

## **BUSINESS & SOCIETY : A SUSTAINABLE RELATIONSHIP**

**In a 1988 US Vice Presidential debate Lloyd Bentsen turned to Dan Quayle, who had compared himself to the great President John Kennedy, and said “I knew Jack Kennedy, Jack Kennedy was a friend of mine, Sir, you are no Jack Kennedy”.**

**Well, I knew Aileen Beattie, Aileen Beattie was a friend of mine , but I am no Aileen Beattie. Her work was prodigious and long lasting. Publications “Making Corporate Reports Valuable” (a work way ahead of its time), “Auditing into the 21<sup>st</sup> Century”, the International Capital Markets Group publication “Who Holds the Reins” which looked at international corporate governance and “Taking Ethics to Heart”, all owed a lot to Aileen. Though ill she initiated and coordinated the Principles v. Rules project. While I could not think and write with the clarity and vision she did, her subject matter was, and is, very dear to my heart. I was, therefore, delighted to be asked to give this first lecture in Aileen’s memory in the certain knowledge that her contribution to our thinking and practice in these areas will be everlasting.**

**The title of my talk is Business and Society:**

- A Sustainable Relationship. I will focus on the contribution to society of business including the accounting profession. In the address I will look at:**
- Ethics and Integrity in Society, in Business and in the Profession**

- **The Role of the Professional and of Business in Serving the Public Interest**

### **Corporate Responsibility to the Environment and to Society (CSR)**

**The background to the ethical conduct of business has its roots in Plato and Aristotle and has developed as population, technology, communication, trade and globalisation have developed through the writings of, among others, Adam Smith, Benjamin Franklin, David Hume and writers on philosophy today. Yet current thoughts, notably those of Donaldson and Dunfee, have a resonance with Plato – the social contract, the unwritten “licence to operate” which all economic activity must have. No economic enterprise is an island. A business exists in a community from which it draws its labour, its capital, its suppliers and its customers - sometimes in a world of several quite different communities with different religions, customs, expectations, economic and social standards and political arrangements. But before I get too theoretical I want to bring you back to the thought that ethics are ultimately about our own actions rather than corporate statements of values however necessary and useful these may be. Some examples of my own spring to mind over the years.....**

*Forty-three years ago when I was an apprentice accountant in Kirkintilloch writing up the books of a client, a customer came in to pay in cash and when I went to write a receipt the director of the company told me not to, he also told me not to make an entry in the cash book. I spoke to the audit partner and he said everything should go through the books. He gave the director a metaphorical spanking.*

*I was preparing the year-end accounts at the Paisley Gazette. There was an entry on the last day of £500 in and £500 out. I asked what this contra entry was. The answer was that the £500 in was for the sale of newspapers and that the £500 out was for “us buying them”. At one penny per paper and 240 pence per pound this was a lot of newspapers. On enquiry I was told “every one does this”.*

*On one occasion the bank had a floating charge on a company’s machinery. I looked out of the window and saw a lorry drive off with the machinery. “There goes your floating charge” said the FD.*

*Then there was the Peter Young affair. Mr Young worked for Morgan Grenfell Asset Management. MG had to be bailed out by its owners Deutsche Bank to the tune of £425 million because of irregularities in some funds. When one executive was asked “But surely you know the difference between right and wrong?” it was clear he didn’t understand the question.*

*As Confucius said “to see what is right and not do it is want of courage or of principles”.*

**All living things have life cycles. Business enterprises are similar and the forms of governance they require as they mature change accordingly.**

**When an individual starts up a business he (or, increasingly, she) may have very few people to whom he is answerable. Perhaps some capital has been provided by family or friends, and these will be his stakeholders but information supplied to them may be quite basic**

**and informal. Stakeholders will include his suppliers who are providing credit, his customers, without whose satisfaction he cannot survive, his employees (if any) who look to him for remuneration and security of employment and the community in which his business operates. Government is always a stakeholder even if only in areas of taxation. Even at this early stage there is a need for ethics and trust. The foundations of your business must be that you are true to yourself.**

