

Chapter 1

Business Ethics

1.1 Introduction to Ethics

Meaning of Ethics

- Ethics is doing what is right.
- Ethics are the principles of right conduct governing an individual or a group.
- The word 'Ethics' is derived from the Ancient Greek "Ethos" or "Ethikos" which means character as the essence of values and habits of a person or group.
- Ethics is choosing what is good or bad and having to do with moral duty and obligation.
- Ethics is not feelings, religion, law, science or culture.
- Ethical behavior is what is morally accepted as "good" or "right" in a particular setting. In contrast, unethical behavior is that does not conform to generally accepted social norms concerning beneficial and harmful actions.

Social Sins

- Mahatma Gandhi advocated people of all faiths to follow ethical principles in all areas of their life and particularly avoid the following seven Social Sins:-
 - (i) Politics without Principles
 - (ii) Wealth without work
 - (iii) Commerce without Morality
 - (iv) Knowledge without Character
 - (v) Pleasure without Conscience
 - (vi) Science without humanity
 - (vii) Worship without sacrifice

Sources of Ethical Standards

1. **Utilitarian approach** – To make the most good & least harm to anyone.
2. **Deontological Approach** – Belief that our ethics are the rights of other person and therefore we should respect it.
3. **Fairness or Justice Approach** – Greek philosophy of following ethics because we must give equal treatment to all.
4. **Common good approach** – Ethics for welfare of everyone in the society.
5. **The virtues approach** – Belief that ethics will become personal habits and upgrade personality.

Business Ethics

- Business Ethics is the application of ethical principles to business.
- Business Ethics are the principles and standards that determine acceptable conduct in business organization.
- These are set of rules which should govern the conduct of business both at the individual or collective level by the application of ethical reasoning to specific business situations & activities.
- A business man has to act only as a trustee of the society for whatever he has gained from the society. The society has the right to expect that productive organizations will enhance the general interests of consumers, employees and community.

Factors influencing ethical behavior

1. **Individual moral standards** and values
2. **Influence of managers** and co-workers, and
3. **Opportunity to engage in misconduct**

Requirements in Business Ethics

- Being ethical in business requires acting with an awareness of -
 - (1) The need for complying with laws, rules and expected behavior i.e. compliance of;
 - laws of the land,
 - customs and expectation of the community
 - principles of morality
 - policies of the organization and
 - general concerns such as the needs of others and fairness.
 - (2) How ethical conduct in business in the interest of its customers, employees, shareholders, government and self-interest of business itself.

Meaning of Stakeholders

- Stakeholders mean such constituents of an organization, the individuals, groups or other members, which are affected by, or can affect the organization in pursuit of its goals.
 - Employees & Directors
 - Trade Unions,
 - Customers,
 - Suppliers,
 - Government & Enforcement Regulators,
 - Lenders & Creditors
 - Shareholders and Investors
 - Community /society as a whole

Benefits of Business Ethics

1. Helps in building better society
2. Better change management during various economic cycles
3. Strong teamwork and greater productivity
4. Enhanced employee growth
5. Compliance with legal requirements governing personnel policies
6. Lower offences and fines
7. Better value management associated with quality management, strategic planning and diversity management
8. Stronger public image

1.2 Ethical Dilemma

Meaning of Ethical Dilemma

- Ethical Dilemma means making a choice from various alternatives.
- Dilemma is not always choosing between wrong and right but sometimes it may involve choosing between right and right.
- Examples of Ethical Dilemma in mythology – Decision of Lakshman and Sita to accompany Lord Rama in his exile, Decision of Bharat to take Lord Rama's throne, Decision of Arjuna to fight against Kauravas in battle of Mahabharata.



- Many times the ethics challenges the profit motive for which an organization exists and it creates the dilemma. This is because, sometimes doing something ethically right may lead to bad effects for business and vice-versa.
- Complexity arises because of:-
 - (1) Significant value conflicts among differing interests (for example conflict of personal interest with corporate interest or conflict of business interest with public interest)

➤ Examination Questions

1. Answer Yes/No (Correct/Incorrect) with brief reasons:-
 - (a) Knowledge without morality is a social sin. [**May 2007**]
 - (b) Ethics and morals are synonymous. [**Nov 2007**]
 - (c) Fairness and honesty are the pillars of success in business. [**Nov 2009**]
 - (d) There is no difference between ethics and morals. [**Nov 2009**]
2. Explain the meaning of the terms 'ethics' and 'business ethics' and also state the requirements of 'business ethics'. [**Nov 2007**]
3. To pay proper attention to business ethics is certainly beneficial in the interest of business. Describe four such benefits which may be obtained by paying attention to business ethics. [**Nov 2008**]
4. "To maintain social contract between society and business, the trusteeship relations are essential". Describe the role of business ethics in this reference. [**June 2009**]
5. What is meant by 'Stakeholders'? Describe those stakeholders who are affected by or can affect the organization? [**Jun 2009**]
6. Explain the social sins listed by Mahatma Gandhi. [**Nov 2010**]
7. Explain the fundamental principles relating to ethics. [**Nov 2010**]

Chapter 2

Corporate Governance

2.1 Corporate Governance

Definition of Corporate Governance

- “Corporate Governance is the system by which companies are directed and controlled...” – Cadbury Report (UK), 1992
- “Corporate Governance has to do with Accountability and Control: who exercises power, on behalf of whom, how the exercise of power is controlled.” – Sir Adrian Cadbury, in Reflections on Corporate Governance, Ernest Sykes Memorial Lecture, 1993
- “...the fundamental objective of corporate governance is the enhancement of the long-term shareholder value while at the same time protecting the interests of other stakeholders.” – SEBI (Kumar Mangalam Birla) Report on Corporate Governance, January, 2000

Meaning of Corporate Governance

- Governance means the **process of decision making** and the process by which decisions are implemented.
- Corporate governance is about promoting **corporate fairness, transparency and accountability**.
- Corporate governance can be defined as the **formal system of accountability and control** for ethical and socially responsible organizational decisions and use of resources.
 - Accountability relates to how well the content of workplace decisions is aligned with the organizations strategic direction.
 - Control involves the process of auditing and improving organization decisions and actions.
- **Corporate governance is about commitment to values and ethical business conduct.** It is a set of laws, regulations, processes and customs affecting the way a company is directed, administered, controlled or managed. This includes its corporate and other structures, culture, policies and the manner in which it deals with various stakeholders. Some of the important best practices of corporate governance framework are timely and accurate disclosure of information regarding the financial situation, performance, ownership and governance of the Company.

Characteristics of Corporate Governance

- (i) Participatory
- (ii) Consensus Oriented
- (iii) Accountable
- (iv) Transparent
- (v) Responsive
- (vi) Efficient and Effective
- (vii) Equitable and inclusive
- (viii) Follows the rule of law

Issues addressed in Corporate Governance

- Corporate Governance is concerned with structures & processes for decision making, accountability control & **behavior at the top level** of organization.
- It influences **how the objectives of an organization are set & achieved**, how the risk is monitored and assured & how the performance is optimized.

- Corporate Governance measures include **non-executive directors**, placing constraints on management power & ownership concentration.
- It includes ensuring of **proper disclosure of financial information** & executive compensation.

