

Business Ethics
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Lecture - 26
Financial Management: Overview and Perspective

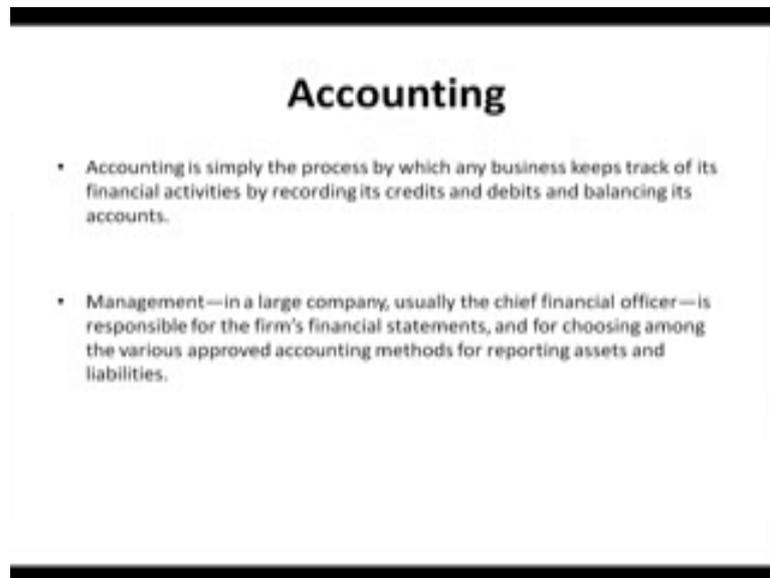
Now, we are going to focus on the Financial Management of the Organization and the ethical Perspectives related to it.

The when you are talking of the financial management of the organization, in the previous discussions we have seen like there is an asymmetry of information between the shareholders at large and the executive members at the management. The principles are less knowledgeable about what the agents are doing. Also in the different models of the stake corporate governance we have seen there is a difference in importance given to the shareholders like small shareholders and a big group of shareholders like more powerful shareholders.

So, there could be again an asymmetry of information between the sharing of information between and the knowledge held about the functions of the organization by the more powerful shareholders and the less powerful shareholders of the organization. So, when it comes to the decision of either shareholder activism or ethical investment, due to the balance out this asymmetry of information which may be prevailing in the organization. One of the very important role is played by the accountant. Here in this discussion we are going to focus on the role of the accountant and the ethical dilemmas issues related to the role of the accountant with respect to the organization.

And we are going to focus in some more details again on ethical investment because that is how the shareholders are managing the finance to some extent of the organization and also trying to see that the organization follow sustainable business practices and that is how they are exerting control on the organization. So, let us now focus on the role of accountants in the organization.

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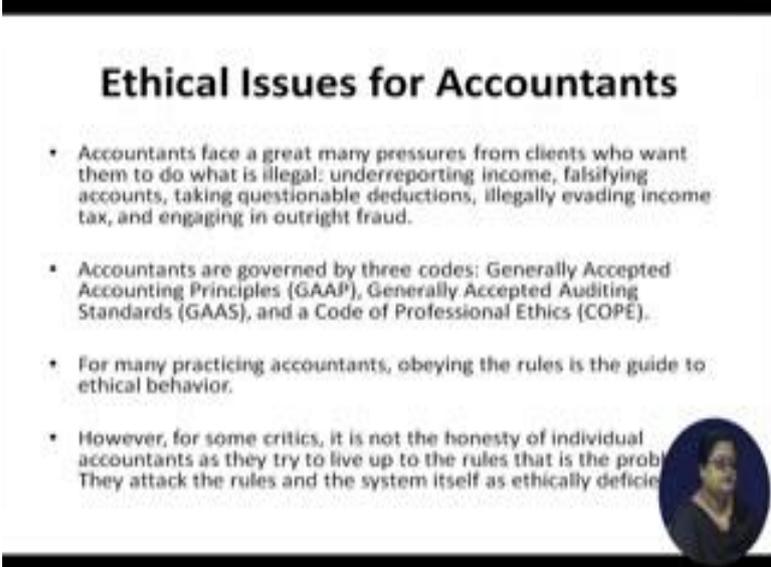
Then we are looking into the process of accounting. It is the process by which the simply the process by which any business keeps a track of its financial activities by recording it is credits and debits and balancing its accounts. Though it looks simple lot of ethical issues can come in the way of this process of recording of credits and debits and how what processes followed in balancing the accounts. Management accounts in the larger company are usually done by the chief financial officer.

