

# Chapter 3

## It's in the property

Faeeza Jaffer (UNISA)  
Gail Fortuin (Stellenbosch)



### Learning outcomes and level of knowledge tested

#### *Learning outcomes*

- Identify and analyse the relevant personal, business and/or professional ethical dilemmas apparent in the scenario.
- Identify the ethical values challenged by the ethical dilemmas and evaluate the impact of the ethical dilemmas on the ethical values.
- Identify the stakeholders affected by the ethical dilemma.
- Apply an ethics-based reasoning process to solve the ethical dilemmas that have been identified.
- Analyse all courses of action and the consequences of each (such as disciplinary action) for unethical behaviour.
- Report ethics-related issues to higher levels of management, legal or regulatory authorities or others, when appropriate.

#### *Level of knowledge*

Basic to intermediate

**Case study**

This case study focuses on the conduct of a financial director, both as a professional accountant and a member of the governing body. The ethical dilemma arises in the property industry/sector.

You are a professional accountant in business and have recently been appointed financial director of PropertyInvest Ltd, a company listed on the Johannesburg Stock Exchange (JSE).

PropertyInvest Ltd was founded by the current CEO, Mr Nooks. The company began its business buying and selling real estate in Gauteng, South Africa. Over time, the company increased its service offerings and now provides a comprehensive range of property services. PropertyInvest Ltd has formed alliances with property companies worldwide, enabling the company to assist interested parties with property sales and residency in several countries locally and internationally. The company is a trusted brand in the property industry and often provides services to high-profile individuals such as celebrities and politically exposed persons (PEPs).

At the time of your appointment, you declared to the board of directors and the recruitment agency that assisted you with the appointment process that you have not had much experience in the property industry. However, both the directors and the recruitment agency believe you to be a fast learner and able to learn the ins and outs of the business without trouble. They were confident in appointing you because of your knowledge of the JSE listing requirements regarding corporate reporting and other necessary disclosures. The board also assured you that the company would be willing to send you on any necessary training that you may require. There seemed to be no other reason not to take up the position and you were excited about the opportunity presented.

During your review of the next month's revenue budget (revenue transactions are categorised according to value) you came across a transaction that PropertyInvest Ltd is conducting on behalf of Mr Robert Caesar, the son of a well-known politician in South Africa. Mr Caesar approached PropertyInvest Ltd to assist him in purchasing a home in one of Cape Town's premier suburbs. PropertyInvest Ltd negotiated the deal on behalf of Mr Caesar. The owner of the home, worth R14 500 000, duly accepted the offer of purchase from Mr Caesar.

Negotiating deals on behalf of high-profile people is not something new to PropertyInvest Ltd's business, hence the deal did not surprise

you. However, this transaction caught your attention because you had read a recent newspaper article in which it was reported that Mr Robert Caesar was under investigation for allegedly embezzling funds belonging to the South African government through a tender process. Consequently, you decided to ensure that the transaction was done properly and in line with policy and practice so that the company is not associated with any wrongdoing.

You obtained the transaction file for the property sale and discovered that the due diligence test that was supposed to have been done on the client was incomplete. The due diligence test had not determined the source of Mr Caesar's funding for the property purchase, in line with the FIC Act.<sup>1</sup> You thought back to the first training you attended, after your appointment to PropertyInvest Ltd, on the regulations affecting the property industry and recalled that the importance of performing due diligence tests on company clients was emphasised. The training referred you to the FIC Act, which stated that PropertyInvest Ltd is obliged to determine the source of a property buyer's funding to ensure that the company is not caught up in any illegal schemes of the buyer such as money laundering amongst other fraudulent schemes.

PropertyInvest Ltd's company policy is in line with the FIC Act and emphasises the importance of due diligence testing. Upon further investigation, it was revealed to you that the CEO, Mr Nooks, had authorised the transfer of the property to the buyer despite the incomplete due diligence. However, the file also showed that the property transfer has not yet been concluded and that the due diligence test could therefore still be completed.

On the basis of the information gathered you decide to approach the CEO to inform him of the investigation against Mr Caesar. You explain to Mr Nooks that upon the review of the following month's revenue budget you came across the impending transfer of the property to Mr Caesar. The transaction revealed that he, Mr Nooks, had authorised the sales transaction on Mr Caesar's behalf, perhaps unaware of the investigation – given that the due diligence tests were still incomplete.

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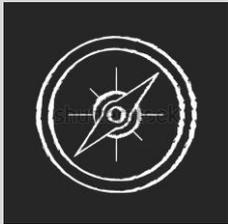
<sup>1</sup> The FIC Act introduces a regulatory framework of measures requiring certain categories of business to take steps regarding client identification, record-keeping, reporting of information and internal compliance structures. The Act obliges all businesses to report to the FIC various suspicious and certain other transactions. The FIC uses this financial data and available data to develop financial intelligence, which it is able to make available to the competent authorities and supervisory bodies for follow-up investigations or administrative action.