**As a business grows so do the obligations to inform these stakeholders but soon outside capital (from banks, or business angels, or venture capitalists) will be required. These suppliers require quite different reporting criteria. They will want to be involved in strategy, setting budgets annually, discussing results at monthly or quarterly intervals, to have rights of veto over capital expenditure, acquisitions and disposals, directors' remuneration, dividends, raising of capital and a whole host of other issues. They may also insist on the appointment of a non executive director to monitor their investment. At the same time, family members may have passed on shares in the business to new generations who have different personal financial requirements and views on where the business should be headed. Professional management in areas such as finance and marketing will begin to fulfil part of the duties of the business founder or his immediate family. More people will now be relying on the ethics of, and trusting, the people running the business.**

**From the pressure to encash some shareholdings for those who do not wish to stay around and perhaps also from a need to raise significant equity capital, a company often undergoes an IPO. At**

**this stage, governance becomes a major issue. People who buy shares or bonds in a capital market (whether through collective saving schemes or direct) may never meet the management, never discuss with them their strategy and may buy and sell their shares between annual meetings or even intra-day. Yet for international capital markets to work these people have a right to be able to trust the financial and other information provided by the company and to believe that the company is properly governed.**

**The events at Enron, Worldcom and others shook confidence in capital markets around the world but these things are not new. A decade before in the UK the talk was of Maxwell and Polly Peck. Further back were the South Sea Bubble, Dutch Tulip scandal and many others. Yet here we were in the 21<sup>st</sup> Century with large sophisticated audit firms, recognised accounting standards, boards of directors boasting independent non executives, audit committees and internal control procedures. How could it happen? Could it happen in the UK and Europe? Could we prevent it?**

**When I was asked to Chair the FRC Group on Audit Committee Guidance, I asked Sir Brian Nicholson (then the FRC Chair) to clarify to whom the report was addressed. His reply was “If you can’t handle ambiguity, don’t take the job on”.**

**Ambiguity doesn’t need many words. Boris Yeltsin was asked to sum up the Russian economy in one word. He said “Good”. Asked to sum it up in two words, he said “Not good”.**

**Unlike Derek Higgs, my FRC Group had on it, 2 FDs, 2 Investors, 2 Audit Partners and a Lawyer – Richard Fleck. – now Chairman of the Auditing Practices Board. We firmly believed in principles based governance. In my experience a set of principles which can be adapted to every size and type of company is more effective than a set of rules which, if complied with, gives the impression of absolving people from further responsibility. The concept of “true and fair” in an audit as an overriding principle is better than saying that every accounting standard has been complied with. The results may be technically, even legally, correct but are they true and fair or are they misleading? Is it a case of form over substance? Isn’t substance rather than form what trusting third party investors in capital markets depend on? Most importantly, principles require expertise and judgement and ethics and integrity which in turn require trust from others.**

**Our Group set out the role of the Audit Committee, gave guidance on rotation of external auditors, the independence of members of the audit committee and of auditors and on non audit services. A key element of our report concerned membership and resources that must be available for the much bigger job that audit committees in the UK now have to do. Although we were somewhat prescriptive about membership and independence of members, we were less prescriptive about financial expertise. It is very important that different types of companies have different memberships of their audit committees depending on the specific risks of different companies. Overall we stressed that the human qualities of the people who were to be committee members - independence of mind,**

**toughness and persistence - were more important in many cases than qualifications in accounting or finance.**

**Just consider this.....**

*You are a member of the audit committee and the Chairman of the Group enters the meeting asking you to make a decision in a hurry before the Board meeting and the decision is to alter an accounting policy to add \$3 billion to the bottom line, what would you do? The Finance Team, an independent firm of accountants, the Group's in-house lawyers, counsel, the other members of the Audit Committee and the Board have all signed off on the change. Do you resign or put in a minority report? If you don't understand or don't believe this is the correct decision you have to stand up. If you don't understand the reasoning you have to ask for an explanation, you have to take a personal view.*

**Let me read from a recently published book on Greed and Corporate Failure by Professor Stewart Hamilton which looked at all the recent disasters.**

**“The recurring themes are poor strategic decisions, overexpansion, especially through often ill-judged acquisitions; the dominant CEO or ‘one man band’; the greed, hubris and lust for power of CEOs and other ‘star’ performers; poor risk management and weak internal controls, particularly with regard to cash; and ineffective boards and their audit committees. We reiterate that fraud is rarely the underlying cause of a company’s downfall. Where it occurs, either the fraud was possible as a result of lax or non-existent**