So, who is responsible for the firm's financial statements and for choosing among the various approved accounting methods for reporting assets and liabilities? So, if we notice the definition and the role very properly, it shows it is depending on the discretion expertise and prudence of the chief financial officer to choose among the various approved accounting methods for reporting assets and liabilities. So, the virtue of the chief financial officer the underline guidelines regarding the professional ethics of the chief financial officer will to some extent definitely will have an effect on what exactly the CFO who is reporting as assets and liabilities, because his role gives him that flexibility of choosing amongst the various accounting techniques available methods available to report assets and liabilities.

So, what is actually reporting as assets and liabilities depends to some extent also on the

discretion and virtue and stated guide guidelines in terms of codes of ethics the professions that the CFO uses while making this choice.

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Ethical Issues for Accountants

- Accountants face a great many pressures from clients who want them to do what is illegal: underreporting income, falsifying accounts, taking questionable deductions, illegally evading income tax, and engaging in outright fraud.
- Accountants are governed by three codes: Generally Accepted Accounting Principles (GAAP), Generally Accepted Auditing Standards (GAAS), and a Code of Professional Ethics (COPE).
- For many practicing accountants, obeying the rules is the guide to ethical behavior.
- However, for some critics, it is not the honesty of individual accountants as they try to live up to the rules that is the problem. They attack the rules and the system itself as ethically deficient.



Because this flexibility is there, these can lead to some ethical issues which the accountants may face. Accountants may face great pressures from the clients who want them to do what is illegal. Under reporting, income falsifying accounts, taking questionable deductions illegally evading income tax and engaging in an out rate firm to appear to the more profitable or to evade income taxes.

So, these demands of the clients may be put to the accountant and the accountant may succumb under this pressure, or based on his own judgments based on the virtue of his character based on his like whether he is guided by professional ethics and whether he wants to follow it or not he can with stand the pressure also. So, there can be pressure from the client to do what is illegal. Accountants are generally guided by 3 codes generally accepted accounting principles, generally accepted auditing principles and a code of professional ethics. So, there could be the dilemma regarding, the when there is a conflict between these guiding principles and the demands and the claims after clients who are there expecting from the accountants. For many practicing accountants obeying the rules is the guide to ethical behavior.

So, they follow a normative commitment, where the guideline is given and for many practicing accountants they try to follow the rules and based on the codes and that is the guide to the ethical behavior; however, in some situation the honesty of the individual as they try to leave up to the rules is where it comes as a problem. So, even if guiding rules are there, at the end as we have already discussed while discussing the normative theories and ethical descriptive theories of ethics, the individual who is making the decision his personal value systems his integrity his or her integrity the his or her way of locus of control how the person can with stand pressure what the person wants to live like the cognitive model development level of the person all these have an impact on the ultimate decision that is made by the person. So, though there are the guidelines to be followed the honesty of the individual accountants and may try to again be in clash while they are guiding follow the guidelines.

And it may so happen the guidelines itself maybe ambiguous in nature and not properly explaining what needs to be done and could be questionable also and an accountant may start to find out like what can be done extra beyond what this guideline is mentioning, because guidelines itself are ambiguous in nature.

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The Accounting Rules

- One major issue is the apparent conflict of interest that is built into the American accounting system.
- A second complaint stems from the fact that the accounting firm simply certifies that the company's accounts are correctly presented and are in accord with the generally accepted accounting and auditing standards.
- As a result of the widespread scandals, the general public lost the confidence it once had in accounting firms and corporations in general, even though only a very small percentage had engaged in wrongdoing.
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- The Sarbanes-Oxley Act was an attempt to help restore public confidence and trust.

