Governance, risk, ethics and theory

MODULE 5 | PART A.3 | STUDENT COMPANION

Corporate governance: the set of rules, relationships, systems and processes by which authority is exercised and controlled, and by which those in control are held accountable. In Australia: the Corporations Act; ASIC; the Financial Reporting Council; ASX Corporate Governance Council principles and recommendations (disclose compliance, or explain why not).

Two dimensions of governance

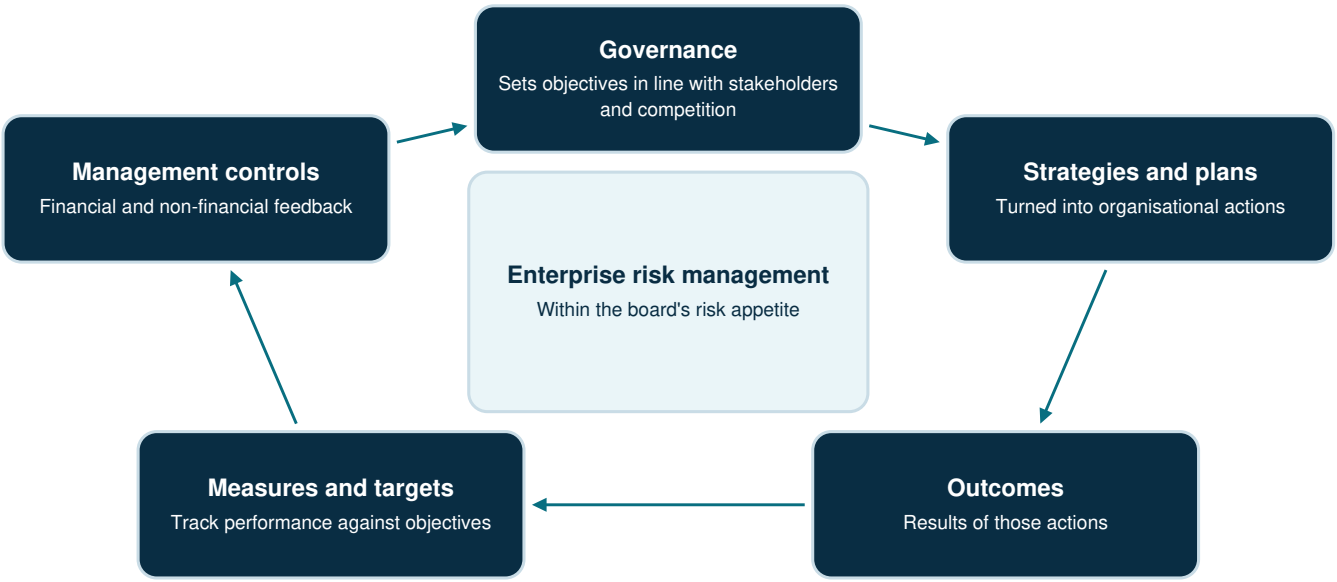
Conformance	Performance
• Assurance, including audit • Understanding and managing risks • Compliance with laws and rules	• Taking risks to achieve objectives • Strategy, resource use and value creation • Risk appetite and expected returns

Good governance balances conformance with performance

The board, risk and performance

Topic	Remember
Board role	Set objectives, monitor performance, report to shareholders; finance, audit and risk committees
Risk appetite	Risk averse, neutral or seeking; make expected returns explicit (hurdle rates, payback, IRR)
COSO ERM (2017)	Integrates enterprise risk management with strategy and performance
ISO 31000:2018	Risk = the effect of uncertainty on objectives
Accountants' role	Report integrity; management control and performance monitoring; risk management framework

Governance, risk and performance



Ethics: principles and threats

Fundamental principles	Threats
Integrity - straightforward and honest	Self-interest - an interest sways judgement
Objectivity - no bias, conflict or undue influence	Self-review - judging your own earlier work
Professional competence and due care	Advocacy - promoting the employer's position too far
Confidentiality	Familiarity - too close for too long
Professional behaviour - lawful, no discredit	Intimidation - real or perceived pressure

APES 110: identify, evaluate and address threats to the principles

Resolving an ethical conflict: weigh the principles and the consequences; raise it internally (if needed with the board); consider legal advice and any reporting duty; if misleading information remains, refuse to be associated with it - which may mean resigning.

Case note - Volkswagen, 2015: the company admitted that about 11 million diesel vehicles carried software that cheated emissions tests; the chief executive resigned within days and billions were paid in fines and settlements.

Sources: Al Jazeera, NBC News and CBS News reporting, September 2015.

Two theories

Agency theory

- Principals delegate to agents, who may act in self-interest
- Sharing rule: bonuses, options, incentive plans
- Information asymmetry: agents know more

Contingency theory

- No universal best performance management system
- Fit to size, environment, technology and strategy
- National pharmacy chain vs one owner-run pharmacy

Practice questions

MODULE 5 | PART A.3 | TRY THESE BEFORE THE WORKED ANSWERS

Question 1 - Name the threat

Situation	Threat
(a) The CFO is asked to review controls she designed last year	
(b) A manager's bonus depends on figures he is preparing	
(c) The CEO hints that 'team players' don't question the forecast	
(d) An accountant has worked with the same supplier for 15 years	
(e) A finance manager argues the company's case to the tax office beyond what the facts support	

Question 2 - Risk appetite

A board says it is 'risk seeking' in new markets but 'risk averse' on safety. How should this shape the performance measures and targets used by management?

Question 3 - Agency

A franchisor pays franchisees a bonus on sales revenue. Explain the agency problem this may create and suggest a better sharing rule.

Worked answers

MODULE 5 | PART A.3 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

Question 1 - Name the threat

Situation	Answer
(a)	Self-review
(b)	Self-interest
(c)	Intimidation
(d)	Familiarity
(e)	Advocacy

Question 2 - Risk appetite

New markets: allow stretch growth targets, accept lower early returns, set explicit hurdle rates and payback limits, and track leading measures (customer acquisition, market share). Safety: zero-harm style targets with leading indicators (near-miss reports, training completion, audits), no rewards that trade safety for output, and escalation of any breach to the board.

Question 3 - Agency

Franchisees may chase revenue through heavy discounting or costly promotions that hurt the network's brand and profit - their goals differ from the franchisor's. Better: reward a balance of profit contribution, customer satisfaction and brand-standard audits, with part of the reward deferred and tied to sustained performance.