Developments in Corporate Governance in India and abroad

- The Cadbury Report on the financial aspects of corporate governance, published in the United Kingdom in 1992, was a landmark.
- Adoption of New listing requirement by NYSE (New York Stock Exchange) in 1998.
- Corporate Governance is getting focused attention for satisfying the divergent interest of the stakeholders especially after corporate scandals & loss of shareholders value at **Enron & Worldcom**.
- The scandals led to numerous Corporate Governance reforms including **Sarbanes Oxley Act** in 2002.
- In India, various committees were set up by SEBI & DCA (Department of Company Affairs) to recommend further improvements in Corporate Governance applicable to Indian companies.
- In February, 2000, based on the recommendation of Kumar Mangalam Birla Committee, SEBI specified principles of corporate governance and introduced a new **Clause 49 in the listing agreement** of stock exchanges.
- In October 2004, SEBI amended Clause 49 in alignment with the recommendations of the Narayana Murthy Committee. This was implemented in June 2006.
- NASSCOM has constituted a Corporate Governance and Ethics Committee headed by N. R. Narayana Murthy.

Framework of Corporate Governance

1. **Appointing non-executive directors**
2. Placing **constraints on management power and ownership** concentration
3. Proper **disclosure of financial information** and executive compensation
4. **Ethics and /or social responsibility committees** on their Boards
5. Guidelines governing **management policies and practices**
6. Indian listed companies are required to comply with **Clause 49 of the listing agreement** primarily focusing on following areas:
 - a. Board composition and procedure
 - b. Audit Committee responsibilities
 - c. Subsidiary companies
 - d. Risk management
 - e. CEO/CFO certification of financial statements and internal controls
 - f. Legal compliance
 - g. Other disclosures

Role of Committees in Corporate Governance

1. **Board of Directors:** The Board's role is that of trusteeship to protect and enhance shareholders value through strategic supervision. The strategy should aim at accountability and fulfillment of goals.
2. **Audit Committee:** They have to provide assurance to Board on adequacy of internal control systems and financial disclosures.
3. **Compensation Committee:** The committee has to recommend to the Board compensation terms for executive Directors and the senior most level of management below the Executive Directors.
4. **Nomination Committee:** It is to recommend to the Board nominations for membership of the Corporate Management Committee and the Board, and oversee succession to the senior most level of management below the Executive Directors.
5. **Investor Services Committee:** It is to look into redressal of Shareholders' and Investors' grievances, approval of transmissions, sub-division of shares, issue of duplicate shares etc.
6. **Corporate Management Committee:** Its primary role is strategic management of company's businesses within Board's approved direction/framework.

7. **Divisional Management Committee:** It is to realize tactical and strategic objectives in accordance with Corporate Management Committee/Board approved plan.

Benefits of good Corporate Governance

1. Protection of **investor interest** (particularly of small investors) and overall strong capital markets
2. Ensures **commitment of the board** in managing the company in a fair and transparent manner
3. Investors have a great faith in companies following stronger corporate governance policies which is reflected in **higher market valuation** of such companies.

Example: Corporate Governance at Infosys

1. Satisfy the spirit of the law and not just the letter of the law. Corporate governance standards should go beyond the law.
2. Be transparent and maintain a high degree of disclosure levels. When in doubt, disclose.
3. Make a clear distinction between personal conveniences and corporate resources.
4. Communicate externally, in a truthful manner, about how the Company is run internally.
5. Comply with the laws in all the countries in which we operate.
6. Have a simple and transparent corporate structure driven solely by business needs.
7. Management is the trustee of the shareholders' capital and not the owner.

MCA Guidelines on Corporate Governance

Ministry of Company Affairs in 2009 issued a draft of Corporate Governance guidelines to be voluntarily adopted by companies.

1. Formal letters of appointment to be issued to Executive & Non-Executive Directors
2. Separation of office of Chairman and CEO
3. Nomination Committee for succession planning in Board and management
4. Restriction on Directorship in number of companies
5. Appointment of Independent Directors
6. Guidelines on remuneration to directors
7. Detailed Responsibilities of Board
8. Training of Directors
9. Guidelines on Quality Decision Making, Risk Management and Performance Evaluation of Board
10. Systems to ensure compliance to laws
11. Setup of Audit Committee
12. Secretarial Audit
13. Mechanism for whistle blowing

2.2 Corporate Social Responsibility

Meaning of Corporate Social Responsibility (CSR)

- Corporate Social Responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large.
- Beyond making profits, a business has a **social obligation** to produce an overall positive impact on the society by fulfilling the needs of employees, consumers, community & society as a whole.
- Besides making profits & being **answerable to shareholders**; organization are also responsible towards its stakeholders like investors, creditors, government, competitors, etc.
- Corporate Social Responsibility is achieving **commercial success in ways that honour ethical values** & respect people, communities & the natural environment.

Meaning of Corporate Citizenship

- Corporate Citizenship means the extent to which business meets its Corporate Social Responsibility.

- In other words, it determines how far the legal, ethical, economic and voluntary responsibilities are being met by an organization.

Areas of CSR

- Economic responsibilities** – Sustainable profit for growth and development of organization
- Legal Responsibilities** – Compliance to the laws and rules of the country
- Ethical Responsibilities** – Just, fair and transparent treatment in every action of the organization
- Philanthropic Responsibilities** – Contribute to community resources and improving quality of life of society at large

Common CSR Policies

1. Strong Internal Controls in areas particularly impacting investor interfacing issues
2. Diversity in employees and eliminating discrimination
3. Treating employees as assets rather than costs or liabilities
4. Integrating employee opinions and suggestions in decision making (Participative decision making)
5. Compliance and exceeding social and environmental requirements
6. Adopting Environmental Ethics in utilization of resources
7. Providing health work environment and production conditions including to contractual employees

Need for CSR

1. **The iron law of responsibility** - In order to continue receiving social sanction, company needs to respond to society's requirements.
2. **To fulfill long term self-interest** - In order to generate more profits and wealth, company is obliged to use public resources responsibly. A better society would produce a better environment in which the business may gain long-term profit maximization.
3. **To establish a better public image** – A favorable public image will help company in establishing consumer and retailer loyalty, easier acceptance of new products and services, niche market access and preferential allocation of investment funds.
4. To avoid government **regulation and control**
5. To avoid misuse of **National Resources** and **minimize Environmental damage**

Factors impacting CSR

1. Increased awareness as to stakeholders right
2. Detailed requirements in fields of accounting, reporting, investment and public investment in wake of corporate scandals
3. Increased responsibility for complete value chain
4. Increasing requirements as to disclosure and transparent reporting
5. Convergence of requirements of Corporate Governance and CSR
6. Growing Investor Pressure and Market-Based Incentives
7. Increased access to information by developments in information technology
8. Quantification of CSR measures as Return on investment

Benefits of CSR

1. Enhanced **brand image** and reputation
2. Reduced Government **regulations and controls**
3. Helps to minimize **ecological damage**
4. Improved **financial performance**
5. Reduced **operating costs**
6. Increased sales and **customer loyalty**
7. Increased productivity and **quality of work life**
8. Increased ability to **attract and retain employees**
9. Achievement of certain other objectives like **easier access to capital** including international capital



Integration of CSR in Business Strategy and Decision Making

- Nowadays, companies are adopting formal techniques to discuss CSR into business strategy & decision making framework.
- Some companies have **established committees**, standing committees or special Boards to include responsibility for CSR issues.
- Companies implement CSR by putting in place internal management system that generally promote:-
 - Adherence to labour standards
 - Respect for human rights
 - Consumer protection environment
 - Avoiding bribery & corruption
 - Protecting environment
 - Reducing the negative impacts of operating in conflict zones
- Each company differs in how it implements CSR; distinction depends upon company's size, sector, culture and the commitment of its leadership.
- Key strategies used by companies for implementing CSR policies are as follows:-
 1. Include CSR in Mission, Vision & Value statements
 2. Include CSR in Cultural Values of an organization
 3. Include CSR in Management structures by creating committees, positions
 4. Include CSR in Strategic planning
 5. General accountability for CSR measures
 6. Employee recognition & rewards for CSR compliances
 7. Communication, Education & Training to employees
 8. CSR reporting in their annual reports

MCA Guidelines on Corporate Governance

Ministry of Company Affairs in 2009 issued a draft of Corporate Social Responsibility guidelines to be voluntarily adopted by companies.