This conflict of like between the personal like honesty what it is telling and the guiding

principles what is guiding the codes are guiding are the principles accounting principles are guiding.

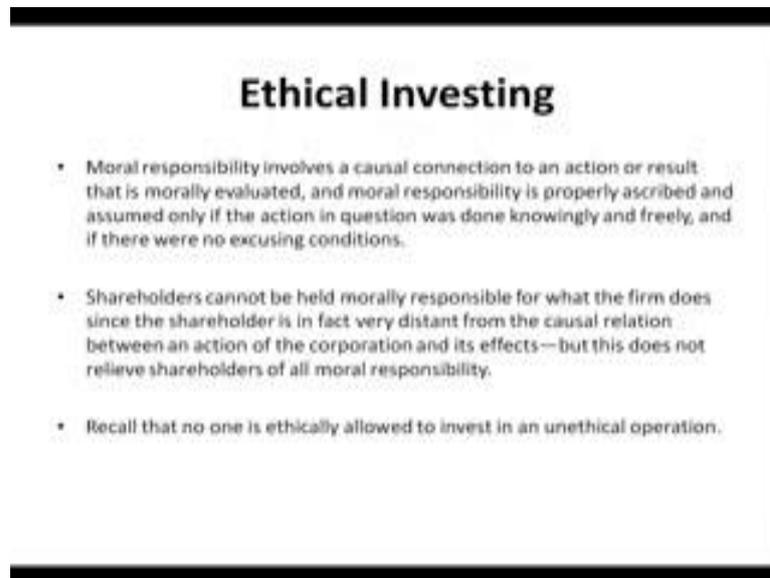
So, could it due to the fact that the accounting firm simply certifies that company's accounts are correctly presented and are in accord with the generally accounting and auditing standards. So, they do not try to go beyond this to find out like what is the source of this presentation, how this firm had at the client organization has actually work, how come it has presented this the documents that have been placed and accounts that are been presented. The only thing done is like the as presented and they are cross checking whether the things as presented are following the ethical standards and guidelines or not accounting standards or guidelines are not.

So, because maybe the accounting firms are maintaining the earth is superficial type of audit role and accounting role and the after effect like the scandals happening after that they may have made the society at large in loose some confidence on the accounting firms, and the corporations in general. So the general stereotype has been formed even though very small percentage of people are actually involved in it, but still as we have understood the stakeholder network theory if you remember.

So, maybe wrong done by one of the firms or a group of firms where they have joined hands with their client organization to present the accounts of the client organization or they have not investigated into depth of it, like the whether accounts that are presented are actually correct or not, but believed under face value of it, have sent ripples throughout the society and the general image of the firms in totality have been become questionable in the societies mind with respect to trustworthiness.

However, the Sarbanes Oxley act which was an attempt to restore public confidence and trust in the firm which deals with reporting of how financial reporting are done, then with respect to give some bribes to the act which states the details of it has been able to restore to certain extent the public confidence and trust on the accounting firms.

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Ethical Investing

- Moral responsibility involves a causal connection to an action or result that is morally evaluated, and moral responsibility is properly ascribed and assumed only if the action in question was done knowingly and freely, and if there were no excusing conditions.
- Shareholders cannot be held morally responsible for what the firm does since the shareholder is in fact very distant from the causal relation between an action of the corporation and its effects—but this does not relieve shareholders of all moral responsibility.
- Recall that no one is ethically allowed to invest in an unethical operation.

Next, we will try to discuss again to certain details on the ethical investing. Moral responsibility as we seen of the firm involves not a just a causal connection, but it involves a causal connection to an action or the result that is morally evaluated and the moral responsibility is properly described and assumed only when the action was done knowingly and freely and if there are no exclusive conditions to it.

Why we are discussing this in this regard? If we remember the shareholder's responsibility towards the firm when we introduced the definition after shareholder in the first few modules of the business ethics course, we discussed that the shareholders have limited liability towards the organization. They are entitling to the profit from on from the shares in terms of dividends and some say in the decision making of the organization through their voting rights and in the how the way that they speak up in the agm.

