is directly linked to the amount of services purchased. You are in the process of finalising a member event and realise that if you direct your staff to exclusively use the services of the preferred supplier, you will personally "qualify" for the latest high-definition television. You have received gifts in the past and see no reason why you should not receive a new television which you have earmarked as a gift for your son.

Incentives or inducements are primarily designed to influence economic decisions. In this case it would appear the preferred supplier is offering the TV as an incentive to secure their service rather than any alternative and both parties stand to gain from the resulting choice. But is acceptance of such inducements ethical and in the interests of the organisation and its members?

If the state manager is a professional accountant and member of a professional accounting body, there is a requirement under Section 350 of APES 110 *Code of Ethics for Professional Accountants* to carefully consider whether an inducement creates a self-interest threat to objectivity where the inducement is made in an attempt to unduly influence actions or decisions. Paragraph 350.3 states that the significance of such threats will depend on the nature, value and intent behind the offer. If a reasonable and informed third party, having knowledge of all relevant information, would consider the inducement insignificant and not intended to encourage unethical behaviour, then the manager may determine that the offer is made in the normal course of business and conclude that there is no significant threat to compliance with the fundamental ethical principles.

It is prudent to maintain a register to record receipt of any meal, gift or entertainment by any employee

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However, as the real or apparent threats to compliance with the fundamental principles do not merely arise from acceptance of an inducement but, sometimes, from the fact of the offer having been made, the manager should assess the risk associated with all such offers and consider immediately informing higher levels of management or those charged with governance of the employing organisation about the inducement.

Direction can also be obtained from any procurement and purchasing policies. Generally, such policies would require those negotiating contracts, obtaining quotations and placing orders to ensure that they act honestly and are accountable. Accountability would require:

- disclosure to the relevant senior manager of any possible personal interest in the purchasing transaction;
- dealing with all suppliers in an honest, fair and even-handed manner and not to prejudice fair and open competition; and
- not accepting purchasing incentives, services or prejudiced discounts.

It is also prudent to maintain a register to record receipt of any meal, gift or entertainment by any employee of the organisation. Such a register should be open to inspection by members to ensure no unreasonable inducements have been received.

In the case of any gift or entertainment, extreme care should be taken to ensure that acceptance:

- is in the best interests of the organisation;
- will not influence decision-making; and
- will not be perceived by others as being unethical.

To assist in demonstrating that the purchasing activities are cost effective, the "best value for money", fair, transparent and accountable and meet your organisational needs, documentation of the reasons for entering into contracts other than those resulting from a competitive quoting or tender process would be advisable. ■

Dilemma resolved by Tiina-Liisa Sexton CPA Australia's ethics adviser.

GETTY IMAGES

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Ethical dilemma: CONFLICTS OF INTEREST ARISE WHEN PERSONAL OR PROFESSIONAL RELATIONSHIPS OR CONCERNS POTENTIALLY INFLUENCE PROFESSIONAL JUDGEMENT

Family ties (and conflicts)

Dilemma: As a member of a not-for-profit board you, along with the other board members, are required to make a decision on the awarding of a contract for the provision of legal services. One of the submissions received is from your daughter. Can you as a board member be objective when deciding to whom the contract should be awarded? Is it unethical to award the contract to a member of your family?

Answer: Not-for-profit organisations are heavily scrutinised, and board members should be aware of any potential conflicts of interest when making decisions. Conflicts generally arise when members' personal or professional relationships or concerns potentially influence their objective professional judgement. Factors such as private and personal interests that either interfere or appear likely to interfere with objectivity are a legitimate concern to those who rely on professional accountants for their judgement.

It is therefore important to avoid apparent and potential as well as actual conflicts of interest. An apparent conflict of interest is one that a reasonable person would think is likely to compromise the professional's judgement. A potential conflict of interest involves a situation that may develop into an actual conflict of interest. There is an actual conflict of interest where, for example, a person has a pecuniary interest in the matter at hand, or a member of their immediate family has a pecuniary interest in the matter at hand.

The principle for defining conflicts of interest is objectivity. Section 120 of APES 110: Code of Ethics for Professional Accountants, states that the principle of objectivity imposes an obligation on all members not to compromise their professional or business judgement because of bias, conflict of interest or the undue influence of others. Relationships that bias or unduly influence the professional judgement of the member should be avoided. However, APES 110 contains no further guidance for members in business on how to deal with conflicts of interest that arise as a result of private and personal interests.

