Understanding business ethics

KPMG SWITZERLAND

AUDIT ▪ TAX ▪ ADVISORY

Editorial

Dear reader
The concept of ethically correct behavior as a goal and Code of Conduct in the world of business has gained in significance with a rapidity which is seldom seen.

Ethically correct behavior is of fundamental importance for every individual, the society in which we live and the entire economy. This we all agree on. But questions abound – what is ethically correct, what are ethics, is there a list of general rules that always apply? Good, bad, right, wrong – these are very general criteria that must be reviewed constantly, reinterpreted and above all reapplied, especially to actual everyday behavior, even if it exacts a price.

Interestingly there is no general practice-oriented work providing basic explanations and definitions which takes into consideration the thousands of years of philosophical discussion behind the struggle to develop the correct definition of ethics.

KPMG deals with various issues in its daily work. Audit, Tax and Advisory – in addition to the specialist knowledge and skills we provide – these services always have an ethical background and moral viewpoint that also must be considered. For this reason we have prepared a brochure covering this subject. By means of a glossary, an historical overview and articles based on real-life situations, we aim to do our part to promote the understanding of business ethics.

By no means is KPMG attempting to set itself up as the guardian of the pure teaching of proper ethics. With this brochure, we attempt to clarify the debate and provide some food for thought.

On that note, I hope you will find the brochure both stimulating and informative.

Dr. Hubert Achermann
CEO
KPMG Switzerland

Table of contents

Since time immemorial, humans have attempted to define the term "ethics" and to find the ultimate foundation for moral principles, because in order for people to act in a manner that is both good and correct, they must know what "good" and "correct" mean.

The history behind the word "ethics"

It all started with Socrates
The term "ethics" was first used by Aristotle, based on the teachings of Socrates. Ethics is a reflection of morals, which encompass the totality of all standards required by a society for a good and proper life. Ethics can be further subdivided into descriptive ethics, i.e. the most precise empirical measurement of actual morals, and normative ethics, which focuses on rationale and critique. Its development spans history from Socrates to Plato, Aristotle, Epicureanism and the Stoics, alongside religions of course, in which it evolved from the consequences of belief systems (where anything that conforms with the Bible, for example, is considered ethical).

This dichotomy was a central theme in the Middle Ages – Thomas Aquinas advanced the idea of natural law, which is inherent in humans and the world, derived from ethics based on eternal law. Thomas Hobbes, David Hume, Spinoza and, of course, Immanuel Kant are the fathers of modern ethics.

The central focus of the debate on ethics is the question of good and how it can be implemented in everyday life. Another term connected with this debate is "virtue," in other words the power and the potential to do good.

No absolute definitions
The sophists believed that there is no general objective perception of virtue, and consequently that it is pointless to search for abstract and absolute definitions; virtues arise as the result of a thesis or an agreement between individuals. In contrast, Socrates and Plato believed it is possible to achieve a good life by following the path to self-knowledge, that is, through continual questioning of oneself, and that this insight automatically determines one's actions. This was cause enough to condemn Socrates to a cup of hemlock for sacrilege. Plato went one step further. He asked how the idea of good came about and how its impact on people's everyday lives could be described.

Achieving happiness by striving to do good
Aristotle is regarded as the father of ethical philosophy. According to him, ethics differs from logical philosophy in that it does not seek insights for its own sake, but rather relates to the practical purpose and end of things. He believed that it is human nature to strive for good because this is how people achieve happiness. He differentiated between two types of virtues – the intellectual and the ethical (Greek for "related to habit"). The former are rooted in reason and also can be recognized by means of reason, while we find the latter in tradition, systems of government, etc., and we must confront them.

To do so we must first set up parameters within which virtue can prove itself; for Aristotle this was the polity, or the Greek city-state. The application of such virtues is more abstract as it entails finding the balance in the middle; hence courage lies between recklessness and cowardice, moderation lies between lust and apathy. In other words, balance is always in the middle between abundance and shortage. Aristotle considers justice – both retributive and remedial – to be the highest virtue.

600 BC–300 AD	500–1400	1400–1600
Ancient World	**Middle Ages**	**Humanism and Renaissance**
Pre-Socrates 600–400 BC	Scholasticism 500–1400	Niccolo Machiavelli 1469–1527
Classical Greece 450–300 BC	Thomas Aquinas 1225–1274	
Socrates 469–399 BC		
Plato 427–347 BC		
Aristotle 384–322 BC		
Hellenism and Late Antiquity 450–300 BC		
Epicureans		
Stoa		

Ethics and pure reason
With the emergence of Christianity, ethics is derived from dogmatic theology, or doctrine, whose ultimate foundation is based on the Bible. Philosophy becomes generally subordinate to theology (ancilla theologiae, handmaiden of theology), and this approach persists until Kant. Kant (see "categorical imperative" in the glossary) established ethics as being solely in the pure reason of human beings, free from all external requirements and constraints. By this he meant that we must break free of our self-inflicted immaturity (caused by strict external regulation, particularly by religious systems); only when we have put this paternalism behind us have we achieved what Kant terms "moral autonomy." Kant's key ethical question is: "What should I do?"

In conclusion, the categorical imperative states that our own actions must be universally valid. Our actions are only ethical when we act out of a sense of duty (and not according to obligation).

As a result of the criticism of a lack of intrinsic determination, Max Weber's ethics of responsibility arose in opposition to the ethics of conviction, which gauges action and inaction by their effects. In other words: taking into consideration the means which must be applied in order to achieve a specific goal, reflecting on the consequences of the action, and critical analysis of potentially negative consequences of the action. In contrast to Kant, for whom duty or ethical intention are the decisive factors, Weber is concerned with the effect, the question "What are the consequences which will result from my action or inaction?".

Ethics as an aid in the decision-making process
The ethicist Hans Jonas studied the ethics of responsibility in light of modern technology. He focuses on the precedence given in cases of doubt to negative predictions, hence his version of the categorical imperative: Act so that the effects of your action are compatible with the permanence of genuine human life on earth. Concern at the effects of your own actions (even on people who are greatly distanced by geography or time) must be taken into consideration.

Discourse ethics (Habermas) assumes that even in view of a lack of objective understanding about what good and bad are, ethics arises as a consensus between different discourse partners. According to Niklas Luhmann, it is not possible for business ethics to exist because it would entail merging two subsystems that cannot communicate with one another as each has a different code.

The current status of the debate is that ethics does not impart knowledge for its own ends, but serves as an aid for making decisions that are morally correct. It is more important, however, to employ ethics in connection with actions and their underlying intentions.

1600–1800	1800–1900	1900–today
Modern Times	**19th century**	**20th / 21st century**
Baroque	Max Weber 1864–1920	Hans Jonas 1903–1993
		Niklas Luhmann 1927–1998
		Jürgen Habermas *1929
Enlightenment		
Thomas Hobbes 1588–1679		
David Hume 1711–1776		
Baruch Spinoza 1632–1677		
Immanuel Kant 1724–1804		

Economic management is a social activity – a self-evident concept that all but vanished from today's economic thinking.

Integrative business ethics or: in search of economic reason

Professor Peter Ulrich, Institute for Business Ethics, University of St. Gallen

The "supporting" role of economic processes in relation to the overriding "vital" aspects of the good life and fair coexistence of human beings in society is no longer a subject for discussion in economics; rather these processes are developing into an economic "inherent logic" of the market that is largely detached from such correlations. This reflects what has actually been happening for the past 200 years – the unleashing of the logic of the "free" market.

This process of economization, which is currently enjoying a monumental boost under globalization, was described by the economic historian Karl Polanyi as the "great transformation." Polanyi succinctly expressed the final state in this process, which luckily has not been realized fully anywhere, in one famous sentence: "Instead of economy being embedded in social relations, social relations are embedded in the economic system." Society as a whole is increasingly treated as an "adjunct of the market," and the "market principle" is exalted as the highest principle of classification, or is even put on a par with the moral principle.

But why can the "free" market not serve as proof of a free society and thus pure economic rationality not serve as complete economic reason? The main problem is that then all social relations would be subject to market logic, i.e. the normative logic of mutual advantage. This is by no means the same as the normative logic of interhumanity as the embodiment of ethical reason (see fig. 1).