But they are not liable for the wrong doing for the organization. They are not liable where how the managers are acting towards the and for the operation of the business. So, shared because they are not liable for it, shareholders cannot be held morally responsible for what the firm does, since the shareholder is very distant from the casual relation between the action of the corporation and the corporation and it is effects. But this does not relieve shareholders of all moral responsibility.

So, though it is very distant from the actual action of the corporation, because the actual action is being performed by the management and it is overseen by the executive directors and the non-executive directors who acts who are present there in the organization to see like the interest of the shareholders are and the other stakeholders of course, are taken care of by the functioning of the organization.

But still, the shareholders cannot totally absolve themselves from the response moral responsibility towards the act performed by the organization. Why? Because whether they are investing in some ethical business or unethical business knowingly, nobody is there to stop the person from doing. It depends on the conscience of the shareholder. So, it is no one is ethically allowed to invest in an unethical operation, if no one is ethically allowed to invest in an unethical operation. So, if as a shareholder I am investing in some unethical operation means I am knowingly doing it. And when I am knowingly doing something and participating investing my money in some unethical operation, then I cannot say I am not responsible I am not morally responsible for the acts of the organization.

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Ethical Investing

- In evaluating a company's ethical practices it is important to consider:
 - The company's policies.
 - The company's record.
 - Whether a company is to be held responsible for anything that any of its employees do, or whether it is to be held unethical only if the action done by a corporate official is part of company policy.

So, it goes on the other way also to move the discussion in this week. If nobody is ethical allowed to invest in unethical operations, and that if somebody does is doing it is

knowingly, and that is how there is a moral responsibility of the shareholders in the functioning of the organization. So, it is the duty of the shareholder also to find out whether the organization is operating in ethical way or not. It is a part of the responsibility a duty of the shareholder to find out whether the organization is acting in an ethical way or not and then invest his or her money for that organization.

How does the shareholder find out like whether the organization is working in an ethical way or not? The evaluating company's ethical practices, it is important to consider the policies of the organization and to check the company's past records. So, whether the company is held responsible for anything of it is for it is employees do, or whether it is to be held unethical only action done by a corporate official is a part of company policy is again a debate that we have discussed, like when we are talking of the past discussion about the corporate moral responsibility.

So, when we have come to the conclusion then individuals are making decisions though corporate officials are making decisions which for in the process of operating the business, which may be ethical or unethical in nature. But these decisions of course, gets facilitated or not facilitated by the internal decision support system of the organization and the culture of the organization. So, by checking in to the company's policies and the past records as companies past records, the shareholders can give a feeling of whether the company itself is functioning in an ethical or an unethical way.

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Ethical Investing

- Some claims that the demands of ethical investing are too stringent and so are impossible to follow.
- Another attack on ethical investing claims that if some individuals and institutional investors do not invest in companies that act unethically, other less scrupulous individuals and institutions will.
- Another frequently used argument claims that ethical investing demands too much because it looks only at specific policies and fails to consider the broader picture.