Mr Nooks replies, 'Oh yes, I read about the Caesar investigation. I thought it is not our problem, so I decided to override the system and bypass the due diligence test prior to the property transfer.'

You go on to tell Mr Nooks that PropertyInvest Ltd has a duty under the FIC Act to find out where the buyer's money is sourced from. Furthermore, the company could be subjected to scrutiny if the investigation confirms money laundering on Mr Caesar's part. This information could affect PropertyInvest Ltd's reputation, by association, and consequently its share price.

Mr Nooks just smiles and goes on: 'I appreciate your enthusiasm. We are not fraud investigators but real estate agents. It's not your job to investigate this matter, and my advice is that you leave it alone. The transaction is near conclusion, and the money will be good. Don't worry, you are new and will learn that these things are part of the nature of the business.'

You leave the CEO's office confused. Is this really the way things are done around here and in the industry? He is right: you are new, and he has more experience. Yet, the whole episode has left you unsettled.



#### **Ethical dilemma**

What personal, business and professional ethical dilemmas are evident from the scenario presented?

#### *Personal ethical dilemma?*

Personal ethics, as previously defined, are ones' own values or normative standards that determine what one considers to be good, right and just behaviour towards others.

The CEO's advice has left you unsettled. Thus, it has led you to question the appropriateness of his advice. This judgement speaks to your own ethical principles, values and commitment and leaves you with a conflict:

- Do you take the CEO's advice and leave the matter as 'the way things are done'? OR
- Do you take the necessary steps to determine whether the transaction is sound and clear of any wrongdoing?

Leaving the transaction as it will avoid conflict between you and Mr Nooks. No employee wants to be at odds with a colleague, let alone with their superior. However, non-compliance will have a negative effect on the reputation of the business and its stakeholders, should the source of the funding be illegal. You will have to live with the consequences of non-compliance on your conscience.

#### *Business ethical dilemma?*

Business ethics are concerned with moral standards (what is morally right or wrong) in so far as ethical principles apply to the business activities of an organisation.

As a director of the company, it is your duty to ensure that the company adheres to national laws and regulations as well as its policies and internal controls. At the same time, you must safeguard the company from potential lawsuits, fines and other losses due to the company's involvement in or association with wrongdoing.

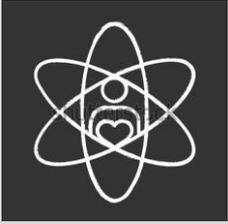
Firstly, failure to carry out due diligence sets the wrong example for employees (that is, allowing the bypassing of controls). The company's policy on performing due diligence tests will not be complied with and the culture will be negatively affected. What is expected in terms of company policy will be opposed by what is done. Is this the message that the directors wish to convey?

Secondly, if the investigation by the South African government into Mr Caesar traces the money to the property, PropertyInvest Ltd will be indirectly associated with Mr Caesar's wrongdoing. The negative publicity could affect the reputation of the company and consequently shareholder value. Is the revenue from one transaction worth the risk of the company's getting a 'bad' reputation or being subjected to litigation for losses?

#### *Professional ethical dilemma?*

You are a professional accountant in business and must therefore adhere to ethical norms applicable to the profession that you are a member of. Consequently, in reaching your decision you must consider whether the action you take

- contravenes the code of ethics of the professional accounting body of which you are a member
- could bring the profession into disrepute.

	<p><b>Fundamental principles (code of ethics)</b></p> <p>The code of conduct of the professional body to which you as a professional accountant belong (for example, SAICA, SAIPA, ACCA) applies. However, the codes of ethics of most professional accountancy bodies are based on the IFAC code of ethics. The fundamental principles in the IFAC's code of ethics are integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.</p>
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### *Integrity*

As a professional accountant, you must act with honesty, sincerity, and due care in all professional and business relationships. Consequently, as a professional accountant you should ensure that the transaction is legitimate and fair. Stakeholders rely on your integrity to ensure that the company's transactions are authenticated.

### *Objectivity*

A professional accountant should not compromise business decisions and judgements because of the biased actions, conflicts of interest or undue influence of others. Therefore, as a professional accountant, you should not submit to the influence of Mr Nooks or ignore your obligation to ensure that the laws and regulations applicable to the company are complied with.

### *Professional competence and due care*

As a professional accountant, you are to attain and maintain the knowledge and skills required to provide the company (PropertyInvest Ltd) with a professional service based on technical and current standards and legislation. Professional accountants must also act diligently in line with technical and professional standards.