**controls, or it was deliberately perpetrated in order to cover up management failings.”**

**I believe that my 5 years in a CA’s office was of enormous value. I think I already understood the difference between right and wrong but seeing this applied in a business context, attesting to figures on which others would depend as true and fair, became vital for a future career in business. However, my training was at a time when every debit had a credit with perfect symmetry and logic, and questions of judgement could conveniently be covered by the Principle of Conservatism. As auditors we stamped every invoice and ticked every figure on the books of original entry but, of course, “auditors were not bloodhounds”. Audit partners seemed to be paragons of virtue and their authority never questioned and an accountant in a professional office was highly regarded by society. Inflation accounting and a raft of new standards of auditing following corporate scandals engulfed the profession in the 70’s. The profession defended itself, led by Sir Ronald Leach and others, but there had been a permanent change.**

**So what does it mean to be a professional, or a profession, today.**

**In looking at professional associations I am conscious of Adam Smith’s statement in The Wealth of Nations**

**“People of the same trade seldom meet together even for merriment or diversion but the conversation ends in some contrivance to raise prices”**

**and also**

**“we rarely hear of the combination of masters but frequently those of the workman but masters are everywhere in a sort of tacit but uniform combination.”.**

**Professions generally have common characteristics.**

- 1. They act in the public interest and independently**
- 2. They behave ethically and with integrity**
- 3. They have technical competence, specialist knowledge and can apply professional judgement.**
- 4. They have a service ethic, client before self**
- 5. They have fiduciary duties, notably client confidentiality**

**Let’s look at how our professionals shape up against these criteria. Critics would say acting in the public interest is interpreted in a rather narrow and simplistic way, that there is little ethical reflection on how accounting contributes towards a more democratic or just society and therefore the public interest as opposed to a small section of society. This criticism is not entirely misplaced but it is a difficult task to present meaningful figures on which capital markets, suppliers, customers, tax authorities, economic planners and others can place reliance and yet give sufficient information on those wider issues that affect society. Some effort is made in corporate social responsibility and other sections of annual reports and I will refer to this later.**

**On the independence of accountants, Sir Andrew Likierman commented in 1989 that this seemed to be restricted to single client**

**dependency, non audit services and professional relationships. I genuinely believe that things have moved on in this area and indeed audit firms self assessment is matched today by the testing of audit committees.**

**Professional bodies issue ethical codes providing a broad framework and codes of professional conduct which give detailed rules for decision making by members in their professional lives. No rule book can cover every eventuality but a set of values can help people to arrive at judgements. However, it is often the case that those who dissent and whistleblow on matters of public interest can end up breaching client confidentiality or even breaking the law.**

**I believe that the chartered bodies, and I speak from knowledge about ICAS, have kept pace with complexity and changed examination curricula to provide the services required. To me it is remarkable also how the profession has provided all the additional help while IFRS was being implemented, new audit/Sarbanes Oxley provisions complied with, and audit staff were being poached to beef up internal audit functions in corporates - all at a time of frantic corporate activity. Having said that, one of the defining characteristics of a profession is its ability to take technical know how and identify how it can be applied to the benefit of society in general. There is little evidence that the professional curriculum fosters this kind of broader political/economic understanding.**

**Since companies appoint, dismiss and remunerate auditors there could be a perceived conflict of interest. However, the safeguard of independent audit committees and the consequences for auditors of**

**ignoring the reliance placed on them by customers, investors, suppliers, employees and pensioners cannot be underestimated.**

**The profession itself has changed through technology and socio-economic factors. A better educated public is more sceptical, less trusting, more likely to question, based on a greatly increased and available flow of information. Some of our greatest leaders in the profession – Lord Benson, Sir Ronald Leach and ICAS’s Sir William Slimmings believed strongly that a profession must prove that it was robust, thorough, transparent and fair in self regulation. As public attitudes have changed this is no longer enough and I speak as one who has seen our disciplinary tribunals in action – no one is harder on the miscreant than fellow members of his or her profession. And our profession is not alone. The shift in social attitudes towards the accounting profession can be seen clearly in other professions such as law and medicine.**