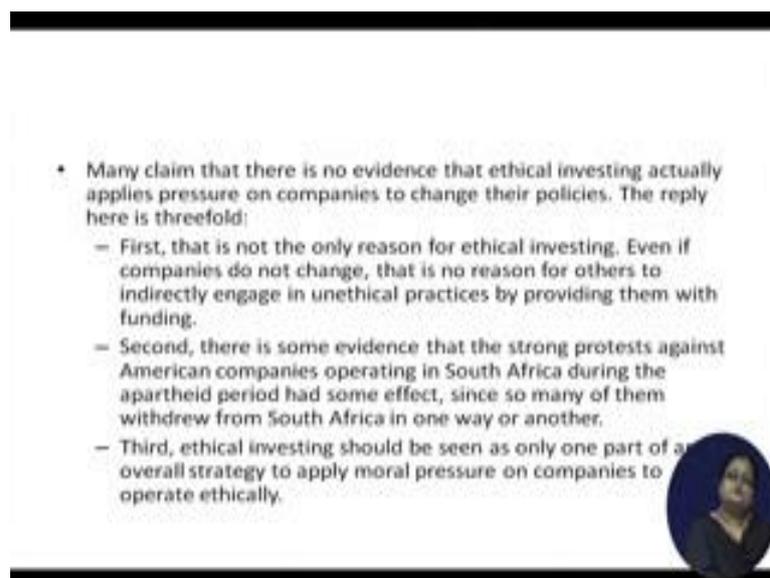


There have been certain debates about ethical investing. Because if you can understand this requires lot of efforts on the part of the shareholder's lot of effort on the part to investigate about the functioning of the organization to study the organization make a survey about it and then come to a decision about whether to invest or not to invest. And they and this may mean involvement of resources in terms of maybe networking that we have in terms of money in the terms of time involvement and so, many other things.

And also the demands of ethical investment like if this this thing the criteria that we saw if these things are followed then only it will lead to positive criteria. If these things are done, then it will fall under negative criteria. These demands of ethical investing are so; some may say these are. So, stringent that it is impossible to follow it. So, other still argue like if some people are not investing in some individuals or institutional investors I do not investing in companies that act in an unethical way, then it is not again the you cannot stop others for from investing in those organizations. If you are not doing it then others will do it. So, why should you be taking so much of pain in investigating about the ethical performance of the organization, you use your resources and then try to invest for an ethical organization. Because you cannot guarantee and say none will invest in unethical organization if you are not doing others may do.

So, how to come to a balance about it this could be an argument for which main function against ethical investing. Another argument claims that it ethical investing demands too much. So, because it looks into like specific policies minute of the policies and fails to look into the broader picture of what is the outcome what it is providing to the society at large. So, this argument maybe is driven by the consequentialist theories which talks of think of the outcome and positive outcome the that it is providing to the society and not to think too much about the intricacies of the policies and practices, which to some extent may hinder the progress of the organization and reach it is outcome which is may be designed to be favorable for the society at large. So, these could be another argument against ethical investing.

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- Many claim that there is no evidence that ethical investing actually applies pressure on companies to change their policies. The reply here is threefold:
 - First, that is not the only reason for ethical investing. Even if companies do not change, that is no reason for others to indirectly engage in unethical practices by providing them with funding.
 - Second, there is some evidence that the strong protests against American companies operating in South Africa during the apartheid period had some effect, since so many of them withdrew from South Africa in one way or another.
 - Third, ethical investing should be seen as only one part of a overall strategy to apply moral pressure on companies to operate ethically.

Another argument could be like there is no connective link. Maybe people have not found any connecting link between which guarantees like ethical investing is actually acting as a pressure on the companies to change their policies. However, to answer to these criticisms we can come to 3 basis points like, act is a pressure on the organization is not the only aim for or reason for ethical investing. Even if the companies are not changing or there is that is no reason for others to indirectly engage in unethical practices by providing them with funding.

So, this could not be the only reason that companies are not changing. So, why go for ethical investing should not be the only guiding reason. Why a person should be looking for companies who are following the guide sustainability guidelines positive criteria and investing in that. Or try to make a choice between like I will invest in this type of companies, I will not invest in the other type of companies. It has there have been evidences like some strong protest against American companies operating in south Africa during apartheid period at some effect and that had led to them to withdraw their business for south Africa in one way or another.

Moreover, we can tell like it can be seen as ethical investing can be seen as only one of the measures one of the overall one part of an overall strategy to apply moral pressure on companies to operate ethically. So, if it is like a single shareholder if you or she decides or if one institution if it decides then maybe the moral pressure is not very high, but if all the related shareholders all the institutional investors starts thinking in a same way, and the pressure is built on the organization by the collective pressure of the shareholders, then it will definitely act as a moral pressure on the organization to think ethically regarding the issues covered under ethical investment.

So, we were not clean like it is the only way to make organizations act in an ethical way, but definitely just one of the important tools given, one of the important mechanisms given in the here hands of the shareholder or shareholders you can use it properly and if it can be used by as a collective strength by all the shareholders, it will definitely have good impact on the organization. And make it morally responsible for it is activities and so that it will continue getting support from the shareholders and the investors and progress in its own business and be sustainable and create a positive impression in the mind of the society also where from it will help to get more shareholders more investors in future.

Thank you.