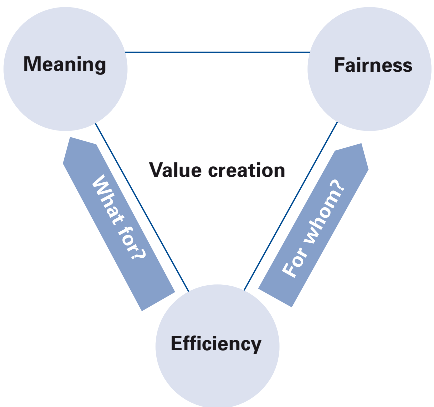
Fig. 1: Economic rationality vs. ethical reason

Economic rationality: normative logic of mutual advantage (market principle)	**Ethical reason: normative logic of interhumanity (moral principle)**
based on interests (what I need is what counts)	based on fairness (what is reasonable applies)
interest in maximizing private gain	intersubjective commitments
advantage conditional on cooperation between mutually disinterested individuals (homines economici)	unconditional mutual respect and recognition of individuals as persons of equal dignity
the other person is only the means to ensuring one's own gain (normative individualism)	the other person is respected in his inherent value as a human – as a condition for the legitimate pursuit of gain
market model of society as a whole (total market society)	primacy of political ethics over market logic (civilized market economy)

The guiding principle of a civilized market economy
Under the sky of a true civil society, economic rationality is by no means the same as economic reason. Free (and, as such, equal) citizens come before the free market! Thus the aim is literally to "civilize" the market economy. Certainly the efficient stewardship of scarce resources – as the typical embodiment of economic rationality – is important. But a sky of real-life practical rational economic management or an unabridged concept of economic reason can be obtained only from some kind of magic triangle (fig. 2): in light of the reflected guiding principles of the good life that we as people would like to live and which our economic management should serve to fulfill (search for meaning), and as a well-ordered society in which the market economy system is to be embedded (quest for fairness).

Against the idea of inherent necessity
It all comes down to the appropriate management of economic arguments of inherent necessity and the underlying value judgments. Supposedly "pure" economic inherent logic is primarily based on a Calvinistic (Zwinglian) ethos and bourgeois thinking, as Max Weber demonstrated. Thus, in questions regarding business ethics and politics, ethics cannot be placed on one side and value-free economic inherent logic on the other: there is always a conflict between mutually normative positions. It is the ideological function of the rhetoric of inherent necessity and common

Fig. 2: Three perspectives of economic reason



welfare to keep the economic rationalization momentum "free" of ethical-political objections. In this rhetoric, that which actually happens – specifically the progressive release of capital valorization logic which breaks down boundaries in every sense – is seen as necessary and approved as good by everyone. The most powerful ideology of our day is rooted in this dual-world concept, with economic inherent logic free of value on the one hand, and ethics that are supposedly economically "extraneous" on the other: "economism." However, there is no purely economic standpoint – only people can have a standpoint!

Integrative business ethics: systematically bringing economic rationality "to its senses"
Therefore, we do not have the choice between an ethical perspective on economic management and one that is free of values. We only have the choice between reflected and nonreflected (i.e. accordingly susceptible to ideology) dealings with the unavoidable normativity of every viewpoint on questions of rational economic management. Every conceivable concept for economic rationality already includes normativeness. "Rationality" always designates a guiding idea on how we as reasonable people should judge and act. The highest normative viewpoint of mainstream economics is efficiency. However, it is not possible to reduce all the other normative viewpoints that are important for the good life and living together, particularly that of justice, to efficiency.

The hallmark of the internationally recognized approach of integrative business ethics, developed by the Institute for Business Ethics at St. Gallen, is the comprehension of the critical fundamental reflection of economic reason (or that which it is assumed to be) as its primary systematic and most important task. In contrast to other approaches, it is content neither with the defense of "market morals" (moral economy) nor with the role of extraneous correction outside the inherent economic logic (corrective business ethics). Instead it attempts, as the ethics of reason in economic management, to establish the economic inherent logic ethically.

Professor Peter Ulrich,
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In the space between the terms "legitimacy" and "legality" rage the moral battles of daily life – thus an affair is legally permissible in a legal marriage, but according to the intramarital morality of couples it is generally not legitimate. Accordingly, people are inclined to pangs of conscience, which are a peculiar psychosomatic reaction that we suffer because as social beings we have been socialized into the moral principles of a specific culture. Pangs of conscience are the best proof of the existence of society, which has taught us its mores in a very involved and expensive process of upbringing by our parents, schools, churches, etc.

A case of morals

Professor Kurt Imhof, Center for Research on the Public Sphere and Society (fög), University of Zurich

What is legal, what is legitimate?
Not only do the moral battles of our daily lives rage in the combat zone between legitimacy and legality, but so too do the battles of the society in which we live – that which is legal and legitimate changes, and this change moves in two directions. The standards of legitimate actions are submerged by the standards of legal actions by means of taboo-removing waves in public communication. Thus living together was considered legitimate long before it became legal, i.e. before the "antiquated" law was abolished. However, the opposite also occurs, via waves of outrage and moralizing in public communication – the standards of legitimate actions spread much wider than the standards of legal actions. As a result, the law will become more restrictive. Thus social change is an eternal game of moral attitudes and established norms.

Those who do not play the game have already lost – their actions are legal, but they miss out on the joys of legitimacy or, conversely, become objects of outrage. Both waves of taboo removal and moralizing have had their day: in the 1970s legitimacy gave way to legality, and since the 1990s legitimacy has surpassed legality by far. Anyone who still believes today that their income as an employee can easily be 500 times larger than that of the average employee's income will see themselves and their company confronted with waves of outrage, which most likely will be supported shortly by legal means, such as shareholders' rights.

Economic activity has been broadsided by this moral avalanche recently. More and more companies are driving home their persuasive communications to consumers with moral commitments. They implement scores of corporate ethics which must also be used in their communications with the public. They declare themselves to be good citizens, certify their social compatibility, avow their antiracial stance, tolerance, environmentally friendly production, policies on equal opportunities and promotion of women, or they actively fight against war or the death penalty in their marketing campaigns. This is very costly, and corporate reputation is more volatile than ever, despite such marketing campaigns.

The phenomenon of moralizing
What are the reasons behind the economy's massive increase in moralizing? There are three key explanations, none of which leads us to expect that this phenomenon will fade anytime soon. The first deals with fundamental changes in the media, the second attributes moral reregulation to the effects of deregulation in neoliberal economic and business models, and the third cites the disappearance of loyalty in employment relationships.

An important factor is the new structural change in the public domain, i.e. the differentiation of an economically oriented media system in all the major Western nations, particularly since the 1980s. Along with this structural change in the public domain comes the media's increasing focus on the information needs of a dispersed public of media consumers. This shift in media logic greatly improves the chance of moral topics and the personalization of everything political and economical being perceived as valid, because issues of good, bad and personalization are now seen as extremely promising ways to increase circulation and viewer ratings. The modern media system is thus creating a significant rise in "exciting" communication events. Particularly since the major creative accounting scandals and recurring stories of executive greed, radical moral judgments are now a permanent part of the basic arsenal of modern financial communication, which has to fight for the public's limited attention. Financial reporting has emulated the style of political reporting, and the personalization of the economy has reshaped companies just as the personalization of politics has reshaped political parties.

Society in a state of social change
However, the huge increase in moral outrage communications against the business environment cannot be explained by the shift in the media alone. It is also a consequence of the social change which we are experiencing in the neoliberal business model. Market orientation, deregulation, the elimination of state quotas, the belief in privatization, advantage of location and tax competition lay at the heart of the Western concept of business in the 1990s. Awareness of the problematic consequential costs for companies caused by the focus on shareholder value and the new profitability-related structure of quarterly balance sheet press conferences has increased since the first major protests by the antiglobalization movement in Seattle. Instead of providing a solution to issues of corporate justice by promoting greater equal opportunities and improving the standard of living for lower-income employees, there has been a redistribution "from bottom to top," and the liberal core principle of equal opportunities now looks rather consumptive. For this reason the consequences of deregulation on an economy emancipated from politics manifest themselves in a quick succession of bursting bubbles.