**Regulation of the accountancy profession is substantially passing to the FRC. To me this is not a disaster, simply a sign of the times. Even judges are no longer appointed by the existing judiciary, a practice which had been a protection for judges from interference by government / the executive. They are appointed by independent boards so that public accountability is clear. The erosion of self regulation should in no way weaken the Institute’s efforts to strive for the highest of standards from their members. Moreover, the profession has huge roles in education and in standard setting, in lobbying the UK government, the EU, regulators here and overseas, and international standard setters on big issues affecting business, the public sector and the profession itself. Perhaps in the past rather than being defensive about major corporate failures we should have**

been much stronger in producing sensible solutions and challenging government initiatives. And I regret the apparent reluctance of partners in professional firms to become trustees or non executives in companies. Perhaps driven by a fear of conflict of interest or the potential surrendering of a future fee earning opportunity. The accounting profession developed a reputation as “people of business” and it would be a pity to see a diminution even of this limited engagement with the wider community from which charities and businesses would benefit.

Regardless of the extent of professionalism actually being exercised by the profession today, and indeed what the term “professionalism” now means in the 21<sup>st</sup> century context, the perception of those who rely on the profession is vital to the confidence and trust which holds the business environment together. For that reason, ICAS is shortly to undertake a survey of perceptions of the profession, and a Working Group, led by soon to be President Isobel Sharpe, is to consider the results and what actions, if any, the profession needs to take.

ICAS, if I am allowed a further small commercial on behalf of my alma mater, was ahead of its time in 1988 with “Making Corporate Reports Valuable” and more recently in 2006 with “Principles not Rules”. The English Institute’s excellent Audit Quality Forum (2004) and the International Federation of Accountants Task Force Report “Rebuilding Public Confidence in Financial Reporting” also contribute to forward thinking.

I am bound to conclude that, since I entered accountancy, life has become more complex, public attitudes have changed and what it means to be a professional accountant is much more about involvement in the community in which we live and with serving

**society and it is this area generally that I would now like to address. If I may I will extend my remarks from professional firms to encompass corporations – businesses, large and small, and the arguments equally apply to employers in the public sector.**

**Corporate Social Responsibility can be measured and reported in four key areas – community, environment, the marketplace and the workplace.**

**Scottish Business in the Community have done considerable research in these areas and have concluded that Corporate Social Responsibility is about enlightened self interest and there is actually a business case to be made.**

**Corporate responsibility provides a means by which companies better understand and manage risk. All businesses take risk and make judgements about the level of risk that is appropriate. Many corporations are broadening their definition of risk to encompass wider and longer term risks that incorporate social and environmental issues. They are engaging with a wider external audience to understand needs and expectations and take action, where appropriate. There is growing pressure for companies to understand and act on a widening range of risks across their business. However, a recent survey suggests that despite many companies understanding the reputational issues associated with sustainability less than 1/3 of respondents are currently incorporating risks or opportunities associated with sustainability into their risk assessment process or business strategies. Corporate responsibility offers more effective management of risk, helping**

**companies to reduce avoidable losses, identify new emerging issues and use positions of leadership as a means to gain competitive advantage or at its basest by influencing new regulation to strengthen competitive advantage.**

**Businesses are run by people for people. They ARE the business. Understanding and aligning their values with that of the business is critical for success. Employment is a significant part of people's lives. Just as people develop and pursue things important to them outside the workplace they expect to be able to flourish as individuals within the workplace. Recent evidence suggests that 3 in 5 people want to work for a company whose values are consistent with their own and they will stay with the organisation while this consistency remains. Corporate responsibility is increasingly the overriding factor in attracting, retaining and motivating a talented and diverse workforce.**

**In 1983 a Royal Dutch Shell survey found that 1/3 of the firms in the Fortune 500 in 1970 had vanished. Shell estimated that the average lifetime of the largest industrial enterprises is less than 40 years, roughly half the life time of a human being. There are many examples of businesses which failed to adapt.**

**Midland Bank in my working lifetime was the biggest bank in the whole world by any measure and was bought by HSBC which was a small bank 40 years before.**

**The Carron Ironworks was the biggest munitions company in the world supplying cannonballs to both sides at the battle of Waterloo yet failed to adapt and disappeared.**