Core Elements

1. Care for interests of all stakeholders
2. Ethical Functioning
3. Respect for worker's rights & welfare
4. Respect for human rights
5. Respect for environment
6. Activities for social and inclusive development

Implementation Guidance

1. Strategy & Programs with clear timelines & targets
2. Partner with local auth., NGOs etc.
3. Allocate specific budgets
4. Engage in Responsible business & CSR forums
5. Disseminate information on CSR policy & practices

2.3 Global Reporting Initiatives (GRI)

What is GRI

- Global Reporting Initiative is a reporting standard for CSR and sustainable development.
- The Global Reporting Initiative (GRI) is a network-based organization that has pioneered the development of the world's most widely used sustainability reporting framework and is committed to its continuous improvement and application worldwide.

- In order to ensure the highest degree of technical quality, credibility, and relevance, the reporting framework is developed through a consensus-seeking process with participants drawn globally from business, civil society, labor, and professional institutions.

Establishment of GRI

- It was established in 1997 with the mission of designing globally applicable guidelines for preparing enterprise-level sustainability reports including both social & environmental indicators.
- The GRI is convened by CERES (Coalition for Environmentally Responsible Economies) & incorporates the active participations of corporations, NGO's, International organization, UN agencies, Consultants, Accountancy org., business associations, Universities & other stake holder around the world.
- The GRI first released its Sustainability Reporting guidelines in 1999 & is now a permanent, independent, international body with a multi-stake holder governance structure.

Vision & Mission

- The GRI vision is that disclosure on economic, environmental, and social performance is as commonplace and comparable as financial reporting, and as important to organizational success.
- GRI's mission is to create conditions for the transparent and reliable exchange of sustainability information through the development and continuous improvement of the **GRI Sustainability Reporting Framework**.

Benefits of GRI

- Sustainability reports based on the GRI framework can be used to **benchmark** organizational performance with respect to laws, norms, codes, performance standards and voluntary initiatives; demonstrate organizational commitment to sustainable development; and compare organizational performance over time.
- GRI promotes and develops this **standardized approach** to reporting to stimulate demand for sustainability information – which will benefit reporting organizations and those who use report information alike.

2.4 International Developments in CSR

- **The Global Reporting Initiative:** It is a reporting standard established in 1997 with the mission of designing globally applicable guidelines for preparing enterprise-level sustainability reports including both social and environmental indicators.
- **AA1000:** Launched in 1999, AA1000, based on John Elkington's triple bottom-line (3BL) reporting is an accountability standard designed to complement the Global Reporting Initiative's (GRI) Reporting Guidelines with the objective to improve accountability and performance by learning through stakeholder engagement.
- **Social Accountability 8000:** SA 8000 is a comprehensive, global, verifiable performance standard for auditing and certifying compliance with corporate responsibility. The principle of SA8000 is that workplaces should be managed in such a manner that basic human rights are supported and that management is prepared to accept accountability for this. SA8000 is an international standard for improving working conditions. This standard is based on the principles of the international human rights norms as described in International Labor Organization conventions, the United Nations Convention on the Rights of the Child and the Universal Declaration of Human Rights. The requirements of this standard apply regardless of geographic location, industry sector, or company size.
- **United Nations Global Compact:** The Global Compact is a voluntary international corporate citizenship network initiated to support the participation of both the private sector and other social actors to advance responsible corporate citizenship and universal social and environmental principles to meet the challenges to globalization.



- **Organization for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises:** The guidelines were first published in 1976 and updated most recently in June, 2004. The guidelines are recommendations addressed by governments to multinational enterprises and are voluntary principles and standards, not legally enforceable. Governments adhering to the Guidelines encourage the companies operating within the countries to observe the guidelines wherever they operate.
- **Benchmarks for Measuring Business Performance:** The Interfaith Centre on Corporate Responsibility (ICCR) has published '**Principles for Global Corporate Responsibility**', which is not a standard but a collective distillation of the issues of concern for institutional investors developed by groups in the U.S., Canada, and the U.K. The ICCR is comprised of more than 275 religious institutions that use their investments to promote social change. The principles cover the entire spectrum of CSR issues, including workplace, community, the environment, human rights, ethics, suppliers and consumers. The principles are published as a reference tool that companies (and investors) can use to benchmark or monitor their own policies, or those of the companies in which they invest.
- **The Caux Round Table (CRT):** The CRT is comprised of senior business leaders from Europe, Japan and North America, and is based in Caux, Switzerland. The CRT has produced **Principles for Business**, a document which seeks to express a worldwide standard for ethical and responsible corporate behavior for dialogue and action by business and leaders worldwide. The principles include the social impact of company operations on the local community, a respect for rules and ethics, support for multilateral trade agreements that promote the judicious liberation of trade, respect for the environment and avoidance of illicit operation, including bribery, money laundering, and other corrupt practices.
- **The Global Sullivan Principles:** Introduced in 1999, the Global Sullivan Principles are an extension to the original Sullivan Principles, which were developed by the late Reverend Leon H. Sullivan in 1977 as a voluntary code of conduct for companies doing business in apartheid South Africa. The underlying principles are economic, social and political justice by companies; human rights and equal opportunity for all employees including racial and gender diversity on decision-making committees and boards; training and development; greater tolerance and understanding; improvement in quality of life for communities with dignity and equality.
- **Asian-Pacific Economic Cooperation (APEC) Business Code of Conduct:** APEC is known as the primary international organization for promoting open trade and economic cooperation among 21 member countries. The APEC Code is based on a variety of other internationally recognized codes and standards and it is designed to supplement and support companies' existing codes of conduct. Besides, the APEC Code addresses policy recommendations to APEC country governments.

