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# Towards Corporate Social Responsibility

**Fred Robins**

*University of Adelaide  
Australia*

<http://frobins@gsm.adelaide.edu.tw>

## **Abstract**

This paper looks at corporate bankruptcies experienced in the United States during 2002. Events are summarised in sufficient detail to identify the weaknesses in corporate governance and social responsibility. Particular emphasis is put on Enron and WorldCom on account of the dramatic impact of these two collapses on American popular and political opinion. However the main focus is on those business activities which are legal but unethical rather than those which constitute fraud and are demonstrably illegal.

Thereafter the paper examines the regulatory responses; notably the Sarbanes-Oxley Act. There is also reference to the views of some informed academic observers. Then, the author attempts to itemise and categorise the various issues which scandal exposed. The author suggests the various elements of corporate governance weakness can be categorised as technical, regulatory or cultural. This leads into discussion of how best to raise standards of corporate responsibility in each of these categories. Regulatory action offers improvement in the first two categories but not in the third.

The last category embraces the broad, ill-defined, ethical needs like social responsibility. Regulation are not well suited to the management of these open-ended issues and, worse, formal rules can distract managers from the real, ethical issues, by forcing them to concentrate on the requirements of technical compliance. The author attempts to think through the implications and suggests there can be no full solution to such ethical problems. These, by their nature, ultimately depend on individual honesty.

**Keywords:** corporate social responsibility; corporate governance; business ethics.

## **Introduction**

Bankruptcies increase in number and receive increased attention in every business downturn. In this respect 2002 might have been a fairly typical downturn year. In the United States, however, bankruptcies and also 'earnings restatements' were unusually dramatic. In fact, the year included five of the ten largest bankruptcies, by value, in the entire corporate history of the country. Moreover, these bankruptcies brought an unprecedented level of corporate fraud and malfeasance into full public view. Even more worryingly, the bankruptcies put the spotlight on a business system which appeared to be characterised by a whole litany of perfectly legal yet unethical activities. These were not just pervasive across

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the national economy but actively promoted by some sections of the business community. The consequences were many. They included the most significant changes in US business regulation since the 1930's. They also included a massive reduction in investor confidence; a consequence which might yet have global consequences. Further, the dark side of American business which has been exposed by these bankruptcies, has parallels in many other countries. For all of these reasons, US corporate history in 2002 is of much more than just American interest.

### **Corporate Scandal in the United States**

The American drama which forms the backdrop to this paper is still less than two years old. Although its roots go back longer, the drama only began to attract broad public attention with the sudden bankruptcy of Texan energy trading company, Enron, which on 2 December 2001 filed for Chapter 11 reorganisation, then the largest in the history of the US bankruptcy code (Zellner et al., 2001). At the time, it was also said to be the largest corporate collapse in terms of investor loss and repudiated debt, of approximately US\$63.3 billion, in American commercial history. An indication of the impact of this event is captured by the dramatic language of an editorial in Business Week dated 17 December 2001, which began:

“Enron Corp’s bankruptcy is a disaster of epic proportions by any measure – the height from which it fell, the speed with which it unraveled, and the pain it has inflicted on investors, employees, and creditors. Virtually all the checks and balances designed to prevent this kind of financial meltdown failed. Unless remedied, this could undermine public trust, the capital markets, and the nation’s entire equity culture.”

Some ten months later, Enron chief financial officer, Andrew Fastow, was charged by the US Department of Justice with fraud, money laundering and conspiracy (Collins, 2002).

Following the demise of Enron, the role of its auditor, Arthur Andersen, the world’s fifth largest global auditor, was subjected to intense scrutiny; by the media, by the regulatory

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authorities and, decisively, by the law. One issue which emerged was auditor conflict of interest. The event served to draw attention to the fact that Andersen's income from non-audit services to Enron exceeded their audit fees. Moreover, scrutiny of the exact role of Andersen staff working within Enron indicated that Andersen had also been undertaking some of the firm's internal auditing; a practice regarded by many as ethically questionable. Moreover, when the Department of Justice investigated the situation in March 2002, it emerged that Andersen had engaged in massive document destruction related to their audit work for Enron (Wharton, 2002). This reality raises a question mark about the firm's regard for both its legal and its social responsibility.