Finally, the clear remoralization of economic activity, compared to the social market economy business model, is also a result of the weakened loyalty between employer and employee. Particularly for middle-class jobs, the intrinsic motivation to work has been

replaced by the extrinsic; turnover rates are soaring – interrupted by anticipated crises – and subjective job security has dropped. Insecurity, just as morals, has always been a factor, that clearly distinguishes between insiders and outsiders.

Growing moral and ethical claims
These consequences of the neoliberal economic and social model encouraged the moral argumentation for reregulating the economy based on outrage communications which in turn fosters the growth of viewership and circulation numbers. Accordingly, businesses are finding themselves increasingly confronted with moral and ethical claims which were previously reserved solely for political and governmental organizations. The deregulation of the media to profit-oriented companies multiplied the news value orientation of outrage cultivation. The deregulation of the economy destroyed both traditional loyalties to social environments and the traditional borders of income claims by management staff, which previously was aligned to the top income of politics, and the deregulation of working relations promotes insecurity.

Regulation and deregulation direct the social battles between legitimacy and legality. Whoever deregulates legal rights will pay the moral price. This price is both higher and much worse than a loss of reputation and, in contrast to that associated with a violation of legality, it is impossible to estimate.

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Corporate social responsibility means that a corporation is accountable for its conduct within the company as well as in its interaction with the community.

Living corporate social responsibility

Dr. Hubert Achermann, CEO of KPMG Switzerland

Corporate social responsibility (CSR) is a consequential term that is currently much in vogue. It means that a company understands its role in society and, as a result, it accepts responsibility not only for its business successes and employees, but also for the social and ecological environment in which it conducts its business. However, it is not enough merely to acknowledge this responsibility. Every company must contribute to CSR in its own way because each sets priorities differently and concentrates on different aspects of social responsibility.

More than 90 nationalities

By working together to achieve our objectives, we create an atmosphere in which all of our employees can put their knowledge, drive and skills to use across various cultures and mentalities. In Switzerland alone our employees represent over 40 nationalities working together. Including the UK and Germany, over 90 different countries are represented by the employees who contribute to KPMG's culture. Such diversity creates an atmosphere shaped by respect, tolerance and acceptance, whereby an individual's freedom overlaps with that of his or her colleagues. This forms an integral part of our culture of "human professionalism."

We wish to share our success and productivity with the community. It is important for us as a company to assume our role in the community as well as to balance economic efficiency with social responsibility. As a service provider, we are influenced by the people around us. One of the many activities that KPMG has promoted in Switzerland and 18 other countries is our "Make a Difference Day." This program encourages employees to spend a work day as a volunteer with selected welfare organizations. Almost 300 of our people in Switzerland took advantage of this opportunity last year. They volunteered for 20 different projects. This enabled them to use their skills in a very different environment.

If measured as a single full-time employee's work hours, their combined effort adds up to almost half a year of work performed in one day for our communities.

Education as the foundation of every community

KPMG has always been committed to promoting education, science and educational institutions in Switzerland. As auditors and advisors we are well aware that the quality of our work and of that of the whole economy depends on qualified employees and on the standard of education provided by the Swiss educational system. This is why KPMG finances various programs such as the Faculty of Auditing and Accounting at the University of St. Gallen. In order for us to continue offering competent services in the future, it is vital that research, education and practical application work together. We go even one step further by continuing our long-standing commitment to the Zurich "Children's University." Twice a year university lecturers discuss findings from their research areas such as "How big is the world?" and "How does a snowflake become an avalanche?" with curious nine- to twelve-year-olds.

KPMG Foundation

Our latest initiative is the KPMG Foundation, which we established last year with the aim of supporting our social commitments and promoting education and cultural sponsorship. The KPMG Foundation is not about administering and distributing lots of money; rather it focuses on the personal commitments and volunteer work of our employees. The foundation is a symbol and basis for our willingness and desire to give something back to the community. The foundation's board of trustees is comprised of KPMG employees from all areas and hierarchical levels.

Environmental conscientiousness

The careful management of natural resources goes hand in hand with social responsibility. At KPMG we do our part by using FSC-certified printing paper and making double-sided copies. In this way we can reduce our annual paper consumption by up to 25 percent because, as everyone has discovered, the idea of a paperless office has turned out to be an illusion. We have also started initiatives aimed at improving energy efficiency and potential savings. To complete our environmental program, we critically review and optimize our procurement activities.

We are convinced that our CSR initiatives are starting to bear fruit, as confirmed by the reactions of our employees and the public. For the vast majority of our people, it is important for a company to support initiatives such as "Make a Difference Day" actively. Such programs promote commitment and volunteerism, and raise awareness that goes beyond having a purely internal impact at KPMG. That is encouragement enough for us to continue on our chosen path.

Dr. Hubert Achermann,
CEO of KPMG Switzerland

If it were easy to behave in an ethically correct manner in everyday life, it were easy to answer each of the following questions correctly. This test is designed to give you some food for thought.

Test: Ethics in everyday situations

1. You find a wallet full of money lying on the street. The street is empty. What do you do?

a Take it to the nearest lost-and-found office.
b Keep some of the money as a finder's reward and then take it to the nearest lost and found office.
c Leave it where I found it in order to avoid any possible implications.
d Find out who owns the wallet and contact the owner directly.

2. You just happen to see your boss dent another car while he is leaving your company's parking garage. He stops, inspects the damage and then drives away. He didn't see you, and next week you are meeting with him to discuss your promotion. What do you do?

a Leave an unsigned note under the windshield wipers of the damaged car with the name of the person responsible for the damage.
b Hold on to this information because it might prove useful depending on how my promotion meeting goes.
c Put the incident completely out of my mind.
d Talk to my boss in private about the incident the next day.

3. As the CFO of a mid-sized company, you are in negotiations with a bank about raising the company's credit limit. The bank director indicates that he will raise the credit limit if you secure a good entry-level job at your company for his son. What do you do?

a Discuss his request with my HR department.
b Explain to the bank director that the higher credit limit and potential employment for his son are in no way related.
c Change banks.
d Inform the bank's supervisory board about this incident.

4. You are to prepare a proposal for a large company. Your own company is in urgent need of this business. A friend could get you the proposals submitted by two of your key competitors. What do you do?

a Use my friend's insider knowledge to ensure that my proposal has the best chance of being accepted.
b Prepare my proposal without insider information.
c Try to come to an agreement with both of my competitors. If I win the account, they will receive a part of the commission.
d Tell my boss.

5. As a bank employee, you research the creditworthiness of various companies. A friend of yours is planning to invest a large amount in one of these companies and asks you for your opinion on his plan. What do you do?

a Refer him to information about this company that is accessible to the general public.
b Give him the relevant available information.
c Explain to him that he is putting me in a difficult situation, which is why I can't give him the information.
d Offer him advice without disclosing any of the information I have gathered.

6. As an employee at a large company, you are offered the head management position at a struggling subsidiary, with the understanding that you will fire at least 50 employees if you take the job. After researching the subsidiary's predicament, you realize that mistakes made by the parent company's management are the cause of the problems, and that the employees who are to be let go are most likely the ones with the know-how to save the subsidiary. What do you do?

a Jump at this opportunity before anyone can take it from me.
b Take the position on certain conditions, namely, if the employees are not fired and I am given more autonomy.
c Try to convince management at the parent company that my analysis is right.
d Find an excuse so I don't have to take this position.

7. Your boss surprises you with a rather unique rule – anything is ethical as long as you don't get caught. Not only is this his opinion, it's also company policy. What do you do?

a Make no comment as this rule has no impact on my day-to-day work.
b Consider sending this definition to a journalist friend of mine.
c Ignore this comment because I know that my own ethical conduct is different.
d Consider which of my colleagues I can talk to about how uncomfortable this rule makes me feel.

Evaluation

In the real world of business there are dilemmas, contradictions, gray areas and points to consider. If that became clear to you while you were answering the questions, then you have already passed the test. In any case, there are not absolutely right or wrong answers to the seven questions.