So how should the board member deal with this current situation? First, it is advisable for all organisations to have a conflict-of-interest policy requiring board and key staff members to disclose interests, relationships and financial holdings that could result in a conflict of interest. Such policies usually require that board or staff members who have a possible conflict of interest abstain from any discussion and decision making regarding that issue. If no such policy exists, the member should nevertheless disclose any conflicts of interest and not be party to the decision to award the contract for provision of legal services. After all, the appearance of a conflict of interest can be just as damaging as the actual existence of one.

An apparent conflict of interest is one that a reasonable person would think is likely to compromise the professional's judgement

Secondly, appropriate policies and procedures to address potential conflicts are recommended. In this case, an established policy and procedure for procuring professional services helps ensure that decisions are made in an informed and objective manner. The awarding of a contract to a board member's daughter is not unethical per se.

However, it is recommended that the member abstain from participating in the procurement process and that established contract awarding processes are applied.

It is also important to continuously educate board and staff members about conflicts of interest. Such an approach emphasises a culture of open discussion about potential conflicts. Finally, recognising situations where conflicts of interest exist requires skill and good judgement because private and personal interests can cloud objectivity. As such, it is often easier to recognise when others are in conflict. It is therefore useful to talk to a trusted colleague or friend when you are in doubt. ■

Dilemma resolved by Tiina-Liisa Sexton, CPA Australia's ethics adviser.

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Ethical dilemma: WHEN THE POLITICAL SPHERE ATTEMPTS TO INFLUENCE OPERATIONS, MEMBERS MUST ALWAYS KEEP IN MIND INTEGRITY, DUE CARE AND PROFESSIONAL BEHAVIOUR

An election in the wind

Dilemma: You are in the process of finalising end-of-year accounts for your state department of health. You become aware that some work that has been commissioned from a consultant into the possible closure of rural hospitals has not been included in the accounts. You have been advised to suppress this information from becoming public knowledge because of an approaching election. The consultants have agreed not to submit their statement of fees, which are significant, until after the election.

Normal accounting treatment would require the consultant's fees to be included in the accounts. Additionally, the actual cost of the potential hospital closures may need to be included as a provision and contingent liability. As the cost would be material, the accounts may also need to include narrative explaining the policy decision. You would like to highlight these issues to the external auditor, who is unaware of this matter, as the item may need to be included in the accounts. How should you deal with this dilemma?

Answer: Members of CPA Australia are required to comply with APES 110: Code of Ethics for Professional Accountants. In particular, members are required to comply with the following fundamental principles, which are applicable in this case: integrity, professional competence and due care, and professional behaviour.

Integrity implies fair dealing and truthfulness, and this principle requires members to be straightforward and honest in professional and business relationships. This means that a member should not be associated with reports, returns, communications or other information when they believe the information contains a materially false or misleading statement; contains statements or information furnished recklessly; or omits or obscures information required to be included where such omission or obscurity would be misleading.

As such, the member should discuss the matter with their finance director and suggest that the accounts be amended and the external auditor be advised of the omission. This may give rise to a potential conflict if the member continues to remain under pressure to act or behave in ways that could directly or indirectly threaten compliance with the fundamental principles contained in APES 110.

Integrity implies fair dealing and truthfulness, and this principle requires members to be straightforward

Paragraph 310.3 states that the significance of threats arising from such pressures, such as intimidation threats, should be evaluated and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate or reduce them to an acceptable level. Such safeguards may include:

- Obtaining advice where appropriate from within the employing organisation, an independent professional adviser or a relevant professional body
- Accessing a formal dispute-resolution process within the employing organisation
- Seeking legal advice.

Furthermore, the principle of professional competence and due care requires the member to act diligently in accordance with applicable technical and professional standards when providing their services. The current decision to exclude the consultants' fees means that the accounts could be materially misstated and may not comply with applicable accounting standards. The issue of professional competence is another reason for the member to formally raise concerns over the significant omission of the consultant's fees with the director of finance. For this reason also, the member should request that the external auditor be informed.

Finally, the principle of professional behaviour imposes an obligation on members to comply with relevant laws and regulations, and avoid any action or omission that may bring discredit to the profession. This includes actions or omissions that a reasonable and informed third party, having knowledge of all relevant information, would conclude negatively affects the good reputation of the profession.

By raising the issue of the omission of the consultant's fees with the finance director, the member is demonstrating concern over a matter that could reflect badly not only on the department of health but also the member and his/her profession. ■

Adapted from a case study in *Ethics and You: a Guide to the CIPFA Standard of Professional Practice on Ethics*, CIPFA June 2006.

Dilemma resolved by Tiina-Liisa Sexton, CPA Australia's ethics adviser