PEARSON EDEXCEL INTERNATIONAL
AS/A LEVEL

ACCOUNTING

Student Book 1

SOCIAL AND ETHICAL ACCOUNTING

In this book, we have looked at the accounting system and costing. The focus of study has been on the financial aspects of accounting, which follow many accounting concepts including money measurement, prudence and accruals. We have studied the principles of accounting, control procedures, financial statements and costing methods. In Chapter 1, section 1.2 (What is accounting?) you learned that the purpose of accounting is to identify, record, measure and communicate information so people can make informed decisions. Much of the information you have worked with has been quantitative financial information. In this section, we will examine the non-financial factors that need to be considered in the decision-making process.

18 SOCIAL ACCOUNTING AND ETHICS

UNIT 1
1.6

LEARNING OBJECTIVES

After you have studied this chapter, you should be able to:
- understand the implications of accounting decisions in the wider social context
- understand the significance of non-financial factors in the decision-making process
- evaluate the effect of accounting decisions on different stakeholders
- understand the role of ethics in accounting analysis and decision-making.

GETTING STARTED

In August 2018, a profitable United Kingdom shoe designer and manufacturer announced plans to close its last UK factory and transferred the production of shoes to India. At the same time in Malaysia, 1800 jobs were threatened by the introduction of an online auction system for the sale of items to the public. What non-financial issues are raised by these decisions? What groups of people might be affected? How will these groups be affected?

ACCOUNTING DECISIONS

Historically, accounting decisions have been mainly based on numerical data obtained from the accounting system. Only financial factors have been considered in making accounting decisions. Examples of accounting decisions include:
- the acquisition and disposal of non-current assets
- the closure of a loss-making department
- the introduction of a new partner into a partnership
- a change to the method of employee remuneration
- a change to the raw materials used in the manufacture of a product.

All of these decisions can be made using only financial information obtained from the accounting system. The main criteria used in reaching a decision are likely to be the effects on profit and profitability. It is often assumed that profit maximisation is the only objective for the owners of a business. But a business does not and cannot operate in isolation from the wider external environment and must consider the impact of its decisions on other groups. Each of the decisions above will affect other stakeholder groups, as well as the owners of the business. Consideration of these wider effects is often referred to as social accounting.

SOCIAL ACCOUNTING

In the context of social accounting, it is important to understand that the word 'account' refers to the concept of accountability – that is, being responsible to others for your actions. Therefore, social accounting is a term applied when businesses are accountable to society. It involves both financial and non-financial factors and assesses the impact of business decisions on all stakeholders of a business.

There are many situations in which a business will make decisions taking into account the wider social environment. These wider social contexts may include:
- the local community
- the environment
- the workforce
- health and safety
- use of natural resources.

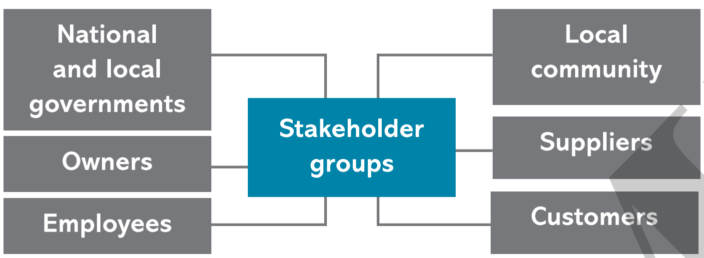
▲ Businesses should account for the affect they have on natural resources

Social accounting recognises that profits may fall if a business fails to meet the needs of the wider external environment. For example, a change in the method of employee remuneration may have a negative effect on the workforce, which might lead to low morale, higher labour turnover and recruitment difficulties.

ACCOUNTING DECISIONS IN THE SOCIAL CONTEXT

Businesses now have to consider the impact of their decisions on the wider community. An increase in global 24/7 media reporting and the use of social media mean that society and stakeholder groups are being constantly updated on the activities of businesses. In order to be seen as socially responsible, businesses increasingly take into account the interests of stakeholder groups when making decisions.

In Chapter 1, we discovered many different users of financial information. These groups of users who have an interest in the activities of a business are known as stakeholders.