Situation 1
(wallet lying on the street)
- **a** Ethical and corresponds to legal requirements.
- **b** Unethical and premature; the owner must give you the legal finder's reward.
- **c** Not illegal, but goes against ethics of responsibility.
- **d** Ethically correct.

Situation 2
(boss's fender bender)
- **a** Anonymous denunciation is unethical.
- **b** Understandable from a human perspective, but unethical as pressure is being applied using an argument which has nothing to do with the promotion.
- **c** This is a question of conscience.
- **d** Ethical, but you risk having your boss interpret the discussion as a coercion attempt.

Situation 3
(credit limit)
- **a** If you mention the connection, you put the onus of the decision on others, if not, it would be unethical.
- **b** Ethical and diplomatic.
- **c** A consistent but also disproportionately radical step.
- **d** Ethical, but the question here would be whether this reaction is out of proportion.

Situation 4
(competitor proposals)
- **a** Unethical and illegal, but may also keep your company from going under.
- **b** Ethical, but it could mean that your company goes under.
- **c** Unethical and illegal, discussing prices and bribery are criminal offenses.
- **d** Ethically correct.

Situation 5
(creditworthiness)
- **a** Ethical, but possibly "inhuman" as only the ethical side is considered in the ethics/friendship dilemma.
- **b** Unethical, a clear violation of banking confidentiality.
- **c** Ethical, lends understanding and transparency to the situation.
- **d** Unethical, this is a gray area, and you are skirting the problem of confidentiality quite neatly too.

Situation 6
(management position)
- **a** Unethical, a pragmatic decision devoid of personal conduct, this is a question of conscience.
- **b** Ethical, but it harbors greater corporate risk.
- **c** Ethical, but this could be a really hard nut to crack.
- **d** Ethical, you have decided that you cannot solve the dilemma.

Situation 7
(special definition)
- **a** Ethically questionable, even if it is formally correct.
- **b** Unethical and disloyal.
- **c** Questionable from the perspective of ethics of responsibility, as your own ethical conduct may clash sooner or later with this definition.
- **d** Ethical and legitimate, if this rule actually corresponds to company policy.

Whether at the philosophical level or in everyday situations, the same fundamental questions about ethics frequently arise.

Fundamental ethical questions

Is it possible to define the difference between ethical and unethical objectively?
No. Philosophy has spent more than 2,000 years debating this question without having found a generally valid answer. Even reference to the Bible (Ten Commandments), Kant **(> categorical imperative),**[1] the ethics of responsibility (measurements of actions by their consequences) or discourse ethics (lack of objective perception means ethics are a consensus between discourse partners) can in the end only provide individual guidance for individual actions.

Is it at all possible for a company to act ethically?
Yes, but not if it tries to hold on to a generally valid definition of ethics. Rather it must set up the parameters to ensure that ethical behavior is rewarded instead of punished within the company. It must create a framework which makes it possible to understand the company's business as a part of social coexistence (corporate social responsibility). And it must threaten sanctions when internal guidelines are not complied with **(> Code of Conduct).**

Is correct ethical behavior not an unattainable goal?
No, not if you don't define it as an ideal state in which everything that happens is good, right and ethical. Rather, it should be seen as a process that plays out in many areas of conflict and for which it is imperative that parameters are created for the individual, company and system to reward compliance with and punish violations of certain basic principles **(> e.g. Global Compact).**

Are ethics something for those who can afford them?
No, because this question assumes that ethics are "nice to have." If they were free, if they caused no potential disadvantages, if everyone would follow them, and if we were being observed, then, and only then would we be able to afford ethical behavior. However, we do not exist independently of the behavior of others, particularly in today's networked and globalized world. And if we are to require others to act ethically, we must do the same.

Are ethics and morals not something inherently personal and private?
Yes and no. Someone who finds a full wallet on an empty street must decide for him/herself whether to keep it or turn it in to the lost-and-found office. If society honors their good behavior with a finder's reward or punishes them for theft, it implements its moral and ethical principles in a general framework of regulations.

[1] see glossary of terms used in ethics on pages 20–22

An explanation of the key terms that repeatedly appear in discussions about ethics and business ethics.

Glossary of terms used in ethics

Business ethics
The scientific discipline of business ethics deals with the question: "How can economic rationality be combined with ethical-practical reason?" The potential conflict that can arise is illustrated by the famous statement made by economic Nobel Prize winner Milton Friedman in 1970: "The social responsibility of business is to increase its profits." This discipline relates to an area of conflict in which varied interests clash. Shareholders supply the company with capital hoping for strong price gains and good dividends in return. Customers look for good quality products that are cheap. Employees want big salaries and good working conditions. Entrepreneurs hope to share in the profits in exchange for taking on corporate risks. Citizens want a functioning social system, supported by corporate taxes, that guarantees infrastructure services. Individuals also want an undamaged environment, social services, peace and general well-being. These varied interests create a complicated area of conflict which can no longer be balanced by adequate reference to general ethical norms.

Categorical imperative
"Act only according to that maxim whereby you can at the same time will that it should become a universal law." In contrast to the belief that the difference between good and bad can be derived from social definitions, an **> ultimate foundation** (e.g. he who acts in accordance with the Bible acts in a good manner) or natural laws which are accessible through human knowledge, German philosopher Immanuel Kant (1724–1804) put forth his idea that the unconditionally binding nature of ethics can only be defined a priori, that is, without experience. What significance this highly philosophical definition holds for **> business ethics** can be found under **> categorical imperative in business ethics.**

Categorical imperative in business ethics
Let us start with a definition of Kant's **> categorical imperative.** Categorical means rules, while imperative (an objective principle) is determined by practical reason. Maxims are self-imposed codes of conduct (subjective principle) where the action is not the means to the end, but should be good. Here it is not the consequences that are the decisive factor, rather the intention and duty to do good. **> Business ethics** play a key role in the debate on **> reputational risk.** Should a company act ethically only when unethical actions would lower its profits, or should it follow ethical guidelines as a matter of principle?

Code of Ethics, Code of Conduct
A company's binding commitment to adhere to specific guidelines and principles when conducting its business. In this context, terms such as Corporate Governance, Corporate Social Responsibility, Corporate Citizenship, Responsible Care, Sustainable Management, Stewardship or Stakeholder Management are used, all of which basically relate to the same thing.

Corporate ethics
A subcategory of **> business ethics.** It deals with the question of which moral value systems a company should satisfy. In other words, how is a company to act correctly when faced with the conflict between the objective of making a profit and ethical principles?

There are three different levels to consider: individual (management, staff), institution (company) and system (economy). Accusations regarding unethical behavior are therefore leveled at different addressees:

1. Economic subjects (bribery, corruption, harassment, lack of responsibility)
2. Corporate (swindler mentality, lobbying, environmental problems, added value)
3. System (push-and-shove society, social injustice, changing values)

Corporate ethics dilemma
Should a company place ethical standards and values above economic goals? Or can it do this only by observing standards and values that contribute to its economic success? Here too the economic imperative – to achieve the highest possible profit at the lowest possible cost – clashes with ethical requirements: ethical standards must be upheld without considering the consequences. Or to put it another way: if a company that follows ethical principles suffers economic disadvantages goes bankrupt as a result, and an unethical competitor profits from this by taking over the freed-up market share, who is the loser? Ethics, the economy, everyone or no one?

Ethics
Ethics attempts to make statements about the good and fair conduct of human beings. Ethics explains how people should act and examines the motives, methods and consequences of people's actions. The term comes from the Greek word "ethos" (habit, custom, character). Ethics occupies the space between what should be and what is; in other words, between reality and the ideal. If all people acted in such a way as to ensure a good life for everyone, then we would have no need for ethics. The purpose of ethics, therefore, is to keep the discrepancy between what is and what should be as small as possible. Ethics deals with consensus, but its subject matter is conflict. The reasons why people act or do not act in a particular way are embedded in **> value systems,** rules and standards.

Ethics in business

Alongside the promotion of ethical conduct by its employees **(> individual ethics),** a company is faced with four areas of conflict between **> morals** and profitability.

