steven mintz / roselyn morris

ETHICAL OBLIGATIONS AND DECISION-MAKING IN ACCOUNTING

text and cases

McGraw Hill Education

fifth edition

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Fifth Edition

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Dedication

We dedicate this book to all the students we have taught over the years, without whom our burning desire to teach ethics would lay dormant. In this book, we strive to awaken students' interest in ethics and ethical behavior. Our goals are to educate accounting students to be future leaders in the accounting profession, stimulate your ethical perception so that you not only know what the right thing to do is but have the courage to do it, and sensitize you to your duty to serve the public interest above all else.

> "Educating the mind without educating the heart is no education at all."
>
> *Aristotle*

About the Authors

Courtesy of Steven Mintz

Steven M. Mintz, DBA, CPA, is a Professor Emeritus of Accounting from the Orfalea College of Business at the California Polytechnic State University–San Luis Obsipo. Dr. Mintz received his DBA from George Washington University. His first book, titled *Cases in Accounting Ethics and Professionalism,* was also published by McGraw-Hill. Dr. Mintz has been acknowledged by accounting researchers as one of the top publishers of research papers on accounting ethics and accounting education. He was selected for the 2014 Max Block Distinguished Article Award in the "Technical Analysis" category by The CPA Journal. Dr. Mintz received the 2015 Accounting Exemplar Award of the Public Interest Section of the American Accounting Association. He also has received the Faculty Excellence Award of the California Society of CPAs. Dr. Mintz writes three award-winning blogs under the names "ethicssage," "workplaceethicsadvice," and "higheredethicswatch."

Courtesy of Roselyn E. Morris

Roselyn E. Morris, Ph.D., CPA, is a professor emerita of accounting of the Accounting Department of McCoy College of Business, Texas State University. Dr. Morris received her Ph.D. in business administration from the University of Houston. She is a past president of the Accounting Education Foundation. She is currently appointed for a six year term as chair of the Qualifications Committee of the Texas State Board of Public Accountancy (TSBPA) and is a board member of the National Association of State Boards of Accountancy (NASBA).

Both Professors Mintz and Morris have developed accounting ethics courses at their respective universities.

Preface

Ethical Obligations and Decision Making in Accounting was written to guide students through the minefields of ethical conflict in meeting their responsibilities under the accounting professions' codes of conduct. Our book is devoted to helping students cultivate the ethical commitment needed to ensure that their work meets the highest standards of integrity, independence, and objectivity. We hope that this book and classroom instruction will work together to provide the tools to help students to instill the ethical values of the accounting profession and professionalism in everything they do. Here is a brief overview of enhancements to the fifth edition. Additional details follow.

Overview of 5th Edition

An expanded discussion of professional judgment highlights the challenges to ethical decision-making for internal accountants and auditors, and external auditors. New material on behavioral ethics addresses cognitive challenges in the performance of an audit. We examine emerging issues in organizations related to equity, diversity, and inclusion, as well as sexual harassment. We build on traditional philosophical reasoning methods by taking the process one step further, that is, to convert ethical intent into ethical action by applying the "Giving Voice to Values" methodology. GVV coverage has been expanded to include new cases in order to provide instructors with more choices when and how to use GVV in class discussions. Whistleblowing obligations of CPAs are covered in full including the 2018 U.S. Supreme Court decision in *Digital Realty Trust, Inc. v. Somers* that clarifies when an accountant must report financial wrongdoing to the SEC under the Dodd-Frank Financial Reform Act. We also examine whether protections against retaliation under the Sarbanes-Oxley Act are working as intended. A 2018 court decision in *Erhart v. Bofl Holdings* held that whistleblowers can use confidential company documents to expose fraud may be a game changer. In this book, we are committed to thoroughly exploring ethical obligations of accountants and auditors. In that regard, we have expanded discussion of some of the rules of conduct including independence, objectivity and integrity, and professional skepticism. We also devote more coverage to acts discreditable to the profession, a growing problem of professional behavior. New rules to disclose critical audit matters and when to include a separate paragraph in the audit report are discussed. Expanded coverage of non-GAAP metrics raises questions about the usefulness of such data, its conformity with GAAP, and SEC guidelines. Ethical leadership is discussed in the context of professional role, professional obligations as a CPA, and dealing with organizational influences.

Several states now require their accounting students to complete an ethics course prior to being licensed as a CPA. This book has been designed to meet the guidelines for accounting ethics education including:

- encouraging students to make decisions in accordance with prescribed values, attitudes, and behaviors.
- providing a framework for ethical reasoning, knowledge of professional values, and ethical standards.
- prescribing attributes for exercising professional skepticism and behavior that is in the best interest of the investing and consuming public and the profession.
- instilling the desire to do the right thing and adhere to the standards set forth in the AICPA Code of Professional Conduct.

Accounting students should strive to be the best accounting professionals possible. To that end, we dedicate the book to instilling a sense of ethics and professionalism.

What's New in the 5th Edition?