➤ Examination Questions

1. Answer Yes/No (Correct/Incorrect) with brief reasons:-
 - (a) Company management has responsibility only towards its shareholders [Nov 2007]
 - (b) The Governance Model positions management as accountable solely to investors. [Nov 2008]
 - (c) In the long run those business firms which do not respond to society's needs favorably will survive. [Jun 2009]
 - (d) Trusteeship provides a means of transforming the present capitalist order of society into an egalitarian one. [Nov 2010]
2. What is meant by 'Corporate Governance'? State the major 'characteristics' of good corporate governance. [Nov 2007]
3. Explain the role played by different committees in regulating the 'Corporate Governance'. [May 2008]
4. What is Corporate Social Responsibility? Why it is needed in Indian Business environment? [May 2007]
5. State the benefits of socially responsible corporate performance. [May 2008]
6. Explain the meaning of the "Iron Law of Responsibility". State the resulting benefits which may be acquired by achieving the long-term objectives through the business activities. [Nov 2009]

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7. What is meant by 'Corporate Governance'? Explain the benefits of Good Corporate Governance. [**May 2010**]
8. Explain briefly the key strategies which can be used at the time of implementation of Corporate Social Responsibility policies and practices in a company. [**Nov 2010**]

Chapter 3

Workplace Ethics

3.1 Workplace Ethics

Meaning of workplace ethics

- Work place ethics is **how one applies values to work** in actual decision making, a set of right and wrong actions that directly impact the work place.
- Ethical decision in an organization is influenced by 3 factors:
 - (i) **Individual moral standards** – When a person himself has good morals, he will not only carry the same to an organization but also set a good example to fellow workers.
 - (ii) **Influence of managers & co-workers** – If the seniors and colleagues behave in an ethical manner, an individual is bound to follow the compliance.
 - (iii) **Opportunity to engage in misconduct** – Any opportunity to indulge in unethical activities encourages other employees to follow the same.
- The behavior of business person towards customers, suppliers & others in their workplace also generates ethical concerns.
- Ethical behavior within a business involves keeping secrets, meeting obligations & responsibilities and avoiding undue pressures that may force others to act unethically.
- Hence, a clear code of conduct **practiced at the highest level, fairness & honesty in its dealings** with the stakeholders and **prohibition of any discrimination & harassment** are the characteristics of highly ethical workspace.

Importance of workplace ethics (Benefits of workplace ethics)

If an employer does not take steps to create a work environment where the employees have a clear, common understanding of what is right & wrong, feel free to discuss & ask questions about ethical issues & reports violations, significant problems could arise which are as follows:-

1. Increased risk of employees making **unethical decisions**
2. Increased tendency of employees to **report violations to outside regulatory authorities** because they lack an adequate internal forum
3. Inability **to recruit and retain top people**
4. **Diminished reputation** in the industry and the community
5. **Significant legal exposure** and loss of competitive advantage in the marketplace

Measures to ensure ethics at workplace (Creating an Ethical Environment)

1. **Ensuring employees are aware of their legal and ethical responsibilities**
 - **Code of conduct**, Ethics Manual
 - Establish open **communication**
 - Use of **cross-functional teams** when developing & implementing the ethics management program
2. **Providing a communication system for reporting non compliance** – so that anyone can report without fear
 - Counselors, Mentors
 - Ombudsman
 - Help-lines
 - Whistle-blowers



- Include a **grievance policy** for employees
- 3. **Make ethics decisions in fair and transparent manner**
 - Taking decisions in group
 - Making decisions public
 - Creating an **atmosphere of trust**
- 4. **Integrate ethics management** with other management practices
 - Appreciation and rewards
 - Setting examples by conduct
- 5. Regularly **updating of policies & procedures**

3.2 Ethical Issues at workplace

- (1) Relationships with suppliers and business partners
 - Bribery, gifts and grafts
 - Partial treatment between suppliers
 - Immoral decision making in selection and keeping of contracts
- (2) Relationship with customers
 - Manipulative and unfair pricing
 - Defrauding customers
 - Incorrect and misleading advertising
- (3) Relationship with employees
 - Discrimination in hiring and handling of employees
 - Harassment at workplace
- (4) Management of resources
 - Misuse of employer's funds
 - Embezzlement and offences involving moral turpitude
 - Tax evasion
 - Disclosing organization's confidential information

Conflict of Interest

- Conflict of interest exists when an individual is confronted with decision making between self-interest and organization-interest.
- It is when the personal interest of an employee comes into conflict with an obligation to serve the interest of other.
- The conflict of interest can be of four types:-
 - (a) **Biased judgment** – When decision is made not on merits but for some other consideration
 - (b) **Direct Competition** – When an employee engages in direct competition with employer
 - (c) **Misuse of position** – When a person makes use of his official position to further his personal interests (even if no harm is caused to employer)
 - (d) **Violation of confidentiality** – When a person uses the information acquired in confidence from employer or its clients for personal benefits.

Managing Conflict of Interest

1. **Objectivity** – Strong commitment to business objectives
2. **Avoidance** – Any interest which impairs judgment should be avoided
3. **Alignment** – Conflicting interests which are unavoidable are aligned by introducing new interests
4. **Disclosure** – Forewarning of consequences, requirements of disclosure act as a deterrent
5. **Policies and Rules** – Company policies such as non-acceptance of gifts etc.
6. **Independent evaluation and judgment** – A third party independent evaluation of transaction
7. **Structural changes** – Following separate functions/departments, transfer policies etc.

3.3 Discrimination and Harassment

Meaning of Discrimination

- To discriminate means to differentiating one object from another.
- Discrimination in workplace involves the following three components:-
 1. Taking decision against some person which is not based on merits
 2. Taking decision on the basis of racial, sexual, religion, age or handicap prejudice
 3. The decision is causing loss or injury to the person subjected to such decision

Discriminatory Practices in workplace

1. **Recruitment Practices:** If the firm employs people selectively only on the basis of referrals, from a particular racial or sexual group, or expressly do not employ people from minorities or women etc.
2. **Screening Practices:** If the organization filters people on some criteria which are not relevant to the requirements of the job.
3. **Promotion & Transfer Practices:** If the promotion, job progression or transfer of an employee is based on caste, creed, sex or any other criteria other than merits.
4. **Condition of Employment:** If the salary or wages are paid differently or different work environment is given to people from different race or religion or sex for the similar task being performed by them.
5. **Dismissal:** Termination of an employee on the basis of race or sex is a clear form of discrimination.

Meaning of Harassment

- Harassment is “tormenting by subjecting to constant interference or intimidation”.
- It creates a negative work environment where work is extracted from the employees by intimidating them and using coercive measures to get job done.

Harassment in workplace

1. **Racial Harassment:** Racial Harassment includes offensive written or physical conduct at the characteristics of a person's race, entire or national origin name or colour. It also includes derogatory name calling racist jokes & so on.
2. **Sexual Harassment:** Sexual Harassment means situations in which an employee is coerced into giving into another employee's sexual demands by the threat of losing some significant job benefit, such as promotion, raise or even the job.
3. **Sexual harassment is a very serious offence which is prohibited** and an employer is held responsible for all sexual harassment engaged in by employees regardless of whether the employer knew or should have known the harassment occurring & regardless of whether it was forbidden by the employer. In order to prevent sexual harassment the following actions are undertaken by an organization:-
 - (a) Implementing Sexual Harassment Policy
 - (b) Communicating the Policy
 - (c) Establishing managing procedures
 - (d) Taking Appropriate Action against defaulters

➤ Examination Questions

1. Answer Yes/No (Correct/Incorrect) with brief reasons:-
 - (a) Promotion policies based on individual merit and not purely on the basis of seniority is discriminatory. **[May 2008]**
 - (b) Ethical behavior is not essential to work environment at the workplace. **[Jun 2009]**
2. Explain in brief the measures to ensure ethics in the Work place. **[May 2007]**
3. State, how far a sound ethical environment in a company may be created and corporate scandals may be avoided. **[Nov 2008]**

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4. Explain the factors that influence ethical behavior of an employee. List out some examples of various ethical issues faced in a workplace. [**Jun 2009, Nov 2010**]
5. Explain the importance of ethical behavior at the workplace. [**Nov 2009**]
6. Write a note on harassment at workplace. [**Nov 2010**]