1. Positive compatibility: corporate activities which are highly profitable and enjoy high levels of moral acceptance (environmental protection businesses)
2. Moral conflict: corporate activities which are highly profitable but not morally accepted (arms dealing with crisis regions)
3. Economic conflict: corporate activities which are not particularly profitable but enjoy high levels of moral acceptance (promoting social programs)
4. Negative compatibility: corporate activities which are not particularly profitable or morally acceptable (senseless investment in a project that harms the environment)

Due to the lack of generally valid criteria it is difficult, even in the fourth case which seems obvious at first glance, to set up a list of generally applicable rules. For instance, is investment in a large dam project senseless and harmful to the environment if, when the dam is built, it generates huge profits, improves the living conditions of many people and replaces flooded areas with new cultivable land?

Ethics in the system

In the context of increasing globalization, companies are forced to remain competitive on an international scale. They are faced with competitors who may have competitive advantages due to other mind-sets or other legal conditions. In specific terms, should a company avoid a profitable mandate in the Far East which would secure numerous jobs in Switzerland if its acquisition were dependent on the payment of kickbacks? There would also be the risk that the manufactured product could be copied quickly with no consideration given to patent protection. This example also demonstrates that the application of ethical standards in business is not abstract and absolute, and can only be discussed taking into consideration the actual areas of conflict.

Global Compact (UNGC)

The Global Compact was passed by the General Meeting of the United Nations on December 21, 2000. Companies are encouraged to sign this corporate agreement on minima moralia and confirm compliance in an annual report. It does not replace any national legislation. It covers ten main principles. Companies that have signed the Global Compact are supposed to:

1. respect international human rights and promote adherence to them
2. ensure that they are not involved in violations of human rights
3. respect the right of their employees to unionize and recognize their right to collective negotiation
4. eschew all forms of forced labor
5. effectively eliminate child labor
6. avoid any discrimination with regard to employment and profession
7. adopt a preventative stance to environmental hazards
8. take the initiative to promote broader environmental awareness
9. encourage the development and spread of environmentally friendly technologies
10. work against all types of corruption

Individual ethics

Individuals in companies are faced with a number of expectations (from the board of directors, colleagues, clients, shareholders, suppliers, business partners), and they must consider structural factors (balance sheet, equity market, customer satisfaction, competition, profit, labor market) in their work. A person's reaction to an unethical demand (e.g. tax evasion instead of tax optimization) is based primarily on their individual ethical principles and implementation of those principles (mindless obedience, career-oriented opportunism, protest, resignation). However, the framework of ethical rules that the company and the system impose on them is also important **(> ethics in the system).**

Institutional and individual ethical rules

> Ethics attempts to provide people with preferred rules to aid in the weighing of good and bad. This relates primarily to individuals and their personal ethical compass. Institutional measures are additional. Ethical action should be doable and feasible and not punished (e.g. through dismissal or loss of business opportunities). This means that individual ethics must be supported by the framework of institutional rules (within the company **> Code of Conduct** and within the system **> Global Compact).** Two different principles which guide actions must be considered here: in business, minimum input should generate maximum output; in ethics, certain standards and values must be fulfilled, regardless of the input.

Morals
The sum of all standards and rules that apply in a society. They can make no claim to being generally valid as they are dependent on different cultural, civil, religious, environmental and regional developments. To take a simple example, the term "politeness" in some cases involves completely different behavior in the US, Japan and Europe.

Need for decision
The term is derived from **> responsibility.** Situations that require decisions are always conflict situations because more than one action is possible. Especially if the consequences cannot be completely foreseen, decisions are characterized by nonrational motives, such as conscience or feelings. A rational approach is to weigh the options, taking standards, dictums and any possible sanctions into account.

Normative ethics
Normative ethics is future focused. It compares the current situation with the desired future situation. This means normative ethics is an anticipatory discipline that responds to an actual or supposed deficit and whose aim it is to make itself unnecessary (by eliminating the deficit). In this way **> ethics** are related to the economy as they are future oriented: people attempt to act in a certain way today so that tomorrow there will be just as much or, better still, even more available. Descriptive ethics is different from normative ethics in that it is the most precise possible empirical compilation of actual **> morals.**

Reputational risk
Possible economic losses that a company suffers as a result of unethical actions. Quantification of this risk can aid in a risk-benefit analysis. A company acts in an unethical way, which causes its reputation to suffer. This loss is quantified, revised by the amount of the requisite damage control costs (e.g. PR, humanitarian donations) and deducted from the potential profit by the unethical action. If the result is positive, the action was unethical. In contrast to this is the approach that a company's actions should be ethically correct a priori **(> categorical imperative).**

Responsibility
The accountability of people for the tasks they perform. This accountability in action or inaction relates to a situation which requires answerability and in doing so applies ethical benchmarks **(> ethics).**

Ultimate foundation
It is difficult to find an ultimate foundation for ethical principles. This term refers to experience and social contracts, which are purpose driven with the goal of ethical actions or religious values. Kant's **> categorical imperative** still forms the basis of all ethics today. Or conversely, accusing a company of acting unethically without any deeper justification, always has such a great impact **(> watchdog organizations)** that defense is only possible if one understands the principles of **> ethics.**

Value systems
Ethical debates are always based on standard parameters, hence value systems. Good, bad, right, wrong – very quickly it becomes a problem of **> ultimate foundation.** "He is at work by eight," does not contain any values; "He does good work," does. In addition, a distinction must be made between individual assessments and fundamental judgments. "This manager earns too much," is an individual judgment (which can be rationalized by the individual), while "No manager is worth that kind of salary" is a general judgment that must be justified with reference to general values. But both are **> moral** judgments.

Virtue
The ability to correctly weigh up ethical standards and their implementation. People are capable of deciding between actions that are morally possible, morally necessary and morally impossible. This requires the ability to distinguish between good and bad, right and wrong **(> ultimate foundation),** even though there is no absolute definition for these pairs of terms, rather they are subject to standards imposed by society.

Watchdog organizations
Mostly NGOs which have taken on the task of publicly denouncing the perceived or actual unethical behavior of companies. The Internet often helps them to bring companies' unethical behavior (child and slave labor, environmental destruction) to the attention of the public by calling for boycotts and relevant reactions on the part of consumers to inflict economic disadvantages upon these companies **(> reputational risk)** and also to force them to change their business practices.

With their systematic reviews of financial data, audit firms make their own key contribution to corporate governance. It identifies the correct path to follow through various conflicting areas, and then takes a stance.

The role of the auditor

Günter Haag, Member of the Executive Board, Head of Audit, KPMG Switzerland

Whenever something goes wrong at a company, one of the first questions is always: "Why did the auditors not pick that up?" Or even: "Did they not want to see it?"

This is due to the expectation gap between the actual work performed by an auditor and the public's perception of it. The audit report is simply a reflection of the company's situation at a specific point in time. When compared with the entire fiscal year, the auditing process, which lasts just a few weeks, is only a snapshot. What's more, the task of the auditors is not to review the management of the company, but to certify the financial statements. If any weak points are discovered, we inform the board of directors or, in serious cases, the general meeting, but not the public. We are not the business police. Our job is to assess corporate risks, among other things.

The truth about auditing is that our work falls within an area that is both complex and full of conflict. The auditor is faced with the constant challenge of deciding between right and wrong and choosing the correct path. This path is largely prescribed by laws and standards. The auditors at KPMG are guided also by processes that have been defined internally. The scope for decision is based primarily on reason, foresight and the ability to weigh commensurability and purpose. Accounting standards are not always clear-cut.

Although ethical principles and behavior are defined in the Code of Ethics of KPMG, today's dynamic business environment still offers enough maneuvering room in which the individual's fundamental ethical attitude is called into play. This attitude forms the basis for a given decision.

Auditors must set clear limits

How is this attitude expressed? An auditor must follow a clear line and be able to set precise limits. There is no other way of managing the more than 4,000 clients of KPMG Switzerland. It is a natural reaction on the part of clients to defend themselves against any negative observations by the auditor. One example is when an audit company refuses to approve the financial statements for X reasons or, in serious cases, the welfare of the entire business is in danger. Such cases pose the risk of job losses affecting all people and a threat to the continued existence of the company. In these instances our job extends beyond a simple audit engagement and challenges the auditor's professional and moral effectiveness.