The Enron and Andersen affairs were not isolated incidents. The past couple of years have exposed the underbelly of American corporate life to an unusual degree. For example, the founding family of the Adelphia Communications Group were found to have "looted the firm on a massive scale". Arthur Andersen were found guilty of obstruction of justice. A Citigroup securities unit telecommunications industry expert was found to have subverted so-called 'analysis' and hyped buy recommendations to clients. Enron was found to have used aggressive accounting methods and phony partnerships to hide debt and inflate profit. Global Crossing and Qwest Communications traded network capacity in a manner designed to inflate their revenues. Merrill Lynch's star internet analyst doctored research reports on stocks of the firm's investment banking clients. Tyco International's CEO and CFO stole US\$170m in unauthorised compensation and illegally obtained another US\$430m from stock sales. And so on. Not surprisingly given this background, a record US\$880 billion of corporate bonds and loans are now distressed or in default and some of the biggest and best-known firms face legal action from investors who see themselves as the victims of a massive con (Thornton et al., 2002). In the words of one well-known banker and diplomat, Felix Rohatyn: "The whole financial system has become corrupt". Or, in the words of the House Financial Services Committee Chairman, republican Michael Oxley: "There is no equity in the equities markets" (Collins, 2002). This is probably enough to convince the reader that there is scope to raise the level of corporate social responsibility in American business. However, in June 2002, yet another major accounting scandal broke, which had far-reaching effect on American public

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and political opinion and directly influenced the legislative response of the US Congress. An internal auditor at WorldCom, America's second largest telecommunications company, uncovered US\$3.85 billion of 2001 expenses which were improperly categorised as capital expenditures. This incorrect classification grossly inflated earnings and its discovery required the company to undertake one of the largest ever financial restatements; some six times greater than that of Enron. This, in turn, revealed that a company apparently generating US\$20 billion in annual revenue was unable to support its US\$41 billion debt. As a result WorldCom filed for protection under Chapter 11. On 26 June 2002, the SEC charged WorldCom with fraud (Rovella, 2002):

“In a scheme directed and approved by its senior management, WorldCom disguised its true operating performance by using undisclosed and improper accounting that materially overstated its income.”

In August, the CFO and the former chief controller were arrested by the Federal Bureau of Investigation and charged with filing false statements with the Securities and Exchange Commission (Chaffin et al., 2002). Soon afterwards a further accounting fraud in excess of US\$2 billion was uncovered (Larsen, 2002). WorldCom, like Enron, had been audited by Athur Andersen. Moreover, of the US\$16.8 million in fees that WorldCom paid Andersen in 2001, only US\$4.4 million was in connection with their annual audit (Kirchgaessner et al., 2002).

### **Issues Arising**

Given the scope of documented malfeasance by business, some of it illegal but more of it legal but unethical, it makes practical sense to list the issues which have contributed to the current crisis of confidence. However this is less than straightforward. There is considerable diversity of informed opinion. For example, Jay Lorsch, Professor of Human Relations at Harvard University, after acknowledging that the Enron scandal is more than just an isolated accounting failure, suggested that corporate improvement is necessary on three fronts: the first is leadership, which should no longer be centralised in the CEO alone; the second is

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independence of audit committees, which should comply with the *spirit* of the New York Stock Exchange definition; and the third is the quality of the information flow from management and auditors to the board, which should be improved (Lorsch, 2002). Few would disagree. However, comments at this level of generalisation offer only philosophical guidance to reformers.