▲ Figure 1 Some common stakeholder groups

Each of these groups is likely to be affected differently by business decisions and it is not unusual to find stakeholders coming into conflict due to their differing objectives. In social accounting it is important for a business to recognise the objectives of all stakeholders.

Stakeholder	Possible objectives
Owners	Growth in profit, high dividends, increased share price
Employees	Higher wages/salaries, job security, job satisfaction, safe working environment
Customers	Value for money, reliable products and services
Suppliers	Timely payment, fair price for product
The local community	Employment opportunities, increased local wealth
National / local governments	Payment of taxes, consumer protection, protection of natural environment

▲ Table 1 Possible stakeholder objectives

The significance of non-financial factors will vary according to the decision being made. Each decision will be unique in terms of its impact on social accounting. Stakeholders will be affected in different ways and each social context will be different.

THE EFFECTS OF ACCOUNTING DECISIONS ON STAKEHOLDERS

Businesses should consider the implications of their decisions in the wider social context and the effects these have on stakeholder groups. Some possible social accounting decisions are detailed below.

Stakeholder affected	Possible social accounting consequences
Owners / shareholders	The press and the local community are likely to have a negative view of the closure of a factory, because it will result in a loss of jobs. The bad publicity this creates will have a negative impact on the company's reputation, which could lead to a fall in share price.
Employees	Employees will be affected by the loss of jobs. Other employees at the company may have concerns about their job security, which could lead to low morale.
Local community	Due to the loss of jobs, there will be higher local unemployment. The unemployed will not have wages with which to buy goods and services, so the local economy might suffer. It is possible there will be a fall in living standards.
Suppliers	Suppliers of goods and services to the business might be concerned about reduction in sales to the business. This could negatively impact their own profitability, their workforce, etc.

▲ Table 2 Implications of the closure of an unprofitable department or factory

Stakeholder affected	Possible social accounting consequences
Employees	Loss of jobs, lack of job security, effect on health and safety from operating machinery
Owners / shareholders	Bad publicity, cost of redundancies, introduction of capital
Customers	Possible change in quality of product from hand-made to machine-made

▲ Table 3 Implications of the replacement of workforce by new technology

Stakeholder affected	Possible social accounting consequences
Owners	Bad publicity might affect share price
Customers	Pressure groups might organise protests against expansion, advise customers to stop buying the product
Local community	Damage to the local environment
Government	Concern at rapid reduction of a scarce resource for future generations

▲ Table 4 Implications of expansion resulting in overuse of scarce natural resources

This is only a small sample of possible accounting decisions and their possible effects on stakeholders. When answering examination questions, you will need to select one or two considerations and explain them in detail, rather than simply listing all stakeholders affected and all the consequences.

ACTIVITY 1

SKILLS CRITICAL THINKING, ANALYSIS

CASE STUDY: FACTORY CLOSURE

Global Garments produces clothing in many different countries. It has recently announced plans to close an unprofitable factory in Bangladesh. The factory is in a poor area of the country with few alternative employment opportunities.

1 State four social contexts that affect accounting decisions.
2 Explain the non-financial factors that Global Garments needs to consider before making a final decision.

EXAM HINT

When answering evaluative questions relating to a business decision, you can use social accounting issues to support or argue against the decision. You can use these non-financial arguments alongside the financial data given.

ACTIVITY 2

SKILLS COMMUNICATION, REASONING

CASE STUDY: STAKEHOLDER DEBATE

1 As a class, decide on a topical accounting decision.
2 Define the term ‘stakeholder’.
3 Identify the stakeholder group that is likely to have the objective of profit maximisation.
4 Identify a likely objective of the workforce.
5 Divide the class into groups of four or five students. Each student within a group should adopt the role of a different stakeholder and present arguments for and against the decision.

ETHICS IN ACCOUNTING

What is ethics?

Ethics can be defined as a set of moral principles or values. Ethics tells us how to behave well and what bad behaviour looks like in a situation. In our case, the context is accounting: the process of identifying, recording, measuring and communicating accounting information to different users. Businesses should report with honesty, issue correct statements and should not withhold relevant information.

The importance of ethical accounting

Accountants need to maintain a high level of ethical behaviour in their work. A fundamental requirement of financial reporting is that financial statements give a ‘true and fair’ view of the company’s financial position. The users of accounting information rely on this information to make important decisions – for example, relating to savings and investment, education and retirement.