Internal control systems influence the auditors' work considerably

Precisely because an audit of financial statements can only provide a snapshot, the audit industry must rely greatly on transactions being documented properly. Especially in the case of large corporations it is utopian to think that the auditor can gain a detailed overview of individual transactions made over the period of a year. The internal control system should ensure that risks are recognized internally before the audit and that the auditor is given reliable information to work with. This can vary greatly from one company to the next. Personal discussions conducted during the several weeks that the auditor is with the client can provide key indications about the performance of the business. To this end the auditor must demonstrate sensitivity and good listening skills.

Engagement acceptance scrutiny

Auditing companies are faced with a latent risk to their reputation. This becomes even clearer when the following question is posed if a problem arises: "Why did the auditors not pick up on that earlier?" Thus it could be that a potential client is turned down for good reasons. This may be because the business fundamentals do not seem to be clear or because the economic beneficiaries or the client are unknown, or because the information about business activities is not stringent enough. Deciding whether to accept an engagement is the first important step in risk management by every auditing company.

If, after thorough investigation, we accept an engagement, the responsibility assumed by the auditing firm is clearly communicated to the client. For example, when a company has to report losses. This is not the auditor's responsibility, but the possible consequences of such losses are. This means that the exact time when a company becomes overindebted must be established correctly. For laypersons this is a minute detail, but for us it is crucial given the possibility of liability suits.

Thus running a business is by definition always fraught with risks. Realistically, the aim is to weigh risks correctly and integrate them into the strategy, not eliminate them completely. Corporate management is responsible for the company's strategy. This is relatively simple with short-term risks such as provisioning and value adjustments as they are quick to impact the books. Longer-term risks are much more difficult to assess. Auditors may advise in the evaluation of risks, but it is not their job to interfere with the management of the company.

Auditing is teamwork

At KPMG we have created structures which we use for addressing and solving such conflicts. In the audit industry, the law sets out very detailed accounting standards with which every auditor must comply. Auditing is a job for team players, not individualists. Team leaders, or lead partners as they are also called, must ensure that their teams uphold these standards by implementing appropriate quality controls at regular intervals.

Last but not least, the new Swiss Federal Audit Oversight Act (RAG) introduced the principle of rotation. After seven years at the latest, the lead partner of the audit team must be rotated. This is a principle that we at KPMG were applying long before the law came into effect. Rotation prevents auditors from becoming too strongly attached to their clients, which might compromise the auditor's independence. The latter forms the basis for our business, coupled with a critical approach.

Independence offers many advantages

Our independence also offers direct advantages to clients. It puts us in a position to analyze the situation from the outside and identify possible problems which may have been overlooked by the company. It is also for this reason that we need to maintain a certain distance and impartiality. To perform at our best, we cannot allow ourselves to be influenced too greatly by the client's perspective.

Of course we also rely on the rules and regulations governing the audit industry which are becoming ever more comprehensive. Increased regulation is generally a reaction to problems that develop. Individual scandals overshadow the fact that in 99 percent of all audits, everything goes as it should: the internal control system does its job, processes are followed scrupulously and all those involved act correctly. Nonetheless, even these companies are faced with mounting administration in order to comply with all new regulations and laws. This is an unsatisfactory development.

If an auditor develops a certain professional skepticism in addition to the precise application of accounting standards, he/she runs less of a risk of being deceived by external circumstances or even by attempted manipulation. However, the sector and every individual auditor in it should not lose their belief that most business people act according to the principle of good faith. Most business people comply with legal regulations and live according to ethical principles. Here too, the few exceptions to the rule confirm that auditors carry out their duty as they should and find the right path to lead them through the many areas of conflict.

Günter Haag,
Member of the Executive Board, Head of Audit, KPMG Switzerland

No one pays more taxes than they have to for ethical reasons. The aim of proper tax advisory services is to adhere clearly to – and fully utilize – the provisions of the law.

Tax ethics are social policy

Jörg Walker, Member of the Executive Board, Head of Tax, KPMG Switzerland

Swiss tax legislation forms the legal framework for tax advisory services. The law defines the rules of the game. Playing within these rules is legitimate. This is what every taxpayer does – it is a truism to say that no one willingly pays more tax than they have to. But what about the ethical requirements placed on the activities of tax advisors? If, in addition to this legal framework, they are obliged to uphold ethical principles which forbid them from withholding additional tax income from the state, i.e. saving the client money, this implies that the existing tax laws are not ethical enough. The definition of proper tax ethics is determined by the legislators and not the tax advisors and ultimately the politicians. What really lies behind the demand for more tax equity is the sociopolitical question of whether it is fair that one person earns more than another, or that one person has assets of 100 million Swiss francs while another has only 50,000. The underlying question is whether the burden is fairly distributed among taxpayers. From this it becomes clear that there must be a debate on ethics in connection with taxes at the legislative level, in which a political consensus can be found which is fair and ethical according to the majority. As the people who apply the laws in practice, it cannot be the responsibility of tax advisors to determine what they feel would be a fair distribution of the tax burden.

Advisors as intermediaries
The role of the tax advisor is to serve as an intermediary between their clients and the tax authorities. Politicians and lawmakers set the parameters. In this interactive relationship the tax authorities also benefit from the advisory industry, in the sense that the industry correctly prepares complex tax returns for companies, relieving the state of this effort and expense. According to contract law, advisors are obliged to represent the interests of their clients, which do not necessarily have to be contrary to the interests of the state. Tax advisors perform their job within these rules, although they certainly cannot be required to act in anticipation of or based on their own beliefs about ethically fair tax distribution. Aiding and abetting illegal actions is a violation of the law, and attempting to impose their own ethical beliefs on a client is a violation of the advisor's duty to represent the client's interests to the best of their knowledge and ability.

In this regard, the concept of "tax optimization" is often brought up as a point of criticism in the debate. This term is often understood to mean a tax advisor enabling a company or an individual to save taxes by using some contrived method that stretches the limits of the feasible – and possibly even goes beyond the limits of the legitimate. In this connection it must be noted, however, that tax optimization does not in itself play the single most decisive role for companies. A business-minded person thinks primarily about optimizing their company's profits. Taxes are just one of the factors to be considered because infrastructure, location, accessibility to sufficiently qualified people, sociopolitical stability and social peace are also key components that influence profitability. The ethical principles in our work come into play in our corporate culture, which also has an impact on the advisory services we provide. With our "human professionalism" approach we pass on our know-how and experience while placing the emphasis on people. This holds true for our work in advisory teams and in our dealings with clients. Based on this premise, it clearly follows that the current situation and the options that we offer our clients in tax advisory and optimization form a comprehensive solution, and are not aimed at exploiting every possible legal loophole. This would not bring any long-term advantages for our clients or for us as advisors.

State taxation in a globalized economy

Large corporations and their tax advisors operate worldwide, but taxes are still levied at the national level. This situation arose historically and created tax competition, which boosts general welfare and causes national economies to flourish but also engenders disfavor and issues of fairness. From our perspective, the overall positive economic effect of healthy tax competition within a nation and beyond political borders outweighs these concerns. Only tax competition creates incentives for states to manage their resources effectively and efficiently. It is society as a whole, however, which must define how much of the collective burden should be borne by each person. If taxpayers and the state are in agreement that the revenues raised are to be used for some purpose which serves the general good, this then comes very close to the meaning of tax equity in a pragmatic way.

Since the introduction of taxes, i.e. payments made by individuals or companies to the community and administered by the state, a great variety of sources have been taxed. Throughout the centuries change has repeatedly taken and continues to take place. It was not so long ago that taxes were levied primarily on property or on the issuing of documents. But the type of added value has changed. When today more and more money is earned through investments rather than work, the discussion naturally arises about whether capital should be subject to greater taxes.