In contrast, Jeffrey Garten, Dean of Yale School of Management, focuses less on principle and proposes five actions which he terms ‘key imperatives’ (Garten, 2002):

1. Regulate auditors; through establishment of a new oversight body
2. Revamp CEO compensation; by disallowing immediate exercise of executive stock options
3. Make CEOs and boards accountable; by making CEOs and CFOs certify that their financial statements present a full and accurate picture of their company.
4. Keep up pressure on Wall Street; by having the SEC report on banks’ conflicts of interest
5. Modernize accounting; by gathering best ideas from around the world to produce one high-grade set of *international* accounting standards

As the foregoing demonstrates, opinion varies on how best to achieve improvement. In what follows the author offers his own simple list of the more significant problems, together some personal judgements and possible ways forward. Obviously, detailed exposure of corporate wrongdoing of many kinds raises more than a single question. So there is more than one issue to be investigated. Like those listed above by others, this author finds it helpful to separate issues but also to categorise them. The following list starts with those problem elements which can be specified most precisely and it ends with those which are most diffuse and difficult to specify with precision. In sequential order of breadth and complexity, they are:

- Accounting rules and principles
- Auditor responsibility and accountability
- Board responsibility and accountability
- Professional conflicts of interest and corporate transparency

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- Regulatory institutions and prudential responsibility
  - The role played by sectional interest, influence and politics
  - The overall quality of corporate governance
  - Corporate ethics, honesty and the law.

All of these issues have received public attention. So each receives some mention in this paper. However, some issues which have received attention, notably the morality of senior executive pay and the long-term inattention of the ratings agencies to the quality of reported company information, are omitted for reason of space.

The first three issues on the list are accounting principles, auditor responsibility and board responsibility. These are all *technical* issues, where improvement may always be possible and where definition is a matter of professional and / or legal agreement. The next three issues on the list are conflicts of interest, prudential responsibilities and the handling of sectional interests. These are all *regulatory* issues, where improvement rests upon the political process, legislation and resultant institutions. The last two issues, the overall quality of corporate governance and business ethics, are much broader in scope. These are, ultimately, matters of *corporate and social culture*, and include general social responsibility. Necessarily, they reflect society's ethical norms of behaviour and the general level of honesty expected of business. It is here that corporate social responsibility primarily resides.

### ***Technical Issues***

Accounting rules, audit practice and the responsibilities of boards, including their audit committees, are essentially technical issues. Whatever the particular principles, practices and legal requirements happen to be, the fundamental purpose in all cases is to contribute positively to the operation of the business 'system'.

#### *Accounting rules and procedures*

These are the most visible group of technical issues. In the aftermath of Enron and WorldCom, company reporting practices have caused a flood of protests from investors. It is

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now clear that many companies have long adopted accounting practices that may be judged 'obscure-but-legitimate to bordering on the misleading' (Fry, 2002). This fiddling to make the books look better is most often legal, but usually makes it very difficult to gain a clear picture of corporate performance (Fry, 2002). In other words, current accounting practices are falling well short of contemporary investor needs and leave much room for improvement.

One much publicised example, which illustrates the scope for improvement, is the use of sophisticated financing vehicles known as 'Special Purpose Entities'. Under the GAAP, as defined by Standard 140, these may be deemed 'distinct' and, thereby, escape inclusion in consolidated accounts provided just 3% of their value is held by non-affiliated parties. In reality, their non-consolidation is often highly questionable, as was the case with those established by the CFO of Enron (Spiegel, 2002); despite their acceptance by Enron company auditors, Arthur Andersen. In any case, the idea that just 3% non-affiliated ownership means the entity may in some sense be 'distinct' from its majority ownership is obviously open to challenge. It is hardly surprising that in January 2003, the SEC and the FASB together produced amended rules and guidance on SPE's which, in a telling recognition of their own past inaction and as a further cause of public confusion, they chose to re-label as Variable Interest Entities (Leone, 2003).

Americans refer to techniques for manipulating earnings as 'cookie jar accounting'. A 2001 survey of auditors conducted by Cornell University's Graduate School of Management found 2630 examples of "earnings management", 56% of which were acceptable to the auditors because they were "borderline legal". Yet in all such cases, it is worth noting, auditors must have subordinated any thought of putting "truth and fairness" into companies' financial statements, to their ability to accept the borderline legal. This reflects a 'Show me where it says I can't do this?' approach to their task. The authors of a recent book, which describes Enron as just the tip of the iceberg, tellingly refer to this approach as "managed mendacity" (Elliott and Schroth, 2002). To the extent that this judgement may be true, it reflects a sad absence of social responsibility from much of current business practice. It is interesting to note in this regard, as did *The Economist* (6 July 2002), that in 2001 only 20%

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of CFOs at Fortune 500 companies are Certified Public Accountants. The magazine goes on to say:

“Ignorance of basic accounting can undermine a CFO’s ability to cope with a challenge that many have faced in recent years: pressure to ‘manage’ earnings.”

