

# When accounting and ethics collide

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Much has been said about corruption in the public sector in the last two months... about 1,300 pages worth to be precise. At the heart of this discourse is deliberate bribery and corruption to secure contracts worth billions of rands, inserting pliable individuals into key positions, and the intimidation of those who had any courage to stand up and be counted



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When people think of bribery and corruption, they likely have this perception of the actions needed to perpetrate financial crime and the locations where this happens. It's not always someone with a bag of cash, someone with a gun, and they're not always in a poorly-lit alley or a smoke-filled room. Financial crime and corruption happening in airconditioned offices, perpetrated by those who claim to be professional accountants, are just as damaging.

When the measures by which management and others will be rewarded, or otherwise held accountable, can be manipulated by a particular accounting outcome, there is a good chance that accounting and personal ethics will collide. While this might seem obvious in the private sector (Steinhoff and Tongaat Hulett are good examples), the public sector is not immune.

The performance targets set for public sector officials are directly linked to the key outputs of the organisation, for example, a reduction in debt, the number of houses built, the amount of money spent on 'social investments'... the list goes on. From a performance management perspective, making sure that the success of the organisation is directly linked to an individual's performance makes sense. However, in doing so, the professional accountants, governance and other oversight structures should be sceptical about the potential for manipulation.

While the manipulation of financial information could take a variety of forms, there is an emerging trend of manipulating accounting policies to achieve a specific outcome. Accounting policies should be designed to provide users of the financial statements with information to (a) hold entities accountable and (b) make financial, economic and other decisions. As government and its actions affect us all, there is a higher degree of accountability required. This means that – as a professional accountant – the question should always be whether the information provided in the financial statements (or lack thereof) – is in the public interest.

## Examples

There are two interesting examples where the choice of accounting policy has sought to hide relevant information from the public:

### **Example 1 – The non-consolidation of controlled entities**

This is always a contentious issue, although much of the debate is usually about the 'materiality' of the subsidiary, or that underlying information may seemingly not be available. From a public sector perspective, investments have been made in small and emerging businesses in various geographical locations under the label of 'social investment'. Soon after, these 'social investments' are drowning in debt and are insolvent. Where government has a controlling interest in these types of businesses, it is critical that they are consolidated to get a full understanding of (a) the money invested (and lost), (b) the obligations that need to be fulfilled, and (c) the risk exposure because of the relationship with the business.

The nature of these businesses' activities is usually dissimilar to those of the parent. The parent could, for example, be an

economic development agency, a pension fund, an asset manager, or an entity with a large investment portfolio. Some would say that a line-by-line consolidation may be misleading to users and warrant a 'fair presentation override'. For example, combining or reflecting investment or levy income with the proceeds from the sale of chickens as revenue may not be a 'fair presentation' of revenue in a single set of financial statements. While it may look strange, this is a picture that the public deserves to know.

In this case, the entities providing the money and the asset manager advising on the investments met their targets in year 1. However, there is little consequence in year 2, when the investment is all but lost. Instead of being concerned about the accounting outcome, the accountants should have applied professional scepticism and wondered why they were in that particular business to start with. The accounting gave the right answer, and if sound ethics prevailed, this would have been known to all.

## **Example 2 – Accounting arbitrage**

What I call 'accounting arbitrage' is nothing more than changing accounting policies, or cherry-picking accounting treatments, to achieve a particular outcome rather than to provide more relevant and reliable information to users of the financial statements. Of course, there are grey areas when it comes to accounting, but to apply 'new' accounting policies or 'new' Standards when the underlying substance of a transaction or an arrangement has not changed, can hardly result in more relevant and reliable information. If the change in policy is indeed warranted, a case could be made that the prior years' accounting was incorrect and should be restated.

'Accounting arbitrage' can be a good way for officials to manipulate results and balance sheets depending on the desired level of performance required by their scorecards. When senior officials that are most often absent from accounting decisions express strong views about the development of accounting policies, accountants should always ask – why?

## **To conclude**

In theory, accounting and ethics should never 'collide'; they should walk hand in hand. And for the most part, I think this is true. However, when accounting can be used as an opportunity to hide nefarious transactions, poor financial management and inefficiency, and help officials meet their performance targets, accountants are placed in the spotlight and have a duty to stand firm.

As a professional, you are duty-bound to not only apply the Code of Ethics but to live by it. What you choose to disclose in the financial statements is no different. If the accounting standards are not being applied as intended in the public sector you also have a responsibility to report 'non-compliance with laws and regulations' (NOCLAR) to management, your governance and oversight structures.

If you are confronted with ethical dilemmas, speak to a colleague, speak to your line manager, speak to the chairperson of your audit committee, speak to the chairperson of your board, speak to someone in your professional body. But most importantly, if you see something, say something!

## **ABOUT THE AUTHOR**

Jeanine Poggolini is CEO of the ASB, a SAICA member and a member of the board of directors of IFAC. The article reflects her individual views.

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