Tax laws change constantly, and must always be adjusted to the development of capital and commodity flows within an economy. Switzerland is a good example because it demonstrates that consistency and the development of tax legislation over the long term provide a stable, calculable basis which both companies and individuals can use as a guideline for the future. The Swiss tax system is considered one of the best and most attractive in the world, but we think there is still sufficient potential for making Switzerland an even more attractive tax location. Competition on the location issue continues to grow, and there are new countries, such as in Eastern Europe, that are very well positioned. Switzerland still has sufficient arguments in its favor, offering more than just tax benefits, but it is no longer the only country that is attractive in terms of taxes. The state, parliament, advisory industry and Swiss companies must work together more closely to find new joint solutions.

The tax system and its laws cannot place the payers on one side and payees on the other. Rather, it must represent a consensus that is beneficial to all. As advisors, we have made the mistake of avoiding involvement in formative and forward-looking discussions for too long. We see it as a part of our duty, specifically because of our broad experience, to help shape this process, or at least to contribute our specialist knowledge acquired in other countries and with foreign systems. Individual participants in the tax system must work together more closely in the future. Not only will this boost the credibility of the system but, above all, it will create a broader consensus which will ensure that Switzerland remains an attractive tax location.

Jörg Walker,
Member of the Executive Board, Head of Tax, KPMG Switzerland

Ethical conduct begins even before an engagement is accepted and accompanies every phase of its execution. By using proven and continually updated processes, potential problem areas are analyzed and included in the evaluation.

Advisory – the basis for risk management

Dieter Widmer, Member of the Executive Board, Head of Advisory, KPMG Switzerland

Advisory encompasses a wide range of activities that KPMG has divided into three main categories:

- Growth: with services such as M&A
- Governance: this includes risk management, internal control systems, legal and regulatory compliance
- Performance: such as improving efficiency or optimizing processes

Advisory moves in an ethical conflict zone. Our task is to advise the client about opportunities and risks and to prepare a basis for making decisions. For example, a company's decision to move its service centers abroad may cause job losses in Switzerland. But it may also give the company a global competitive edge, enabling it to keep jobs here in Switzerland.

KPMG does not offer advice on strategy. This means that the decision whether laying off employees will boost performance is and remains a business decision to be made by the client.

Advisory also points out possible M&A risks such as tax risks, neglected investments in research and development or outdated machinery at a takeover target. KPMG's ethical principles include supporting the client while maintaining impartiality toward the client's business. Depending on what the client requests, we will either discontinue our services after the engagement is completed or continue supporting the client over an extended period.

Ethical conduct from the start
Our conduct toward a potential client, from the initial meeting to the end of the engagement and beyond, is always guided by ethical principles because there are clear processes that have been set up for accepting the engagement. If we have no understanding of the specific type of business, do not know the actual principal, or find the financing or sources of financing questionable, these are possible grounds for refusing the engagement. This applies specifically if we are asked to adapt accounting standards to the individual needs of a client. Such requests are red flags. Hence, it is essential that every individual employee has excellent capabilities. Just as important at KPMG is the continuous ensuring of independence. Clients expect us to offer an independent and objective opinion that is not influenced by economic factors or conflicts of interest.

At the same time, there is always the pressure of profitability, which of course, KPMG must achieve too. KPMG's globally valid Code of Conduct forms the basic structure and provides comprehensive guidelines. In addition to the predetermined process for accepting engagements, the conduct and judgment of each individual employee at KPMG is vital. To this end, the 400 or so Advisory people at KPMG Switzerland are carefully trained, and ethics is a key component of this training. Managers are made aware of problem areas in everyday management; and they then provide relevant information on potential areas of conflict to their teams and monitor the implementation of adequate countermeasures.

Structural and individual
In addition to internal corporate principles, the fact that Advisory people always work in teams plays an important part in dealing with ethical problems. This means that no one is ever left to make an ethical decision on his/her own. The team members' various value systems are brought into play, which are relevant in the context and can be discussed within the team. Internal quality assurance as a function is responsible for the proper resolution of problems, thus complementing the process.

On a personal level, we respect the values of each employee. Someone who is against nuclear energy, for example, would never be obliged to work on an engagement in this sector. Or, if an advisory engagement involves completion in a politically unstable country, an employee would never be forced to participate against his/her wishes. We are guided by respect for different values and offer a structural environment that accepts individual value systems and ethical positions without imposing penalties.

Public pressure
The nature of our work puts the audit and advisory services constantly in the spotlight, thus exposing them to public criticism. Hence, we are acutely aware of the ethical aspects of our work.

We cannot act as the moral conscience of the business world. We would have no such credibility, nor is this our task. Thus, within the framework of risk management, we point out problems which are connected to the social reputation of a client. A relevant example is unethical working conditions in Asia. We do not decide for our clients whether they are prepared to take such a risk and bear the consequences.

KPMG is also faced with pressure from our competitors. We cannot and do not wish to compete against companies that price their services below cost, which means they have to make up the loss by charging other clients more. The same holds true for stipulations made about the nature of our activities, which we can never accept. In addition to our advisors' conduct on site, for which we create structures and offer training and awareness courses in order to promote ethical behavior, we have the advantage that such decisions are made within our teams.

Importance of frameworks
As advisors it helps to refer to global frameworks such as the Global Compact. They form the basis for proper professional conduct. In addition, we are active at the national level in passing new legislation, enabling us, for instance, to verify statements about environmental protection or carbon emissions in annual reports. In this regard, more control makes sense, and we verify compliance with such regulations. As advisors we do not impose any such rules ourselves. In the debate over managers' salaries, advisors are not required to present their opinions about justifiable or correct amounts, but they are supposed to review the propriety of the process of determining salaries according to relevant company guidelines and to point out possible reputational risks.

A basis of trust
We build a relationship of trust between ourselves and our clients. This is sometimes strained if a client "hides" behind KPMG or if it cites a statement from an internal KPMG report out of context, omitting the previous critical or restrictive comments. In such cases we are bound by confidentiality and cannot take any action publicly.

We have to endure this conflict situation as well as public criticism of our work. However, it must be remembered – we are advisors, not decision makers. We are not running the business but providing the company with the basis upon which to make decisions, pointing out risks, which include potential reputational damage as a result of unethical behavior.

Within KPMG we have created structures which make it possible for individual employees to act within the framework of their own ethical values. They can review their positions in teams and refuse engagements in individual cases without any problems.

Moreover, at KPMG we are aware that our type of activity and broad specialist knowledge pose possible risks to our own reputation and for this reason, despite market pressure, we refuse engagements if they do not pass our own internal review process.

Dieter Widmer,
Member of the Executive Board, Head of Advisory, KPMG Switzerland

Accounting scandals and corporate meltdowns in Switzerland and abroad have highlighted the need for credible auditing. The system prevailing at the time and international developments revealed various shortcomings and disadvantages of audit regulations and audit companies.

Inspiring confidence in the financial market

Daniel Senn, Member of the Executive Board, Head of Audit Financial Services, KPMG Switzerland

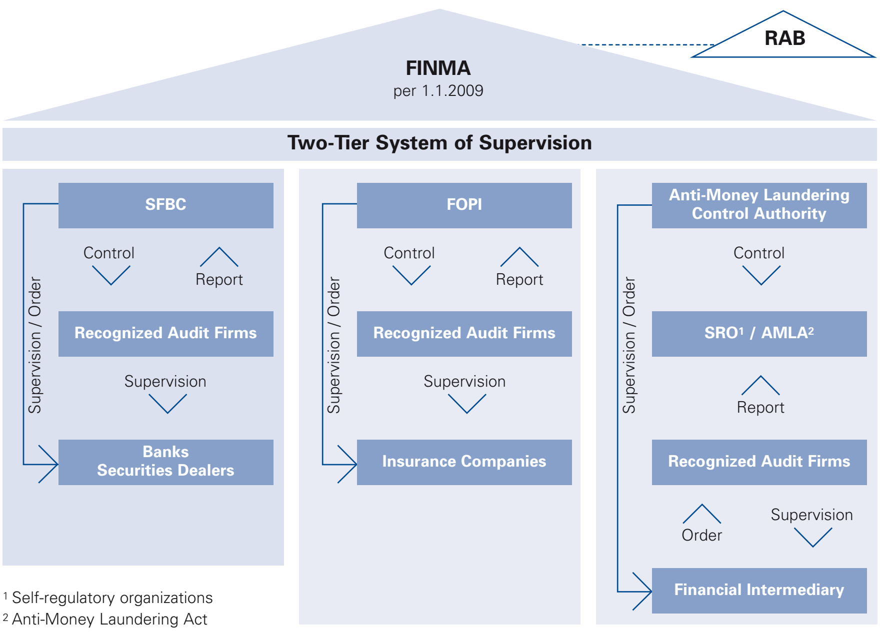
Swiss Federal Audit Oversight Authority and Audit Act for all larger companies and organizations
In light of recent scandals and meltdowns shortcomings of audit regulations finally led to a revision of the Swiss Code of Obligations (particularly audit law) and to the passing of the new Swiss Federal Audit Oversight Act (RAG). The new Swiss Federal Audit Oversight Authority (RAB) established on the basis of the Audit Act was set up in September 2007 and will be fully operational on April 1, 2008.