It is also interesting to note a recent exercise by Standard & Poor’s to calculate what truly clean accounting might make major American companies look like. S&P claim to have spent a year identifying the “core earnings” of the S&P 500 group. Their conclusion, after rigorous accounting for stock options and pensions, is that their earnings per share for the 12 months to June 2002, was less than half what Wall Street analysts reported and about one third less than the companies themselves reported under the generally accepted accounting principles (Henry, 2002). Up to the present time, GAAP standards have *not* required the cost of awarding stock options to senior management to be treated as compensation and, therefore, *no* valuation of options has been subtracted from reported profits. Once again, it is obvious that there is scope for improvement.

#### *Audit responsibilities*

A second group of technical issues relate to auditing and auditor independence. Much of the attention given to Enron, WorldCom and also the very many companies which have dramatically restated their earnings recently, has focused on the auditing of published accounts. Audit procedures, audit firms’ deferential attitude towards the management of client firms, and the ethics of the accountancy profession at large, have all been the subject of public debate. Indeed, the three key provisions of the resultant US legislation, the Sarbanes-Oxley Act, relate directly to auditing: the establishment of a new, independent oversight body for auditors, a total ban on auditors providing *other* services to their clients, and the formation of mandatory audit committees by company boards (Kohler, 2002). The common thread in both the public debate and the consequent legislative thrust has been a determination to secure and protect the independence of auditors, both from the pressure of their clients and from conflicts of interest of their own.

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Recognition of the desirability of auditor independence is not new. For example, in 2000, the SEC disclosed that *most* PricewaterhouseCoopers partners in the US had breached the rules and fined the company \$5 million for violating audit independence provisions (Harris, 2002). Post-Enron and WorldCom, there will now be a tightening of auditor independence standards. The underlying problem, however, is that auditors are always going to be influenced by the managers or board members who hire them. He who pays the piper will always call the tune. So it may be unrealistic to expect auditors to report malfeasance if the people paying them are those responsible. The situation has been likened to schools appointing their own inspectors, or, in the worst cases, like criminals appointing their own policemen (Brittan, 2002). Recent experience demonstrates that auditors need to *better* represent the interests of shareholders, their primary responsibility, and that they be *more* resistant to the pressures and inducements of their paymasters. However, to achieve this outcome they might need to be appointed by some new means. Theoretically, auditors could be appointed by the stock exchange where a company's shares are traded. Alternatively, where a unified and trusted regulatory institution exists, it is possible that this institution could appoint auditors. However, no *obvious* alternative to the client company exists.

#### *Board responsibilities*

A third group of technical issues relate to the responsibilities, structures, oversight capabilities and independence of company boards. These issues, too, have been the subject of much debate both before and since Enron collapsed. Given that the causes of recent bankruptcies and profit re-statements go deeper than mere accounting standards, or, even auditor independence issues, it is not surprising that thoughts have turned to broader issues of corporate governance. Board-related issues include (Humphry, 2003): board composition; directors' independence and competency; remuneration; related transactions; integrity of financial reporting; the role of auditors and audit committees; risk management; management codes of ethics; and shareholder participation and democracy. This is quite a list.

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It is salutary to begin by noting some of the things which have been said. A McKinsey commentary on a survey of some 200 directors of US companies began with the statement: “How long must corporate boards look bad?” (Felton and Watson, 2002). A recent *global* survey by PricewaterhouseCoopers found 60% of financial institutions believed the trust of investors had been eroded to such an extent many respondents felt that “fundamental” regulatory change was needed. One major change, so far as boards are concerned, is likely to be a requirement that boards establish clearly identifiable audit committees and that audit firms be selected and appointed by these committees rather than by management. A second major change is likely to be a strengthened requirement that a majority of board members be demonstrably independent of management.