Chapter 4

Environment Ethics

4.1 Environment Ethics

- Globalization continues to unleash far-reaching changes. The biggest benefit of globalization has been the rise of companies and economies and the consequent creation of jobs.
- However, the most telling consequence of development has been the deterioration of the environment.
- As a responsible corporate citizen, an organization has to treat environment as a participant and a beneficiary of progress.
- As business expands, the **carbon footprint** needs to be limited.
- **Environmental ethics is a larger issue** that concerns ethical behavior of an organization.
- Environmental ethics goes beyond the problems relating to protection of environment or nature in terms of pollution, resource utilization or waste disposal.
- Industries that are based on natural resources like minerals, timber, fiber & foodstuffs, etc. have a special responsibility:-
 - To adopt **practices that have built in environmental consideration**
 - To introduce process that **minimize the use of natural resources & energy** reduce waste and prevent pollution.
 - Make products that are **environment friendly** with minimum impact on people & ecosystem.
 - Adopt **Green Accounting** Systems

Business as part of Ecological System

- The corporate world, the industry or others engaged in the use of natural resources or environment services are closely linked with environment and natural resources.
- Business organizations depends on natural environment for their energy, material resources and waste disposal and that environment in turn is affected by the commercial activities of business firms.
- So all business firm must ensure that their activities do not injure the ecological system. This resolve is called **ecological ethics**.
- It is based on the idea that the environment should be protected not only for the sake of human beings but for non-human parts of the eco-system for their own sake.
- Hence, as ecological systems are interrelated & affected by business; business forms an important part of it.

4.2 Sustainable Development

- Sustainable development refers to **maintaining development without compromising the ability of future generation** to meet their own needs.
- Every country or society needs to understand that while fulfilling own social, economic and other requirements, we must not jeopardize the interest of future generations.
- We know that there cannot be any economic growth without ecological costs. High economic growth means high rate of extraction, transformation and utilization of non-renewable resources.

Therefore, increased development and higher GDP is generated at the cost of environmental damage and resource depletion.

- Hence, in charting out any development program the organization must include an element of **resources re-generation** and **positive approach to environment**.
- Environment management should be a priority area & a key determinant to sustainable development for any business organization.

Key Areas of sustainable development

- Inter-city redevelopment
- Rural development
- Clean, efficient and sustainable transportation system
- Conservation of natural resources
- Energy conservation
- Ecosystem management
- Green Buildings
- Prevention of pollution
- Waste reduction and Waste management
- Recycling of resources
- Preservation of natural beauty and wildlife habitat

4.3 Pollution and Resource Depletion

- Pollution refers to the **undesirable and unintended contamination of the environment** by the manufacture or use of commodities.
- Resource depletion refers to the consumption of finite or scarce resources.
- In a certain sense, **pollution is also a type of resource depletion** because contamination of air, water, or land diminishes their beneficial qualities.
- **Main forms of pollution**
 1. Air pollution
 2. Water pollution
 3. Land pollution
 4. Fossil Fuel Depletion

Global Warming

- Greenhouse gases most importantly **carbon dioxide** occur naturally in the atmosphere to absorb and hold heat from the sun, preventing it from escaping back into space, to maintain earth's temperature so that life can evolve and flourish.
- However, due to increased industrialization the greenhouse gases have been released far more than required into the atmosphere, particularly by the burning of fossil fuels such as oil and coal.
- This has caused rise in the levels of greenhouse gases and resulting in increasing amounts of heat, raising temperatures around the globe.
- **Increase in Global Warming has caused following complications:-**
 1. Higher Temperatures
 2. Variable climatic conditions
 3. Melting of glaciers
 4. Rise in sea levels
 5. Oceans becoming acidic & destruction of marine life
 6. Reduced agricultural and animal species and yields
 7. Increased and severity of diseases
 8. Increased droughts
- **To restrict global warming the two main initiatives are:-**



- (a) 1992 – The United Nations Framework Convention on Climate Change
- (b) 1996 – Kyoto Protocol (Reduction by 5% in emission by developed countries by 2012)

Ozone Depletion

- Ozone is a layer in the lower stratosphere which screens all life on earth from harmful ultraviolet radiation.
- This ozone layer, however, is destroyed by CFC gases used in aerosol cans, refrigerators, air conditioners, industrial solvents, and industrial foam blowers.
- Shrinking of ozone layer causes increase of ultraviolet rays which in turn will **increase in:-**
 1. New and severe skin cancers
 2. Eye diseases
 3. Destruction of major crops sensitive to UV rays
 4. Destruction of food for marine life
 5. Destruction of terrestrial plants
- Restrictions in ozone depletion achieved by:-
 - (a) 1985 – Convention on Ozone depletion at Vienna
 - (b) 1989 – Protocol on substances that deplete ozone at Montreal
- It is believed that if above international agreements are adhered to; the ozone layer is expected to recover by 2050.

Acid Rain

- Acid rain is a threat to the environment that is caused by combustion of fossil fuels (oil, coal, and natural gas) used by utility companies to produce electricity.
- Burning fossil fuels releases large quantities of harmful gases into the atmosphere.
- These gases combined with water vapors become harmful acidic water which comes back in form of rain and not necessarily on the sources from where it originated.
- This is soaked back into soils and falls directly on trees and other vegetation.
- **The following are the effects of acid rain:-**
 1. Damage to species of fish and other aquatic organisms
 2. Lakes and rivers that have become highly acidic
 3. Damages forests and indirectly destroys the wildlife and species
 4. Contamination of drinking water
 5. Corrosion and damage to buildings, statues, and other objects

Need to control pollution

1. To prevent health hazards
2. To save environment
3. To prevent economic loss
4. To avoid natural disasters

4.4 Conservation of Natural Resources

- Conservation refers to the strong or **rationing of natural resources** for later uses.
- Environment protection should be always in mind while achieving economic growth.
- If companies redesigned products & adopt latest technologies available; they can achieve the goals of reduction in wastage & conservation of resources.
- **Eco friendly technologies** throughout the product life cycle & maximization of waste play major role in protecting the environment & conservation of resources.
- **Conservation** is the only way of ensuring a supply for tomorrow's generations.
- Accordingly, waste management can be achieved by:-
 1. **Minimum waste production**

2. **Maximizing re-use of waste and recycle it**
3. **Promoting environmentally sound waste disposal practices.**

4.5 Benefits of Eco-Friendly Practices

1. The goals of **reduction in wastage & resources** depletion can be achieved.
2. Incorporating environmental issues in the process of developing a product improves **corporate performance**.
3. **Eco friendly practices** results in **more savings**. e.g. Process of recycling of the waste.
4. Business firms will be able to **create wealth** if they respond to the challenges of sustainable development as unsustainable products will become obsolete.
5. Proper environmental costs can be reflected with the help of green accounting system & even consumer would adjust market behavior in a way that would **reduce damage to environment**.
6. Business firms using eco friendly practices will gain **competitive knowledge**.
7. Sound management of wastes is among the major environmental issues maintaining the quality of environment and achieving **sustainable development**.

4.6 Green Accounting

- Green Accounting system basically focuses on deficiencies in conventional accounts with respect to the environment.
- It makes efforts to see that environmental costs are properly reflected in the prices paid for goods & services.
- As a result companies & consumers would adjust market behavior in a way that would reduce damage to environment & decrease pollution and waste products.
- Price signal will also influence human behavior to avoid exploitation or excessive use of natural resources.
- Such measures will facilitate the approach of “**3Ps - Polluter, Pay, Principles**” & thus avoid policy decisions which are non-sustainable for the country.