Unethical accounting

Unethical accounting often happens when a business does not follow the generally accepted accounting principles and concepts or IAS rules. In 2001, it was discovered that the US multinational company Enron had not shown a true and fair view of their financial statements. They had kept huge liabilities off their statement of financial position and had falsely increased revenues. In 2009, it was discovered that Indian IT services company Saytam had falsely claimed revenues of $1.5 billion and that $1 billion claimed in cash assets did not exist.

Both these examples show that unethical accounting can be on a huge scale and involve vast sums of money. However, not all unethical behaviour is on this scale. It can occur in many of the accounting transactions you have studied.

Unethical practices include:

- inflating revenue by recording sales which have not yet taken place
- treating revenue expenditure as capital expenditure or the other way round
- overstating the value of closing inventory by not writing down inventory that is not in use any more
- overstating the value of trade receivables by not accounting for bad debts or accounting for doubtful debts.

You will be aware that many accounting concepts and conventions are intended to ensure that financial statements show a fair and true view of a company and that ethical accounting has been maintained.

ACTIVITY 3

SKILLS ANALYSIS, CREATIVITY

CASE STUDY: CODE OF ETHICS FOR ACCOUNTANTS

The Institute of Chartered Accountants in England and Wales has a Code of Ethics for accountants that has five fundamental principles. The first two are:

- Integrity – to be straightforward and honest in all professional and business relationships.
- Objectivity – to not allow bias, conflict of interest or undue influence of others to override professional or business judgments.

Source: ICAEW Code of Ethics

1 Research the other three fundamental principles and produce a poster to show them and their meaning.

CHECKPOINT

1 What do you understand by the term 'social context'?

2 Identify two accounting decisions affected by social accounting.

3 Identify four stakeholder groups.

4 State one stakeholder group and one possible objective of this group.

5 Explain the difference between financial factors and non-financial factors.

6 What is ethics?

7 Accounts should give a true and fair view of a company's financial position. Is this statement true or false?

8 It is ethical for a company to include in its trade receivables account amounts owing from a customer who has gone bankrupt. Is this statement true or false?

EVALUATE

When answering evaluation questions on social and ethical accounting, it is important to show your reasoning and consider both positive and negative arguments, before reaching a justified conclusion. Let us look at the following scenario: a business plans to close an unprofitable department.

The social accounting issue could be the workforce. It could be argued that closing the department will lead to a loss of jobs – this would be an argument against the decision. However, it could also be argued that closing the loss-making department will give the remaining employees greater job security.

Arguments for	Arguments against
Greater job security for the remaining workforce	Loss of jobs – negative impact on local community
Increased profits for owners	Bad publicity for the owners
Suppliers are confident that the business will continue to operate and they will continue to make some sales	Suppliers might be concerned about reduction in sales to the business

▲ Table 5 Arguments for and against plans to close an unprofitable department

As with all evaluative questions, there is no right or wrong answer. Your decision will be based on the specific arguments you have made.

SUBJECT VOCABULARY

ethics a set of moral principles or values that tell us how to behave well in a situation.

social accounting a type of accounting used by businesses which takes into account both financial factors, such as profit, and non-financial factors from a social context, such as the impact on the local community and the environment.

stakeholder user of financial information who has an interest in the activities of a business.

EXAM PRACTICE

EXPANSION PROPOSAL

SKILLS CRITICAL THINKING, INTERPRETATION, REASONING

Agri Products grows and produces a variety of agricultural products including rice and coffee for export. Due to an increase in demand, it is considering expanding by purchasing more farmland from local farmers. It is forecast that the expansion would increase the net profit margin from 5 per cent to 20 per cent. Due to the extensive use of technology, few additional workers would be required. In addition, the expansion would require the use of vast amounts of water from the local river.

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1 Explain the difference between social and ethical accounting. **(4 marks)**

2 Evaluate the expansion proposal of Agri Products. **(12 marks)**

EXAM HINT

The terms social accounting and ethical accounting are often used incorrectly in general conversation. As an accounting student, you need to be able to distinguish between the two concepts. They are not the same thing and the terms are not interchangeable.

▲ There is an increasing demand for rice