### ***Regulatory Issues***

Regulatory issues, so far as this paper are concerned, are those which relate to the character and effectiveness of public institutions with a direct responsibility to ensure the acceptable behaviour and satisfactory governance of companies.

#### *Conflicts of interest*

One problem which is traditionally the responsibility of regulators, is conflict of interest. Difficult problems arise when conflicts of interest are ‘institutional’ or ‘systemic’ and it is institutional and systemic weaknesses, as much as individual shortcomings, which have been highlighted during recent scandals. One particular concern is conflict of interest facing auditors. As noted above, the root problem is that auditors are appointed and paid by company *management* but their first responsibility is to the *shareholders*. Thus their primary duty to a group of people they do not know, yet they are subject to direct pressure and intervention from those who have awarded them the business and pay their fees. As has long been recognised, in this situation accountants and auditors can easily be subject to a conflict of interest between the ‘code’ or ‘ethics’ of their profession and their responsibility to their

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‘client’ and employer. This conflict of interest is inherent to our contemporary business system; it is ‘systemic’.

A quite different conflict of interest involving auditors is that between performance of their role as independent auditors, with their role in marketing their firms’ *non*-audit consultancy services to their audit clients. This conflict of interest has grown greatly in importance over recent years, especially in the US. Consequently, this is what has driven most of the recent debate. WorldCom, as noted above, paid its auditor Arthur Andersen a total of US\$16.8 million in fees in 2001, but only \$4.4 million of this was in connection with the annual audit (Kirchgaessner et al., 2002). The overall picture in the US is clear from figures quoted by former SEC chairman Arthur Levitt in his book: “Take on the Street” (Levitt, 2002). Whereas in 1976 audit fees made up 70% of accounting firm revenues, the figure for 1998 was just 31%. In 2000, S&P 500 companies paid their auditors US\$3.7 billion for non-audit services, more than three times the US\$1.2 billion in audit fees.

Another conflict of interest exposed in the wake of recent bankruptcies has been that of investment bank ‘analysts’. These so-called ‘experts’ have been shown to have worked in a manner designed to generate investment banking business rather than produce the expert and informed stock appraisals for which their clients pay. In this case, the conflict of interest is institutional. It derives from the fact that two quite different classes of financial service are offered by the same company. Bank ‘analysts’, whose first responsibility should be to those who buy their advice, have been shown to be subverted, by their bosses and through incentive payments, to support the selling of more profitable investment services.

The importance of conflict as an issue in professional conduct becomes very obvious once it is noted that the annual performance of Arthur Andersen partners was partially measured by their ability to cross-sell services across the firm (Ryan, 2002). Its importance is even more obvious when it is noted that for many corporations payments to audit firms for non-audit services has greatly exceeded their audit fee payments.

Such conflicts are, in principle, susceptible to regulatory management. At the same time they are not necessarily easy to regulate successfully. But the establishment of appropriate

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legislation, or code of practice norms, can certainly help to reduce them in number and limit their impact. The most obvious improvement on current practice, now under active consideration in the US, is to put a straightforward prohibition on audit firms accepting non-audit work from their audit clients. Of course, there are those whose interests would be adversely affected by such a change and there may also be tricky decisions required about where exactly to draw the line between audit and non-audit work; especially in the context of tax advice. However, if the objective is judged desirable then the difficulties can be overcome. There can be little doubt that it is the best way to make progress. An additional way to discourage auditors from cuddling up to clients is to require boards to establish audit committees with an enhanced role and significant independence from management. This, too, is likely to be done.

In many respects, 2003 is the year which will see the legislative and regulatory result of the 2002 corporate collapses. In the US, the SEC will create its new five-member Public Company Accounting Oversight Board together with its initial attempt to flesh out and implement all the other regulatory details of the Sarbanes-Oxley Act. Time alone will reveal the actual impact of this on the quality of corporate governance.