4.7 Developments in India

- Chipko movement to prevent felling of trees (1973)
- Air (Control and Prevention of Pollution) Act 1981
- Amendment of Factories Act, 1948 to include provisions for preventing pollution
- Central Pollution Control Board and similar Boards in each state
- Approval from Pollution Board and regular certification audits
- Emission Norms prescribed for smoke, gas and other effluents
- Smoking banned in public places
- Ban on use of recycles plastic bags
- Amendments in Motor Vehicles Act to specify and adhere to emission norms

➤ Examination Questions

1. Answer Yes/No (Correct/Incorrect) with brief reasons:-
 - (a) Depletion of Ozone layer will have adverse effect on human beings and not on vegetation. [**May 2008**]
 - (b) Business does not sub-serve environmental ethics. [**Nov 2008**]
 - (c) Water pollution is also a kind of resource depletion. [**Nov 2008**]



- (d) There is no economic growth without ecological costs. [**Jun 2009**]
 - (e) Corporate Social Responsibility is closely linked with the principles of sustainable development. [**May 2010**]
 - (f) A good environmental practice improves corporate performance. [**May 2010**]
 - (g) Business and industry are closely linked with environment and resource utilization. [**Nov 2010**]
2. What is meant by 'Sustainable Development'? State the special responsibilities of the industries that are based on natural resources. How the adoption of Green Accounting System helps in avoiding policy decisions which are non-sustainable for the country? [**May 2007**]
 3. What is meant by 'Environmental ethics'? How does its non-adoption leads to 3 Ps Viz., Polluter, Pay and Principles? Explain. [**Nov 2007**]
 4. Explain how corporate social responsibility minimizes the ecological damage and helps in achieving long-term objectives, so that the business may gain long-term profit maximization. [**Nov 2008**]
 5. Explain the concept of Green Accounting System. [**May 2010**]

Chapter 5

Ethics in Marketing

5.1 Ethics and Marketing

Reasons for Ethics in Marketing

1. **Public confidence in marketing:** Unethical practice such as misleading package labels, false claim in advertisements, infringements of well establishment trademarks, etc. not only declines public confidence in marketing but also damages reputation of all marketers. To reverse this situation, Companies must set high ethical standards & enforce them in consumer's interest as consumers are lifeblood of business.
2. **Government regulations:** Most of the governmental control and limitation on marketing is the results of management's failure to live up to its ethical responsibilities at one time or other.
3. **Social power:** Marketing executives hold and use a great deal of social power as they influence market & speak out on economic issues. However, there are responsibilities tied to this power & if marketers do not use their power in a socially acceptable manner then that power will be lost in long run.
4. **Image of the organization:** Buyers often form an impression of an entire organization based on their contact with one person & mostly that person represents the marketing functions.

5.2 Healthy Competition

Meaning of Competition

- Competition is a situation in a market in which firms or sellers independently strive for the buyer's patronage in order to achieve a particular business objective. e.g. Profit, Sales or Market share. [World Bank, 1999]
- Pre-requisite for good competition is trade. Trade is the unrestricted liberty of every man to buy, sell and barter, when, where and how, of whom and to whom he pleases.
- In an unregulated free market, the owner of goods can withhold them from market in order to extract a high price.
- Therefore, the solution lies in increasing competition so that there is more number of sellers. It is the only way to protect the interest of ultimate consumer.

Competition Policy and Law

- The economic reason of a competition policy is the **preservation and promotion of the competitive process**.
- It encourages **efficiency in the production and allocation of goods and services** over a period of time through its effects on innovation and adjustment to technological change.
- In an effective competitive environment, the sellers will have equal opportunities to compete and therefore, the quality of output will determine sustainability and success in the market by meeting consumers demand at the lowest possible cost.
- The result of a competition policy is a Competition Law.

Competition Laws in US & UK

- USA – 3 major federal anti-trust laws

1. The Sherman Act passed in 1890 aimed at restraint of trade and monopolization of interstate & foreign commerce
2. The Clayton Act passed in 1914 to overcome the failures of Sherman Act. It attempts to nip monopolize in the business by specifying practices that monopolists used to gain monopoly power
3. The Federal Trade Commission Act, 1914 to prohibit unfair methods of competition
- UK - The UK Competition Act 1988 which came into force in 01.03.2000 aimed at prohibiting the agreements with the objective of preventing, restricting of distorting competitions which directly or indirectly fix prices, trading conditions limit/control products, markets sources of supply.

Competition Law in India – Competition Act, 2002

History – Monopolies and Restrictive Trade Practices Act, 1969

- Based on recommendations of Monopolies Enquiry Commission, 1965, MRTP Act was enacted in 1969 and MRTP Commission was set up in 1970.
- The objectives of the MRTP Act have been as follows :-
 - (a) to **prevent concentration of economic power** to the common detriment and **control of monopolies**;
 - (b) to **prohibit monopolistic trade practices**; and
 - (c) to prohibit **restrictive trade practices** and **unfair trade practices**.
- The role of the MRTP Commission in regard to control of monopolistic trade practice was investigatory and advisory to Central Govt.
- After the adoption of economic reforms programme since 1991, the MRTP Act lost its relevance was finally repealed w.e.f. 1.9.2009.

Present – Competition Act, 2002

- Central Government appointed a committee under the chairmanship of SVS Raghvan which submitted its report in May, 2000, proposing scrapping the MRTP Act and enactment of a new Competition Law.
- **The Competition Act, 2002** which passed on 13th January, 2003 is a step towards harmonizing international trade policy.
- **The Competition Act overrides any other law and shall be in addition to, and not in derogation of, any other law for the time being in force.**
- **The Acts objective** is to provide:-
 1. For establishment of a commission to prevent **practice having adverse effect on competition**.
 2. To **promote & sustain competition** in market
 3. To **protect the interest of consumers**
 4. To ensure **freedom of trade carried on by other participants** in markets
- **Parameters of Competition Law:-**
 - (a) Prohibition of certain agreements considered to be anti-competitive in nature.
 - (b) Exploitation of dominant position by imposing unfair conditions and restricting production of goods and services.
 - (c) Regulation of combinations which causes or likely to cause an adverse effect on competition within India; such combinations are considered to be void.
- Section 3 of Competition Act provides that no enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India. Any agreement entered into in contravention of this provision shall be void.
- Any agreement entered into between competitors which
 - (a) **directly or indirectly determines purchase or sale prices**;



- (b) **limits or controls production**, supply, markets, technical development, investment or provision of services;
- (c) shares the market or source of production or provision of services by way of allocation of geographical area of market, or type of goods or services, or number of customers in the market or any other similar way; and
- (d) **directly or indirectly results in bid rigging or collusive bidding**; shall be presumed to have an appreciable adverse effect on competition.
- This also includes the following agreements:
 - (a) tie-in arrangement;
 - (b) exclusive supply agreement;
 - (c) exclusive distribution agreement;
 - (d) refusal to deal; and
 - (e) re-sale price maintenance.