**Although the death of these firms may be attributed to economic change and redistribution of resources, high corporate mortality is a symptom of deeper problems that afflict all companies in that most organisations learn poorly. According to SBC 80% of European business leaders believe that responsible business practices allowed companies to invigorate creativity and learn about the marketplace. Over 80% of both employees and CEO's believe responsible organisations are more creative.**

**The investment community is increasingly regarding corporate responsibility as a proxy for “quality of management” of a company. 86% of institutional investors across Europe believe that social and environmental risk management will have a significantly positive impact on a company's long term market value. Whether seeking finance for new ventures or additional investment, corporate responsibility is an opportunity to widen access to all types of capital. For the investment community, CSR applies all the way down the supply chain and this includes overseas suppliers and it includes environmental issues as well as treatment of employees and methods of doing business.**

**Finally, according to SBC, 78% of business leaders across Europe believe that only by fully integrating responsible business practice will companies be more competitive and 70% of CEO's say that corporate responsibility is vital to profitability. CSR opens**

**opportunities to reduce present or future costs to the business and it serves to improve competitiveness, market positioning and profitability.**

**I have not known a time when entrepreneurs and corporate leaders have been so conscious of their social responsibilities. Entrepreneurs in Scotland such as Sir Tom Hunter are effectively leading a new Scottish Enlightenment. In an area in which I am working, 16-19 year olds Not in Employment, Education or Training, I have been astonished at the time and effort devoted by business leaders and their staff directly, and indirectly through voluntary organisations, to solving community problems.**

**I have devoted most of my address to corporate governance and ethics in business. Before I close I want to say that I believe passionately that we need to create the wealth for it to be available for distribution. To do this we need to improve the entrepreneurial environment for large and small businesses and the climate to foster the birth of new ones. We need to reduce regulatory burdens and have better more focused and efficient regulation. We need to halt or reverse the blame culture and restore balance and proportionality in regulation and administration and we must fight hard to support principles rather than rules and maintain scope for professional judgement. For business and the professions we need a greater realisation that we are part of a community. Rather than writing a few CSR paragraphs we need to live the values that we would all subscribe to. By empowering our employees and colleagues we can improve the society in which we and our families live and in which our customers, suppliers, employees and their families live.**

**In closing I want to say that ICAS gave me a great education and the basis for a career and some strong ethical principles. I mentioned some heroes such as Lord Benson, Sir Ronald Leach and Sir William Slimmings. There are many other heroes such as Professor William Baxter who took the theory of accountancy to new levels and incidentally taught a young Brian Carsberg. Professor David Flint at whose feet I learned at Glasgow University and the late great Sir Ian Morrow for whom the expression “company doctor” was coined. If you wanted an example of someone of integrity who could stand up even to a hostile government at the time of the Rolls Royce rescue, here is your consummate hero.**

**There are heroes around today, Professor Percy, something of a mentor to me cares deeply about the profession, about standards and about the Scottish Institute.**

**Norman Murray a long term colleague of mine, is the current president. I cannot describe him as a hero despite the outstanding success of Cairn Energy which he chairs, but he exemplifies this quality of integrity. In the 1980’s, he and I were in California raising a fund for our new employer, Deutsche Bank. We had no fund, no employees and no customers. As we tucked in to a sumptuous meal in the expensive Bel Air Hotel in Los Angeles, Norman looked across the table at me and said “Robert, who is paying for this?”**

**Women have played a huge role in our institute. Primrose Scott under whom I served as a JVP came from a small practice but brought to Council a very strong code of ethics. Isobel Sharp who is**

**our next President and who held the post Aileen had in ICAS immediately before her brings a formidable intellect and strong ethical beliefs to the post. Finally, Aileen Beattie. I hope my musings have not dented her reputation – she deserves better. She made a real impact on the Institute of Chartered Accountants of Scotland and on the development of thinking in accountancy. Sir David Tweedie has called her irreplaceable. I have another word. I was describing to Derry Irvine, long before he became Lord Chancellor, a particular business man whom I greatly admired. I said that I thought that the business figure was an outstanding human being. Derry agreed but put it another way - he said “he is considerable” Ladies and Gentleman Aileen Beattie was and is “considerable”.**