### *Prudential Responsibilities*

Events have demonstrated that existing market discipline and self-regulation have utterly failed to give adequate protection to the investing community and the general public. Put more provocatively, market forces proved unable to detect, or to discipline, the opportunism of the unethical (Kuttner, 2002-1). Consequently, the need for effective market regulation and the case for upgrading the existing regulatory system, hardly needs to be made. Donald Jacobs, a former Dean of Kellogg School of Business, has commented: "Enron is bringing about the most sweeping structural changes in governance that have ever occurred". Even if this is an exaggeration, the unopposed passage of the Sarbanes-Oxley Act has shown that legislation and regulation are now being given greater public trust than individuals and institutions with vested interests to protect. Of course, whether renewed regulatory vigour

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does in fact produce improved standards of governance and social responsibility remains to be seen.

### *Professional Interests*

Professional groups always pay close attention to their own interests and seek to further those interests. In business, as elsewhere, society has to strike a balance between these sectional interests and the good of the whole. This is what the relevant legislation and regulatory framework is supposed to achieve. Those sectional interests which have received most critical appraisal during the recent crisis are the accountancy profession, in particular auditors, and senior corporate management. Accountants and auditors are criticised for willingly misleading the investing public by failing to insist that a 'true and fare' picture of companies be given in financial statements. CEOs and other senior managers are criticised for enriching themselves at the expense of shareholders, quite legally, by receiving large payments in the form of *unexpensed* stock options; for the most part irrespective of performance. Both groups are criticised for largely disregarding their fundamental responsibility to shareholders. A less central group subject to criticism, mentioned elsewhere in this paper, are the stock analysts of the investment banks. Other groups subject to criticism include the regulators and the regulatory institutions; and, in the US at least, interest group-supportive politicians. In addition, it must be noted, are corporations themselves. They, too, have interests to promote at times, just as Enron actively promoted deregulation of the energy industry.

What is relevant in the context of this paper is the stance of the accountancy profession and the big audit firms with regard to current attempts to tighten standards of corporate governance. Far and away the most informative indicator of this is given by the pre-crisis response of the profession to initiatives by Arthur Levitt, former chairman of the SEC under President Clinton. In 2000, Levitt tried to tighten standards of investor protection through requiring stock options to be treated as an expense and by requiring that auditors be independent 'in fact and appearance'. The big five accounting firms strongly objected to these proposals; more than anything else to protect their large non-audit business. The industry very

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effectively mobilised Congress, most of whose members received campaign contributions from the accounting industry, to block the proposed reforms and even to threaten the funding of the SEC itself. Levitt later commented in his book: “the accounting firms were passive when it came to standing up for investor interests” (2002). So it can be seen very clearly that there are indeed occasions when sectional interest leaves no room at all for any wider view of the public interest, or, social responsibility.

By mid-2002, the US accounting industry was being viewed more cynically. Yet the industry ignored the public mood and still reacted in a narrow way, warning that it was undesirable to place restrictions on auditors. Previously, American accountants answered to a self-policing entity called the Public Oversight Board. Some influential business groups, on the other hand, applauded the proposed Sarbanes Bill (Schroeder, 2002). In principle, it would be reasonable to expect the 340,000-member American Institute of Certified Public Accountants (AICPA) to work positively in support of honest corporate books. Yet they steadfastly opposed upgrading of regulatory standards, despite the demonstrable need for it. As scandal has now revealed, AICPA professional standards and peer-review systems were, arguably, laughable. They spent relatively little on self-policing and accountants were rarely disciplined. In particular, industry peer review failed to prevent palpable conflicts of interest from being ignored (Kuttner, 2002-2). AICPA argues that its members are the ones with the expertise needed to write the rules. Critics, including three former chief accountants of the SEC, contend that AICPA has consistently tilted its standards to shield big auditing firms from liability when they fail to detect financial fraud. More generally, according to the managing partner of one mid-size American auditing firm: “AICPA failed to defend the integrity of audits and financial statements, the very underpinning of the profession” (Henry and McNamee, 2003).

