

MANAGEMENT ACCOUNTING – RISK AND CONTROL STRATEGY

Martin Corboy discusses frameworks for tackling ethical dilemmas and proposes a five-step approach to answering questions on the subject.



The examiners for paper P3 stress the need for students to appreciate how the various elements of the syllabus interlock. If an organisation's senior managers need to make strategic choices so that it can reach its targets, they will require control systems to guide it towards the intended destination. The risks that the organisation will face on that journey are numerous. A variety of control systems can be used to reduce those risks to an acceptable level, if not eliminate them. They include HR controls, whereby employees are properly trained and motivated to do the right things. They also include mission statements and corporate cultures and management styles. A company's internal code of conduct is another critical control system, but students must also understand the role of ethical codes in the management accountancy profession and how to use them to deal with the kinds of ethical dilemmas that many of them will inevitably face in their work.

There has been much academic discussion on how to formulate an ethical approach to solving such problems. I

particularly like the so-called *Mirror test*. This suggests that, if you want to determine whether a proposed course of action is ethical or not, ask yourself how you'd feel if it were reported on the front page of this newspaper and became public knowledge. Would it cause you any embarrassment? Would it embarrass your employer or client, your family or friends, your fellow CIMA professionals or the wider accounting community? If you think it would, it may be that the plan is not ethical and needs to be reconsidered.

Other useful frameworks include the "virtue test" (how would a virtuous person whom I look up to react in my situation?) and the so-called Biblical golden rule: do unto others as you would have them do unto you.

Of particular relevance to management accountants is the social contract theory – ie, that accountants have a contract with society – given the emphasis that IFAC's and CIMA's codes of ethics place on the duty of accountants to serve the public interest first and foremost. Again, this can be useful while assessing options in an ethical dilemma.

Another practical framework, identified by Gerry Johnson, Kevan Scholes and Richard Whittington in *Exploring Corporate Strategy* (Prentice Hall, 2005), consists of the following four principles:

- **Principle of investigation.** You should ascertain all the facts to understand exactly what is going on. This is always critical, as there are often grey areas and there may be conflicting stories about what actually happened. In any situation involving fraud, it's especially important to investigate how it was committed, who was involved and what internal controls – if any – were breached. Your post-investigation recommendations should always comment on the need to tighten the controls. (Don't compartmentalise your knowledge here – ensure that you consider all aspects of the P3 syllabus if they are relevant to the question.)
- **Principle of proceduralism.** In any investigation, all the proper procedures must be followed. They may be a legal requirement anyway, as they will often be written into a contract of employment or form part of normal employment regulations. These procedures might include the right of an employee to be represented at disciplinary hearings, the rule that one should never be a judge in their own cause and the principle that both sides to a dispute should be heard.
- **Principle of utilitarianism.** The consequences of each option being considered and the costs versus benefits of each in terms of its potential impact on all stakeholders should be fully considered before any decision is made. (Again, this is something that students should bear in mind when answering an ethics question. There will usually be a number of options, each with different probable outcomes.)
- **Principle of beneficence.** The outcome sought in any ethical conflict resolution

should be the one that causes the least harm to the most stakeholders – ie, the “maximin approach”, where the maximum number of people gain a minimum level of satisfaction. This is consistent with an approach to ethics whereby the consequences of a decision are more important than the factors leading to it. In other words, an action can be judged as ethical once its results are known – it’s the “consequentialist approach” to ethics.

When faced with any question on ethics, candidates should appreciate that any actions proposed to solve a dilemma must accord with the five fundamental principles laid down by CIMA for the ethical conduct of its members and students. The principles – integrity, objectivity, confidentiality, professional behaviour and professional competence, and due care – are drawn from the IFAC code of ethics, which all accountancy bodies affiliated to IFAC use as the basis for their codes. An overall approach should first ensure that the solution is legal, bearing in mind all relevant regulations. Second, it should be in line with CIMA’s fundamental ethical principles.

My suggested approach to answering questions on ethics comprises the following five steps:

- **Analyse the situation.** Most ethics questions are presented as “A asks B to do C, which is in breach of D”. B will probably be you or someone who has come to you for advice and A will probably be a senior manager or boss. You can take it that D is your institute’s ethical principles or some similar code of conduct that B should follow. As accountants, our codes of ethics always take precedence over any corporate code that might apply to our status as an employee. There shouldn’t be a clash, but our professional codes come first if there is one.
- **Identify the ethical principles involved.** Your main reference guide should be the code that governs your conduct as a CIMA student and, hopefully, a future member. Most scenarios will cover a number of ethical principles. Typically, these will involve confidentiality (are you being asked to disclose client information?), integrity (are you being asked to give false or misleading information?) or objectivity (are you under

EXAM PRACTICE

As an example of how to use the five-step approach, try the following ethical question. It came up in the old Organisational Management and Development paper, which has largely been incorporated into papers P3, P4 and P6. The model solution is a mini answer plan – ie, discussion points are raised but aren’t as fully developed as they’d be in a full answer. It will appear in the students’ section of CIMA’s web site (<http://snipurl.com/26gej>).

You were appointed financial controller of a firm of builders’ merchants almost a year ago, with the prospect of becoming FD if you performed well. An old-established customer, a contractor called X, which has expanded to take on a large contract, is causing problems with delayed payments. X is a family firm, largely owned by its managing director, Y. Following a discussion at a management meeting, your sales director and a member of staff visited the customer with instructions to “try to resolve the matter of delayed payments”.

At the meeting, the sales director took the lead, having known Y for years. Y provided the last annual accounts and the latest management accounts and contract accounts. This one large contract that X had undertaken represents 70 per cent of its activity. If all, or almost all, suppliers allow extra credit for material and X uses its limited remaining bank facilities to pay its workforce, Y thinks the company should be able to complete the next stage

of the contract; get the architect to certify that the work has been completed; and obtain a progress payment. This would enable X to pay its suppliers, get more materials and finish the contract. But Y considers the company will make a significant loss on the contract and will only be able to trade on a much reduced scale thereafter.

The sales director suggested, and Y agreed, an arrangement by which Y would make a payment from personal funds, against which your company would release materials to X. When it receives the progress payment, X will pay your company from its company’s funds and reduce the amount owing to well within normal terms. Your company will then repay Y the personal funds he has paid. It was agreed that this arrangement should be discussed and agreed with your managing director in the morning. On his return, the sales director said that this sort of arrangement was probably the only way of getting any money back – if X went into liquidation, nothing would be recovered.

Later you received a telephone message that Z, the finance director of another firm of builders’ merchants, whom you know through local CIMA branch meetings, has asked you to call back urgently regarding the credit status of X.

You are required to write a report to your managing director, evaluating the ethical considerations and recommending the action to be taken on the account and on the telephone message (25 marks).

economic pressure from your boss or personal pressure from a friend or relative?)

- **Identify the available courses of action.** There will usually be more than one. Think widely – the more points you can make, the more marks you can earn, as long as your suggestions are practical.
- **Analyse the consequences of each option.** Think clearly and logically about what the outcomes would be if you were to make the choices you have identified.
- **Make your recommendation.** If a report is called for, provide one. Even if it’s not

specifically required, the report format can be a useful way to present your answer.

And always remember the other golden rule: never recommend anything that will break the law or any of the fundamental principles of CIMA’s code of ethics.

Martin Corboy FCMA, a former director of BPP Ireland, is a freelance tutor. Visit the new ethics area on the CIMA web site (www.cimaglobal.com/ethics) to access a summary of the code, guidance on ethical dilemmas and a library of ethics resources.