5.3 Consumer Welfare

Consumer Interest and Public Interest

- Consumer interest and public interest are considered synonymous but they are actually different.
- Consumer is a member of a broad class of people who purchase, use, maintain and dispose of products and services. Consumer's interests are affected by pricing policies, financing practices, quality of goods and services and various trade practices.
- Public interest, on the other hand, is something in which society as a whole has some interest.
- Governmental policies may be formulated in the 'public interest' but which may not be in the ultimate interest of the consumers. For example, a farmer wants the price of goods he consumes to be as cheap as possible but wants the highest price for his produce.

UN Guidelines for consumer interests

- The UN guidelines has call upon governments to develop, strengthen & maintain a strong consumer policy and provide for enhanced protection of consumers by enunciated various steps & measures around **8 themes**:
 1. Physical safety
 2. Economic interest
 3. Standards
 4. Essential goods & services
 5. Redress
 6. Education and information
 7. Specific areas concerning health
 8. Sustainable consumption
- The **Consumer rights recognized by UN** guidelines can be used as touchstones for assessing the consumer welfare implications of competition policy & law and to see how they help or obstruct the promotion of these rights.
 1. Right to Basic needs
 2. Right to Safety
 3. Right to Choice
 4. Right to Representation
 5. Right to Redress
 6. Right to Information
 7. Right to Consumer Education
 8. Right to Healthy environment

5.4 Consumer Protection in India

Consumer Protection Act, 1986

- After studying the consumer protection laws in UK, USA, Australia, Consumer Protection Act, 1986 was enacted in India to offer protection to the consumers.
- Unlike other laws which are punitive or preventive in nature, the provisions of this Act are compensatory in nature.
- The Act intends to provide simple, speedy and inexpensive redressal to the consumer's grievances.
- **Definition of Consumer under Section 2(1)(d) of Consumer Protection Act, 1986:**
 - Consumer means a person who buys any goods or services for a consideration. It also includes any other user of such goods or services when such use is made with the approval of the buyer. But it does not include a person who obtains such goods or services for resale or for any commercial purpose.

Definition of Consumer – Section 2(f) of Competition Act, 2002

- “Consumer” means any person who –
 - (i) **buys any goods for a consideration** which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and **includes any user of such goods** other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment when such use is made with the approval of such person, **whether such purchase of goods is for resale or for any commercial purpose or for personal use;**
 - (ii) **hires or avails of any services** for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and **includes any beneficiary of such services** other than the person who hires or avails of the services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first-mentioned person whether such hiring or availing of services is for any commercial purpose or for personal use.

Difference between definition of Consumer under Competition Act and Consumer Protection Act

- The major difference in definition of Consumer under Competition Act vis-à-vis Consumer Protection Act is that while in Competition Act, Consumer includes a person who buys goods or services for own consumption or for resale or for any commercial purpose, whereas in Consumer Protection Act, Consumer does not include a person who obtains such goods or services for resale or for any commercial purpose.

Example

A retailer was purchasing goods regularly from XYZ Ltd. for the purpose of resale. There were defects in the goods in one of the lot purchased and as a result the retailer suffered loss of his share in competition. The retailer sued the said company for this reason. The company contended that the goods were purchased for the purpose of resale and therefore, not bound. Is it a valid contention? Explain clearly the provisions of Competition Act, 2002 in this regard.

Answer

Whether purchase of goods is for resale or for any commercial purpose or for personal use, the purchaser is a consumer under Competition Act, 2002. Therefore the contention of XYZ Ltd. is not valid and not tenable.

Consumer Protection Councils in India

- In India, we have 3-tier structure of Consumers Councils at Central, State & District levels which are as follows:
 1. The Central Consumer Protection council at Central level



2. The State Consumer Protection council at State level
3. The District Consumer Protection council at District level
- The **objects of the consumer protection councils** shall be to promote & protect the rights of the consumers at their representative levels which are as follows:
 - (i) **Safety** – Right of protection against marketing of goods which are hazardous to life & property.
 - (ii) **Information** – Right of information about the quality, quantity, purity, standard & price of goods & services.
 - (iii) **Choice** – Right to access to variety of goods & services at competitive prices.
 - (iv) **Hear** – Right to be heard and to be assured that consumer's interest will receive due consideration at appropriate terms.
 - (v) **Redress** – Right to redress against unfair trade practices.
 - (vi) **Education** – Right to seek consumer education.

➤ Examination Questions

1. Answer Yes/No (Correct/Incorrect) with brief reasons:-
 - (a) Consumer purchases goods and health services for personal purposed only. [May 2007]
 - (b) Consumer and Public interest are both synonymous. [May 2007, Jun 2009]
 - (c) Ethics are necessary in marketing to build Brand image only. [May 2007]
 - (d) Competition Act, 2002 protects the interest of consumers. [Nov 2007]
 - (e) Ethical behavior in marketing is necessary to avoid Government intervention/ regulation. [May 2008]
 - (f) Consumer for personal use and consumer for commercial use are synonymous. [Nov 2008]
2. Explain the extent to which it is possible to observe ethical behavior in marketing. Also explain in brief the merits and demerits of the above. [May 2008]
3. A retailer was purchasing goods regularly from XYZ Ltd. for the purpose of resale. There were defects in the goods in one of the purchase lot and as a result the retailer suffered loss of his share in competition. The retailer sued the said company for this reason. The company contended that the goods were purchased for the purpose of resale and therefore, not bound. Is it a valid contention? Explain clearly the provisions of Competition Act, 2002 in this regard. [Nov 2008]
4. Explain the pragmatic reasons for maintaining ethical behavior in marketing through marketing executives. [Nov 2009]
5. State the objectives of the Central Consumer Protection Council in India. [Nov 2010]

Chapter 6

Ethics in Accounting and Finance

6.1 Ethics in Accounting & Finance

Importance of Ethics in Accounting and Finance

- Finance and Accounts is the only business function which accepts responsibility to act in public interest.
- Not only finance & accounts professional is supposed to observe ethical behavior in performing his duties to the organization, he is also responsible to other stakeholders such as Shareholders, Regulators and Government.
- However, scandals involving financial regularities in companies such as Enron, WorldCom, Quest, Xerox and lately Satyam put a question mark on the ethics observed by Finance Professionals.

Potential Conflicts face by Finance & Accounts Professional

- **As consultant/auditors in public practice** – A practicing professional should take adequate care to identify situation that could pose a conflict of interest. If not followed, they may give rise to threat to comply with the fundamental principles and violation of professional code of conduct.
- **As an employee** – An employee is also under an professional obligation to comply with the fundamental principles laid down by the organization. Situations where superiors or the top management may apply pressure on the employees to perform activities are:-
 1. Contrary to law or regulation
 2. Contrary to technical or professional standards
 3. Facilitate unethical or illegal earnings management strategies
 4. Mislead others, intentionally or otherwise others (Auditors, regulators etc.)
 5. Issue, or otherwise be associated with, a financial or non-financial report that materially misrepresents the facts
 6. Obstruct tax or legal compliances

Reasons for Unethical Behavior

1. **Emphasis on short term results:** Company's manipulated accounting entries to depict good profitability in order to raise further capital from the market. This is one of the primary reasons for downfall of companies like Enron, WorldCom, Satyam, etc.
2. **Ignoring small unethical issues:** Tolerance of small lapses lead to larger problems. So, the companies should develop an environment where small ethical lapses are taken seriously so that they are not repeated in the future.
3. **Economic cycles:** To prevent disclosure of ethical problems in times of depression, companies should be extremely careful & vigilant during good times. It must ensure itself that the effect of depression on the company's financial statements will be limited & company will be able to bear losses & at the same time it makes the situation acceptable for the share holders.
4. **Complex Accounting Rules:** In the era of globalization, accounting rules are changing faster & becoming more complex. It becomes difficult to identify deviation from these complex set of requirements. The difficulty associated with identifying abuse is the reason which may promote unethical behavior.

