

FACTFILE: GCE PROFESSIONAL BUSINESS SERVICES

UNIT AS 1: BUSINESS ETHICS AND RISK MANAGEMENT



Learning Outcomes

Business Ethics

Students should be able to:

- demonstrate understanding of the ethical responsibilities of a professional business services firm when dealing with a client, including the principles of:
 - fairness and integrity
 - trust and confidentiality
 - transparency and openness;
 - freedom from bias or influence; and
- analyse how having an ethical code benefits a professional business services firm, including:
 - public relationships;
 - corporate image; and
 - protection for the professional business firm;

Risk Management

- demonstrate understanding of the need to assess and manage risk for a client;
- apply and analyse the elements of a risk assessment, including:
 - identification and description;
 - estimation using an appropriate risk assessment matrix including quantitative and qualitative scoring; and
 - evaluation;



What is business ethics?

We often think of businesses in relation to money and profit. Business ethics is the application of ethical values to business behaviour and is relevant to the conduct of individuals and the organisation. We can think about ethics in three ways;

- the ethics of the individuals who work in the business – some people are more likely to bend the rules than others;
- the organisational culture of that specific company – for example ethical fashion chains like Braintree Clothing; and
- the industry wide culture – for example the big banks have a reputation for poor ethical behaviour.



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The core values that shape the ethical behaviour of an individual, organisation and industry include the following:

- Fairness and Integrity
- Trust and confidentiality
- Freedom from bias or influence;
- Transparency or Openness

Fairness and Integrity

Business practices showing fairness and integrity include:

- Ensuring fees reflect the value of services provided and are considered fair and reasonable by clients;
- Professional business services firms not entering into agreements with competitors to unlawfully restrict competition / set price / allocate clients; and
- Professional business services firms not gathering information on competitors e.g. industrial espionage.

Having integrity occasionally requires a Professional business services firm to deliver unwelcome or challenging information to clients rather than being evasive or withholding information in fear of losing the client.

Trust and Confidentiality

These are values which, if compromised, can be difficult or even impossible to regain and can be devastating to the survival of an organisation. Examples include the confidential storage of client information; not disclosing a client's information to any other parties e.g. competitors, and not using information obtained for personal gain (e.g. buying stocks or shares).

Confidentiality must also be considered by a Professional business services firm when working with the same client in different areas of their business. Many organisations ensure they have their own confidentiality arrangements in place to ensure staff do not share information – these are often called Chinese walls and are typically conceptual rather than physical. The ability of Professional Business services firms to protect the confidentiality of such information is critical to maintaining the trust of their clients. Regulations that specify legal requirements for information security tend to improve compliance in this regard.

Transparency and Openness

Transparency and Openness concern how open and clear Professional business services firms are about fees or how opinions and advice is given and received.

Freedom from bias or influence

This concerns the ability of the Professional business services firm to be objective in all their dealings with clients. They should act independently in forming professional opinions and in collating the advice given to clients.

If there is a difference of opinion, Professional Business services firms should not alter their advice but will try to handle them constructively and professionally.

What are the ethical responsibilities of a professional business services firm?

Statutory work and ethical responsibilities

The statutory functions provided by Professional Business services firms (specifically audit) require them to be independent and the perception of the general public is vital for example, independence may be brought into question if a Professional Business services firm's partners play golf with or go on holidays with the finance director of a bank they audit.

What is audit?

An examination of the financial accounts of an organisation - as presented in the annual report - by someone independent of that organisation. It is required by law. Most of the big companies in the UK are audited by the big Professional Business Service firms. These firms then also offer other consultancy services.

Professional Business Services firms need to ensure that the statutory work they carry out is free from bias, transparent and they remain confidential. Other areas of work

Companies often look for specialist business advice, for example help analysing risks the business faces, specialist tax advice or an external appraisal of the direction the company might take with mergers or acquisitions.

When a company wants this type of advice, the first port of call is often the professional business service firm which is doing the audit. Why?