The Audit Act first introduced an approval procedure under which a supervisory authority checks whether auditors and audit companies meet legal auditing requirements. Auditors of public corporations are also subject to state supervision, and quality assurance systems and audit records of listed companies are reviewed at least every three years by the supervisory authority.

Auditing companies under federal oversight are subject to particularly strict quality and independence requirements.

Audit oversight of auditing companies strengthens our industry. Very few corporate audit companies offer their services to listed companies. As one of the bodies required by law, statutory auditors make a major contribution to the trust placed in a company and their public reporting.

The Swiss Federal Financial Market Supervisory Authority (FINMA) for financial institutions
The new FINMA incorporates the Swiss Federal Banking Commission (FBC), the Anti-Money Laundering Control Authority (AMLCA), the Swiss Federal Office of Private Insurance (FOPI), etc. FINMA will officially begin operations on January 1, 2009, if the related law enters fully into force.



[1] Self-regulatory organizations
[2] Anti-Money Laundering Act

The Financial Market Supervision Act (FINMA Act) will unify and improve the structure of the previous supervisory authorities. There are no new obligations for the institutions subject to it. Additional supervisory tools for overseeing the financial markets will make it easier for the supervisory authority to sanction violations of financial market laws. In this respect, the FINMA Act provides an opportunity to improve Switzerland's reputation as a financial market.

Seven laws contained in the FINMA Act

FOPI
- Insurance Supervision Law
- Insurance Contract Law (partial aspect)

FBC
- Banking Law
- Stock Exchange Law
- Collective Investment Scheme Law
- Debentures Law

AMLCA
- Money Laundering Law

FINMA and Oversight Authority will work together closely
Under the new Commercial Register Ordinance, Commercial Register administrations are also required to check whether all audit firms listed in the Commercial Register have the requisite approvals as per the Federal Audit Oversight Authority register.

This ordinance will further improve the quality of auditing services in Switzerland, which are of key importance for the capital markets and the economy as a whole.

Daniel Senn,
Member of the Executive Board, Head of Audit Financial Services, KPMG Switzerland

It takes years to build a reputation, and wrongful conduct by a single employee can be enough to cause it lasting damage. Prevention is much more important than trying to catch misconduct after the fact.

Living corporate culture as a means of prevention

Anne van Heerden, Head of Forensic, and Peter Jonker, Forensic, Integrity Services, KPMG Switzerland

In order to commit a crime, there must be a motive, opportunity and justification. The definition used in criminology also applies in the business world. The Forensic department at KPMG is responsible for identifying, clarifying and preventing economic crime. Often there are a number of factors that lead to an employee's improper conduct: personal problems, debts or a difficult phase in their life.

Preventing fraud in forensic work is just as important as discovering it. One key question is: What must be done to prevent this from happening? This simple question presents management with a monumental challenge.

On the one hand it means that the opportunity to commit a crime should be limited by means of clear guidelines, and the risk of a crime should be reduced to a tolerable level by practical controls. On the other hand it is about raising corporate culture to a high ethical level so that there is no breeding ground for criminal potential. This is a challenge, as shown by the public service announcements against drinking and driving.

Correct assessment of potential consequences

There is still a long way to go until every individual is convinced that these announcements are not about

increasing revenue from fines. Their purpose is to show that drunk drivers represent a danger to themselves and others. The aim of such campaigns is to make offenders aware of their actions, to assess the potential consequences correctly and to internalize it all. In the best-case scenario, this leads to changed behavior, which, as we all know from personal experience, is a very difficult process.

Creating awareness
Codes of Ethics or Mission Statements are orientation parameters which only develop their power in daily business life if they are implemented correctly. Consider two simple examples:

- An employee takes company copy paper for personal use. Is this "merely" unethical, or is it actual theft?
- An employee sends out a mass mailing at the company's expense because everyone does it. In this case it is not enough to reprimand the misconduct of the employee.

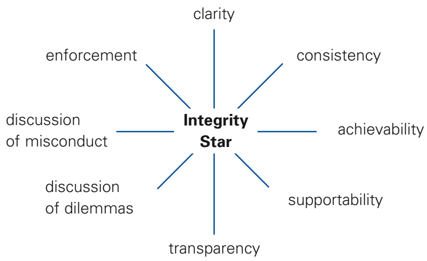
The introduction of guidelines, which impose penalties for such behavior, is just the first step. The more essential next step is to make employees aware that unethical behavior will not be tolerated.

Which methods may employees use to close a deal? Are they allowed to extend invitations, send gifts or make financial promises? In addition to clear internal rules and legal provisions, there is a need for integrity management, which must first make employees aware that in business problem situations or gray zones will always exist. These problems cannot all be covered by extensive regulations alone. A corporate culture which excels at ensuring that communicated values are adhered to and rules complied with is surely a good prerequisite and stable support to bring employees' own uncertain assessments up to a satisfactory level. If all employees are aware of these cultural values and know that they can ask questions to help resolve difficult situations within the company's ethical parameters, we have progressed significantly in the corporate environment.

Prevention is essential
Of course it is unethical and criminal to become rich by dipping into a company's coffers. Even employee behavior that is "merely" unethical can damage a company's reputation, and the financial consequences are often difficult to assess and thus potentially more serious. In a corporate environment where sensitivity to misconduct thrives, it is increasingly important that global firms not only formulate internal rules and values, but also implement them. This can only work in cooperation with employees. This can be done in workshops to raise sensitivity or by using an "Integrity Thermometer" (see box), which provides comprehensive insight into the ethical culture of a company. It is then possible to create structures that serve not only as guidelines in problem situations or with gray areas in daily business, but also as deterrents to criminal or unethical behavior.

"Integrity Thermometer"
The "Integrity Thermometer" is a scientifically founded, Internet-based, confidential tool developed by KPMG which is already used in numerous countries. It is based on a structured and anonymous survey of company's management and employees. It provides companies and organizations with insight into prevailing types of behavior, highlights their causes, and suggests measures that need to be taken.

The "Integrity Star" presents a catalog of measures



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Links and reference literature

Links

The following links provide additional information on the activities of watchdog organizations, foundations, research institutes and the UN.

www.corp-ethics.com
www.corporatecitizen.de
www.bankwatch.org
www.corporateeurope.org
www.corpwatch.org
www.csreurope.org (corporate social responsibility in Europe)
www.ethicalconsumer.org
www.genewatch.org
www.philias.org (foundation)
www.transparency.org
www.unglobalcompact.org
www.accountability.org.uk
www.evb.ch (The Berne Declaration)
www.foeg.unizh.ch (Center for Research on the Public Sphere and Society [fög] at the University of Zurich)
www.iwe.unisg.ch (Institute for Business Ethics at the University of St. Gallen)

Literature

This is a selection of practice-oriented papers and articles that further explore the topic of ethics.

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Dietzfelbinger, Daniel: Aller Anfang ist leicht.
Unternehmens- und Wirtschaftsethik für die Praxis. München, 2004
Practical introduction with a good overview of current discussion including concrete case studies.

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