### *Confidentiality*

Professional accountants (in business) have a duty to maintain the confidentiality of information relating to their employer. However, as a director or member of the governing body, you may be required to disclose information to the relevant authorities when such disclosure is a legal requirement. Since the due diligence test can still be completed there is currently no need to disclose non-compliance to the relevant authorities.

### *Professional behaviour*

Professional accountants are required to conduct themselves in a manner that will not bring the profession into disrepute and to comply with relevant laws and regulations.

Should the due diligence test not be completed, and the sale go ahead, the company would not be adhering to laws and regulation. You, as the financial director, can be held accountable for the company's failure to comply with the FIC Act. This may result in the questioning of your professional behaviour. In addition, since the behaviour of members of the profession reflects on the profession itself, negative publicity elicited by the unprofessional behaviour of one member can raise questions about the ethical principles and conduct of all members of the accounting profession.



#### **Ethical principles**

Which of the ethical characteristics required of members of the governing body of PropertyInvest Ltd are affected and how? (According to the ethical leaderships characteristics cited in the King IV Report, Part 5.1, Principle 1.)

### *Integrity*

It is important that you, as the financial director of the company, act in good faith and in the best interests of the company. Your integrity is in question if you agree to follow the advice given by Mr Nooks, as this action may not necessarily be in the best interests of the company. The company's reputation could be negatively affected should the money received for the property be traced to an illegal source. You are aware of the risk to reputation and of the fact that due process (policies and internal controls) has not been followed.

### *Competence*

As a member of the governing body, you are responsible for ensuring that you have the required knowledge of the business, of its industry, and of the laws that govern the industry. You need to take the necessary steps to acquire this knowledge – for example, attending a course on property legislation. You are also required to be familiar with the codes, rules and standards applicable to the company and its operations. Therefore, you have a duty to ensure you have the knowledge and skills (competencies) to hold your position as financial director.

However, your duty extends beyond the training that you attend. The characteristic of competence also requires that you perform your duty with reasonable care and skill and make informed decisions. Consequently, you have an obligation to ensure that the due diligence test is completed and that the source of the funds used to pay for the property is determined. Once the test has been completed and the source determined, an informed conclusion can be made as to whether the transaction in question is above board or whether the company has become an indirect party to money laundering.

### *Responsibility*

As a member of the governing body, you are required to take responsibility for the company's actions and for preventing negative outcomes. As the financial director, you are duty-bound to ensure that company policies are appropriately approved, implemented and monitored. Furthermore, being responsible means acting in the best interests of the company. Linked to integrity, protecting the company is the governing body's priority.

The incomplete due diligence test is in contravention of the FIC Act as well as company policies and internal controls. As financial director, you are responsible for ensuring that there is no non-compliance and that the due diligence test is duly completed. As mentioned previously, failure to do so may have negative outcomes for PropertyInvest Ltd if, for example, the source of funds for the purchase of the property is seen to be related to Mr Caesar and the money laundering charges are proved.

### *Accountability*

Being accountable means that, as a member of the governing body, you are responsible for the execution of the governing body's duties. Accordingly, even if the CEO has authorised the transaction, your accountability as a director in terms of the Companies Act is not abrogated.

### *Fairness*

In assessing fairness, you should determine the impact of the transaction on the company and all the stakeholders including investors, the government, regulatory authorities, employees, customers, and wider society. Compliance with the FIC Act is accordingly in line with the fairness principle. If income is generated from illegal sources, the company would be party to an illegal business practice (fraud), which is to the detriment of, for example, the people of South Africa.

### Transparency

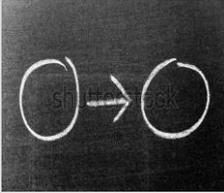
Transparency relates to the way governance roles and responsibilities are exercised. As the financial director, you have a duty to be appropriately transparent about all transactions of the company. Completion of the due diligence test will ensure that the transparency principle is adhered to as the company will then have nothing to hide.



- Customer selling his/her property: The customer who is the seller of the property trusts PropertyInvest Ltd to sell the property, on the basis of the company's reputation and execution of other property transactions. The customer may not be able to recover the selling price of his/her property, should the source of funds be illegal.
- Employees: The property sales transaction, if found to be based on a fraudulent business practice such as money laundering, can result in negative publicity and loss of trust in the company. This may result in loss of business for PropertyInvest Ltd, which may result in retrenchments.
- Financiers: A reduction in operations and profitability will decrease investor value. Some investors expect a return from profits, often calculated as a percentage of revenue. For financiers that expect a return on profit, a decrease in revenue would thus result in a decrease in profit return.
- Shareholders: A property sales transaction that is based on a fraudulent business practice can result in negative publicity for the company. The share price could then be negatively affected, thus decreasing shareholder value.
- The South African government: If the property is transferred and the source of funds is traced to illegal activity, the government would expect recovery of the money through sale of that property. This could be a long and expensive legal process, and the government may be unable to recover the money fully.
- South African public/wider society: The South African public stands to lose if state money that was destined for service delivery was illegally obtained and then laundered through a property to which the

business is a party: the money could become untraceable and irrecoverable.