- They understand the business already from an external point of view
- They act independently and that can highlight problems better than an internal view

If the firm responsible for the independent audit of the financial statements also provides non-audit functions there can be a conflict of interests, a risk of over familiarity (could this mean they are not independent any more?), and an over reliance on a single source of income from this client (and therefore are the professional business services firm less likely to provide bad audit opinion if needed?).

How does having an ethical code enhance the following?

Public relationships.

Corporate Image.

Protection for the professional business firm?

Case study

You work for a Professional Business services firm, Y Consulting. When meeting a client – a small local chain of gyms – a member of staff tips you off that a supplier of theirs is committing fraud. The supplier is your friend's company. Y Consulting helps this supplier with their tax affairs as well.

Consider the following points, highlight some of the ethical issues and then outline what you might do?

- The allegation is unproven; therefore any investigation into the truth of the claim should be kept confidential. You should refer this to your manager who will take the appropriate action.
- The supplier is a friend of yours. There is a conflict of interest because it will be difficult for you to maintain freedom from bias or perception of freedom from bias.
- The supplier is already a client of Y Consulting. There is a requirement to be honest, but also, to ensure confidentiality of information, do you tell the tax team at Y Consulting so they can investigate?

Benefits of an ethical code

An ethical code demonstrates a firm's culture and commitment to ethical behaviour: accountants and other financial specialists will have specialist professional standards that they must adhere to. Codes of Conduct or Ethical Codes allow firms to demonstrate how they go beyond this and create a culture of ethical behaviour.

An ethical code can act as a framework for employees: staff are meant to use the framework when considering if an action they are about to take is ethical. This clarifies the need for staff to take responsibility for making ethical decisions and where something is unclear the ethical code will demonstrate how they should address the issue. This should decrease the chance of unethical behaviour occurring in the firm.

An ethical code can provide protection for the Professional business services firm: if an employee does not follow the requirements of their code and the firm can show that the person was adequately trained, then this may also offer the firm some protection.

An ethical code can increase confidence: Professional business services firms see behaving ethically as a key part of being a 'professional' and having a good ethical code should ensure all those they deal with have confidence in them.

Risk management – what is risk?

Risk can also be called uncertainty – it is the possibility of more than one future outcome. Professional business service firms help clients assess the risks facing their business and go on to analyse these risks and help them manage the risks.

Risks can be routine, with measureable likelihood and impact of their occurrence. These are quantifiable risks and can form part of risk assessments. Other risks considered are highly unexpected events, for example in 2010 a volcano in Iceland caused a large volcanic ash cloud which shut down most of Europe's airspace for a week. The financial impact on airlines was \$1.7bn lost revenue (around £1.1bn)¹.

For unanticipated risks, businesses can prepare more effectively by having good contingency planning with details of the plan of action in the event of a major disruption to normal business operations.

¹Source – International Air Transport Association (IATA)



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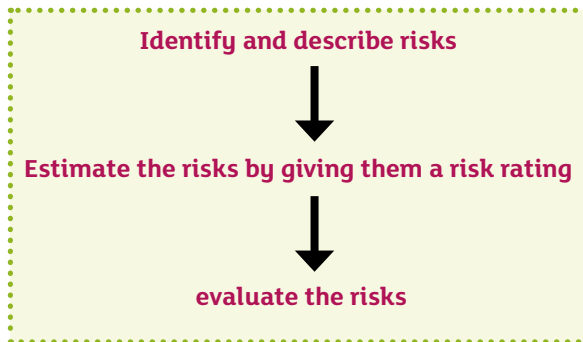
The need to assess and manage risk

Before Professional Business services firms can assist clients, they will develop a risk profile of the client’s operations and assess their needs. A risk profile identifies the acceptable level of risk for the company. Some businesses will be keen to diversify and take more risks.

There are international risk management standards that companies can use to implement risk management and companies may also need assistance in following these standards.

Risk assessments

Risk assessments consider what could go wrong for a business and then plan how to prevent it from happening. It can be summed up as two questions – “what might happen?” and “what should we do?”