It is sensible to recognise two things. First, more obviously, that the accounting profession is everywhere organised, politically influential, and well able to defend and promote its interests. Second, more worryingly, it is naive in the extreme to assume that this

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professional interest will be swayed by considerations of social responsibility in circumstances where this is thought to conflict with sectional interest. So it follows that when speedy action is the priority, it may be desirable for the regulatory authorities to work in collaboration with the accounting profession. However, it also follows that some form of independent and effective regulation of the profession is essential if the wider public interest, including that of the investing public, is to be protected..

### ***Cultural Issues***

#### *Quality of Corporate governance*

According to a McKinsey survey of over 200 institutional investors in 31 countries, published in July 2002, the quality of corporate governance has emerged as the single most important factor influencing their decisions (Skapinker, 2002-1). Investors said the quality of corporate governance included the effectiveness of directors. Three quarters of those polled claimed they would pay a premium for well-governed companies. When asked to identify issues which most affected their investment decisions, 71% mentioned accounting disclosure, far higher than any other issue. This factor is highly significant given that critics of the current situation often point to accounting failure as the *core* governance problem (Clarke and Dean, 2002). Following the demise of Enron, WorldCom and others, this view should cause no surprise. Such cases have demonstrated for all to see that we can neither trust companies' accounts nor the auditors who put their names to them (Skapinker, 2002-2). One implication is obvious; namely, that considerable effort should go towards working out how accounting can be reformed to provide a clearer idea of a company's "true" financial position.

Enough has been said already in this paper about the dark side of current corporate governance. One of the encouraging signs of the times is a book entitled: '*Building Public Trust: The Future of Corporate Reporting*' by Samuel DiPiazza and Robert Eccles (2002). The book is encouraging on account of its content and because its authors are from PricewaterhouseCoopers. Indeed, Samuel DiPiazza is PwC's global CEO. It is interesting that these two leading accountants from a Big Four firm offer constructive proposals for

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accounting system upgrading. They offer a three tier model of corporate transparency leading on to three central ethical responsibilities for the accounting profession. It is good to find some prominent Big Four accountants actively interested in improvement.

### *Corporate Ethics*

Critics of contemporary standards often argue that legislators and regulators continuously fail to get the *principles* of corporate governance right. A major strand of this criticism is that reformers fail to put “truth and fairness” at the *centre* of financial statements and, therefore, much of the discussion of corporate governance reform is empty. Little is said, they would argue, about personal integrity; despite contributions like DiPiazza & Eccles.

It has to be recognised that there is a general problem in trying to spell out “grey” in black or white terms, as though there could somehow be a simple formula for good, sound judgement. The temptation at the present time, under the pressure of crisis events, is to confront ethical weaknesses with detailed regulation. Reflection, however, tells us that regulation may be desirable when dealing with technical issues but cannot by itself remedy ethical problems. Worse, regulation may even shift the focus of concern from important ethical issues to mere compliance with regulations. In short, solutions to corporate governance and social responsibility problems cannot be found in regulatory mechanisms *alone*.

## **Conclusion**

There is no doubt that the accounting profession, its auditors, not least the Big Four or Five, and its regulators, have all been found wanting. It follows that *‘better’* regulation of accounting and auditing is desirable. This is also possible. Events have also revealed a number of associated issues, like executive pay schemes and various conflicts of interest. These, too, can benefit from *‘better’* regulation. Happily, changes designed to improve the US regulatory regime are already in the pipeline.

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At the same time, recent events have exposed a vast reservoir of fraud, greed, and legal *but* unethical behaviour. Fraud will always be present in business. It has to be held in check by legislation. The more difficult issue is legal but *unethical* business behaviour. This lies at the heart of current debate on the quality of corporate governance. It presents a subtle and intractable series of problems. There can be no perfect solution. The best way forward is probably to examine each particular ethical issue individually and to respond with carefully measured, incremental steps. In each case, the folly of trying to *overcome* ethical issues by rigid, universal rules needs to be explicitly recognised and avoided. At the same time, the best possible '*principles*' and '*guidelines*' should be promulgated by regulators and, importantly, actively endorsed by the relevant professional associations. Policing, as ever, needs to be vigilant.

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