6.2 Fundamental Principles relating to Ethics in Finance and Accounts

Principle of Integrity

- Integrity means “adherence to moral and ethical principles”. Professional has to adhere religiously to honesty and straight forwardness while disclosing their representative professional duties. The following act of responsibility would help to comply with the integrity principles.
 - Avoid activities which could affect goodwill of an organization.
 - Refuse to get involved in activities which could adversely affect the achievement of organization objectives.
 - Communicate adverse and favorable information with those concerned.
 - Avoid conflicts.
 - Refuse favors or gifts which could influence action taken or to be taken.

Principles of Objectivity

- According to this principle accounting and finance professionals should not allow bias, personal views, conflicting interest and undue influence of themselves or other to override business judgment. They should communicate information fairly and objectively in a transparent manner.

Principles of Confidentiality

- This requires accounting & financial professional to refrain from disclosing confidential information related to their work. Such information may be however disclosed to:
 - (a) Subordinates & ensure that they too maintain confidentiality &
 - (b) When under legal obligation or because of some statutory ruling

Principles of professional competence & due care

- Finance & accounting professional need to update their skills and knowledge from time to time and shall ensure the client or employers receive competent professional services based upon current developments in the related areas.

Principles of professional behavior

- This principle requires accounting & finance professional to comply with relevant laws and regulations and avoid such actions which may result into discrediting the profession.

6.3 Ethical Threats in Accounting & Finance

1. **Self Interest Threat** - May occur as the result of the financial or other interest of finance and accounting professional or of immediate or close family members.
2. **Self-review Threat** - May occur when a previous judgment needs to be reevaluated by the finance and accounting professional responsible for that judgment
3. **Advocacy Threat** - May occur when professional promotes a position or opinion to the point that subsequent objectivity may be compromised.
4. **Familiarity Threat** - May occur when professionals has close relationship in the work environment & such relationship impair his selfless attitude towards work.
5. **Intimidation Threat** - May occur when a professional may be prohibited from acting objectively by threats, actual or perceived.

Examples of Ethical Threats

Threat	As an Employee	As an auditor or consultant
Self-Interest	• Financial interests, loans and guarantees in the company the professional is working. • Incentive compensation arrangements	• A financial interest in a client or jointly holding a financial interest with a client. • Undue dependence on total fees from



	• Inappropriate personal use of corporate assets. • Concern over employment security. • Commercial pressure from outside the employing organization.	• a client. • Having a close business relationship with a client. • Concern about the possibility of losing a client. • Potential employment with a client. • Contingent fees relating to an assurance engagement.
Self-review	• Review and justification of business decisions/data is done by same person who has prepared data or taken decision.	• The discovery of a significant error during a re-evaluation of the work • Reporting on the operation of financial systems after being involved in their design or implementation. • A member of the assurance team being, or having recently been, a director or Officer of that client.
Advocacy	• Making false or misleading statements with the intention of promoting organization's position	• Promoting shares in a "listed entity" when that entity is a consultancy or a financial statement audit client. • Acting as an advocate on behalf of an assurance client in litigation or disputes with 3rd parties.
Familiarity	• Financial reporting or business decisions influencing in favour of a family member • Long association with business contacts influencing business decisions. • Acceptance of a gift or preferential treatment, unless the value is clearly insignificant.	• A member of the engagement team having a close or immediate family relationship with a director or officer of the client (or with employee who can exert influence) • Accepting gifts or preferential treatment from a client, unless the value is clearly insignificant. • Long association of senior personnel with the assurance client.
Intimidation	• Threat of dismissal or replacement or of immediate family member over a disagreement about the application of an accounting principle or the way in which financial information is to be reported for external use as well as for decision making purposes. • A dominant personality attempting to influence the decision making process, for example with regard to the exclusion of irrelevant costs from projected cost estimates	• Being threatened with dismissal or replacement. • Being threatened with litigation. • Being pressured to reduce inappropriately the extent of work performed in order to reduce fees.

6.4 Safeguards to reduce or eliminate Ethical Threats

Safeguards created by profession, legislation or regulation

1. Corporate governance regulations
2. Professional or regulatory monitoring & disciplinary procedures

3. Educational training & experience requirements for entry into the profession
4. Professional standards
5. Continuing professional development requirements
6. External review by a legally empowered third party of the reports, returns, communications or information produced by concerned professionals

Safeguards in work environment

1. Strong internal controls
2. Appropriate disciplinary process
3. Organization's ethics & conduct programs
4. Performance evaluation Policies & Procedures
5. Recruitment procedures emphasizing the importance of employing high caliber competent staff
6. Top Management and Leadership that stresses the importance and expects ethical behavior
7. Communication of organization's policies and procedures and its training and education
8. Transparent and open environment to encourage employees to freely communicate any ethical issues or concerns without fear.

6.5 Ethical Conflict Resolution

- While evaluating compliance with the fundamental principles, finance and accounting professional may be required to resolve a conflict in the application of fundamental principles.
- The following **factors needs to be considered** either individually or together with others, during a conflict resolution process:
 1. Relevant facts
 2. Ethical issues involved
 3. Fundamental principles related to matter in question
 4. Established internal procedure
 5. Alternative course of action
- Having considered these issues, a professional should determine the **appropriate course of action** that is consistent with fundamental principles identified & weight the results of each possible course of action.
- If the matter remains unsolved, the professional should take following steps:
 - (a) **Consult** the appropriate person within the firm or employing organization for help in obtaining resolution.
 - (b) The appropriate person will be one who is responsible for governance of the organization, such as Board of Directors.
 - (c) It may be in the best interest of the professional to **document the detail** and the substance of issue.
 - (d) If a significant conflict cannot be resolved, **obtain advice** from the relevant professional body or legal advisors. However, due care must be taken so as to avoid any breach of confidentiality.
 - (e) If after all relevant possibilities, the ethical conflict remain unresolved, it is appropriate to **withdraw** from the engagement team or specific assignment or to resign altogether from the engagement team, the firm or the employing organization.

➤ Examination Questions

1. Answer Yes/No (Correct/Incorrect) with brief reasons:-
 - (a) Window-dressing of financial statements will not be useful in the long run. [Nov 2007]
 - (b) Ensuring fair treatment to whistle blowers will help in creating good ethical accounting environment in a business enterprise. [May 2008]



2. Consumer Explain briefly the matters to be considered and the steps that may be taken by a Finance and Accounting professional when he is required to resolve an ethical conflict in the application of Fundamental principles. [**May 2007**]
3. Finance and accounting professionals working as employees in an organization have to face various threats which make it difficult for them to comply with fundamental principles relating to ethics. Explain the safeguards in the work environment which may be created by a business enterprise to overcome such threats. [**Nov 2007, May 2010**]
4. Self interest threats may occur as a result of financial or other interests of finance and accounting professional. Give three examples each of such threats when the accounting professional is working as-
 - (i) An auditor or consultant
 - (ii) An employee in a company. [**May 2008**]
5. Explain the reasons for unethical behavior among finance and accounting professionals. [**Jun 2009**]

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