As a result of this process, a Professional Business services firm can then advise a client on the

appropriate action to take in relation to the risk.
Identification and description of risks

The first step is to identify the risks facing the business. They can fall into various categories; for example:

- financial: impact of exchange rate changes
- people: recruiting and retaining good staff
- reputational: negative social media reviews
- health and safety: accidents on a factory floor
- environmental: disposal of hazardous waste from a hospital

Please note this list is not exhaustive, it is just for illustration.

How might a Professional Business services firm identify risks?

- Examine various corporate documents (businesses should have a ‘risk register’ as a starting point);
- Physical examination of the business e.g. visit factory or shop outlets, visit complaints department; and/or
- Interview key staff.

Description just means the risk is explained in words, for example “Fire could be caused by faulty electrical equipment”.

Estimation of risks

“If you can’t measure risk, you can’t manage it.”

Quantitative estimation may use a simple risk assessment matrix which assesses the likelihood of the risk happening with the impact / severity of the risk, should it occur. Both likelihood and impact are given a score, which is then multiplied together to be evaluated.

Example of a risk assessment matrix

Likelihood and Impact scoring:

High – 3

Medium – 2

Low – 1

Maximum score in this matrix is 9 (3 x 3) and lowest is 1.

| Risk | Likelihood | Impact | Total (Likelihood x Impact) | Risk rating | Action required |
|------|------------|------------|-----------------------------|-------------|-----------------|
| A | High – 3 | Medium – 2 | 6 | High | |
| B | Medium – 2 | Medium – 2 | 4 | Medium | |
| C | Low – 1 | High – 3 | 3 | Low | |
| D | Low – 1 | Low – 1 | 1 | Low | |

There can be more statistical and financial approaches to quantitative risk estimation – estimating the expected cost of a risk.

Qualitative risk management is less prescriptive and does not rely on data or statistics. It brainstorms risks, for example using a mind map, and thinks about whether it might be high, medium or low risk using the best judgement of the team.

Evaluation of risks

The categorisation of risks as high / medium / low rating is the first step in evaluating risks. Firms would then respond to the risk in order to either eliminate or reduce the risk:

- Transfer the risk – sharing the risk e.g. by taking out insurance;
- Terminate the risk – for risks rated high avoiding it may be the best option;
- Tolerate – accepting the risk is most suitable for low risks; or
- Treat – reducing the risk by putting systems in place e.g. detailed procedures to be followed on factory floor to reduce likelihood or impact of accidents.

Once they have dealt with the risks, they will continue monitor the risk profile – some may change regularly (e.g. exchange rate impact due to political uncertainty) and there may be new risks to consider.



Sources for further study

1. Institute of Business Ethics: www.ibe.org.uk
2. Times 100 business case studies – search for business ethics
3. Ethical cases for accountants available in this document produced by the Consultative Committee of Accountancy Bodies, an umbrella organisation of the accountancy institutes in the UK and Ireland. <https://www.icaew.com/-/media/corporate/files/technical/ethics/ethical-case-studies/ccabeg-case-studies-accountants-public-practice.ashx?la=en>
Scenario 3 would be a very detailed, top end case study about conflicts of interest.
4. Association of Accounting Technicians disciplinary cases: <https://www.aat.org.uk/about-aat/professional-standards/disciplinary-processes-and-tribunals/disciplinary-outcomes>
5. Health and Safety Executive: www.hse.gov.uk
6. Hall, D. et al. (2010) 4th edition. Business Studies. [Ethics Ch 125]; [Risk: pp 19, 211, 290, 540].
7. Risk Analysis and Risk Management: https://www.mindtools.com/pages/article/newTMC_07.htm



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Cost of volcanic ash cloud in 2010 – report at:

<https://www.iata.org/whatwedo/Documents/economics/Volcanic-Ash-Plume-May2010.pdf>

Consultative Committee of Accountancy Bodies: www.ccab.org.uk

Institute of Business Ethics: www.ibe.org.uk

Institute of Risk Management: www.theirm.org

Institute of Chartered Accountants in England and Wales: www.icaew.com