- Fellow directors: Your fellow directors may also be held personally and professionally accountable for any wrongdoing or non-compliance, in terms of the Companies Act, King IV and the JSE listing requirements.

	<p><b>Consequence management</b></p> <p>(a) What are the possible consequences if</p> <ol style="list-style-type: none"> <li>1. you decide to take further action and complete the due diligence test, OR</li> <li>2. you decide to leave the matter as instructed?</li> </ol> <p>(b) What possible actions can you take to resolve the situation appropriately?</p>
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### 1. **Decision to take further action and complete the due diligence test**

The consequences of this decision are two-fold.

- *Consequences for you, as the financial director and a professional accountant*

Your decision may cause conflict between yourself and the CEO, since he asked you to leave the matter alone. The IFAC code<sup>2</sup> refers to such a situation as undue pressure by a superior. In line with the code, you should consider approaching the CEO and explaining your discomfort with the decision. If the CEO does not change his/her decision, you may consider

- B discussing the matter with a higher level of authority within the company
- B your options in accordance with the company's code of ethics, including policies and procedures
- B obtaining legal advice to determine what options are available to you
- B evaluating the option of pursuing a whistle-blowing line.

<sup>2</sup> Refer to the section 'Fundamental principles (code of ethics)', above, for more on the IFAC code.

- *Consequences for the company*

The decision to complete the due diligence test will ensure that the company complies with applicable laws and regulations. It will also ensure that the approved policies and internal controls are maintained and adhered to and prevent a future adverse internal audit finding.

Furthermore, the completed due diligence test will provide proof of the source of the funding. If the funds were obtained legally, there should be no reason for concern and the completion of the due diligence test will give you 'peace of mind'. If the due diligence test shows that the funds were obtained illegally, you will have to determine the correct reporting lines to follow to ensure that the company is protected. Actions that can be taken if you discover that the source of funding is an act of money laundering include

- B informing the next level of authority of the company – for example, reporting the event to the audit committee – in a responsible manner and with due care
- B obtaining legal advice and determining the options available
- B consulting confidentially with the regulatory authority and/or your professional accounting body regarding the matter concerned.

## 2. **Decision to leave the matter as instructed**

Deciding to leave the matter as the CEO instructed will not ensure your integrity. Furthermore, it may create a perception amongst other staff members that controls can be overridden, thereby encouraging the wrong behaviour from other staff members. The decision would be in direct contravention of the principal values of King IV and amount to non-compliance with laws and regulations, for which there may be repercussions for the company and for you as an individual.

An investigation by the authorities may trace the embezzled money to the property transaction. The consequences of such a finding would be as follows.

- *Consequences for you, as the financial director and a professional accountant*
  - B You may be found liable for breach of your fiduciary duties as a director, in terms of the Companies Act. Furthermore, you may face possible investigations by the professional accounting body that you are a member of.

B You may be unable to defend the company's position in the matter, as the processes followed are not transparent. The CEO's 'claim' that due processes were followed will be insufficient for you, as financial director, to avoid liability and the accusation that PropertyInvest Ltd is a party to possible illegal dealings.

- *Consequences for the company*

B The possibility of fines, litigation, misleading financial statements.

B Potential loss of reputation, which could negatively affect trust, resulting in lower profits and share price, which may cause losses for financiers, shareholders and creditors alike.



**'Food for thought'**

Have you considered or given thought to ...?

**For discussion/debate**

1. What sort of leadership style does the CEO display in terms of the requirements of King IV?
2. What relationship could Mr Nooks have with Mr Caesar, and do you think Mr Nooks is disclosing all the information he has about the transaction? Is there a possible conflict of interest on the part of Mr Nooks?
3. If you were in MR Nooks position, how would you have handled the matter, the same way or differently and why?
4. After completing this case study, considering the various consequences for the different decisions taken, which decision would you implement? Consider to whom and what would you give your loyalty to as a person and a member of the company?
5. Mr Nooks indicated that it was not your responsibility to investigate this matter. Do you think that you should have investigated this matter further when you became aware of it? When do you decide to leave a matter or rather to investigate it further?

**Ancillary material**

The following articles relate to real-life examples of money laundering and related-party transactions that have taken place in the property industry and from which the concepts for the above scenarios were obtained.

Copy the links below into your browser to access the articles:

- <https://www.corruptionwatch.org.za/possible-aiding-of-money-laundering-by-properties-company>
- <https://www.corporatecomplianceinsights.com/best-2016-money-laundering-schemes-real-estate>