In response to feedback and guidance from numerous accounting ethics faculty, the authors have made many important changes to the fifth edition of *Ethical Obligations and Decision Making in Accounting: Text and Cases,* including the following:

Connect

- **Connect is available** with assignable cases, test bank assessment material, and SmartBook. **SmartBook** is an excellent way to ensure that students are reading and understanding the basic concepts in the book and it prepares them to learn from classroom discussions. Several of the **Chapter Cases** are available in an auto-graded format to facilitate grading by instructors. The purpose of using the digital format is to better prepare students ahead of class to free up instructors to discuss a broader range of topics in their lectures and in the give-and-take between teacher and student. **Connect Insight Reports** will also give the instructor a better view into the overall class's understanding of core topics prior to class to appropriately focus lectures and discussion. The **Connect Library** also offers materials to support the efforts of first-time and seasoned instructors of accounting ethics, including a comprehensive Instructor's Manual, Test Bank, Additional Cases, and PowerPoint presentations.
- **Learning Objectives** have been added and linked to specific content material in each chapter.

End-of-Chapter Assignments

Each chapter includes 25 discussion questions (20 in chapter 8) that are designed to review important topics in the text with students and apply their knowledge to new situations. Ten cases (5 in chapter 8) cover a variety of topics deemed most important in each chapter. We have purposefully kept most of these cases short to provide ample time for discussion in class about the ethical issues and to not get too bogged down with financial analysis. However, we do provide many SEC cases that focus on the numbers and are more comprehensive. We hope the mixture will serve the interests of all instructors.

The major cases have been restructured in the fifth edition to provide a selection of short and long cases, all of which have one thing in common: through the questions at the end of each case students are given the opportunity to tie together important topics discussed in the text and apply their knowledge of ethical reasoning to more complex situations. We have included on the web some of the discussion questions, end-of-chapter cases, and major cases from the third and fourth editions not carried over to the fifth edition to make way for new cases and keep the book fresh and up to date. Instructors may find this material useful for assignment purposes. We have also revised and enhanced additional Instructor's Resource Materials and supplements.

Chapter-by-Chapter Enhancements

Chapter 1

- Expanded discussion of Egoism to include Ayn Rand's *Rational Egoism,* a method of ethical reasoning popular with today's young adults and millennials.
- **New** coverage of moral turpitude and other "Acts Discreditable to the Profession." Recent studies have indicated violations of this ethics rule by CPAs are on the rise because of DUI and other offenses. Additional concerns in this area may exist over time especially in those states that permit recreational use of cannabis.
- Expanded discussion of the Principles of the AICPA Code of Professional Conduct, the public interest obligation, and regulation in the accounting profession.

Chapter 2

- **New** discussion of cognitive biases that can influence audit decision-making.
- **New** discussion of *equity, diversity, and inclusion.*
- Enhanced discussion of the GVV technique. Chapter 2 discusses the foundation of the approach including examples on applying the methodology. There are twenty cases in the book that apply GVV. These cases are designated as "a GVV case."
- Discussion of Volkswagen "Dieselgate" scandal.

Chapter 3

- Updated results from the Association of Certified Fraud Examiners Global Survey of Fraud.
- **New** discussion of corporate social responsibility including *sexual harassment.*
- Expanded discussion of the Sarbanes-Oxley Act and whistleblower protections.
- Expanded discussion of the Dodd-Frank Financial Reform Act and when to report financial wrongdoing to the SEC.
- Implications of the U.S. Supreme Court decision in *Digital Realty Trust, Inc. v. Somers* and how it may influence when would-be-whistleblowers inform the SEC of financial wrongdoing.
- Analyze when whistleblowers can use confidential company documents to expose fraud.
- Examine Equifax Data Breach in the context of corporate governance.

Chapter 4

- Enhanced discussion of professional judgment in accounting.
- Expanded coverage of KPMG Professional Judgment Framework.
- **New** discussion of problems for auditors who uncritically accept management's representations in an audit.
- Comprehensive discussion of the Revised AICPA Code of Professional Conduct including the threats and safeguards approach to determine when violations exist of independence, integrity and objectivity, and the presence of ethical conflicts.
- **New** discussion of confidentiality and disclosing fraud.
- Expanded discussion of ethics in tax practice.
- Discussion of recent cases brought against CPA firms for violating the AICPA Code.

Chapter 5

- Expanded discussion of errors, illegal acts, and fraud.
- Expanded discussion of Private Securities Litigation Reform Act and reporting requirements to the SEC; fraud and confidentiality issues explored.
- **New** Discussion of Professional Skepticism Scale that measures traits conducive to developing a questioning mind and informed judgment.
- Discussion of findings of the Center for Audit Quality of audit deficiencies.

- Expanded discussion of PCAOB audit inspection process and high rate of deficiencies of audit firms.
- **New** requirements to disclose critical audit matters in the audit report.

Chapter 6

- **New** cases that explore in depth legal obligations of accountants and auditors.
- **New** discussion of audit malpractice.
- Expanded section on legal liabilities under Sarbanes-Oxley.
- Expanded discussion on regulatory issues and PCAOB inspections.
- **New** requirements under SSARS No. 21 for compilations and issuing non-compilation reports.
- Enhanced coverage of auditor liability for internal control over financial reporting.

Chapter 7

- **New** discussion of earnings guidance and forward-looking-statements.
- **New** discussion of SEC Regulation G and Item 10(e) of Regulation S-K that define a “non-GAAP financial measure” including Compliance and Disclosure guidelines.
- Expanded discussion of non-GAAP financial measures including EBITDA and other non-GAAP performance measures.
- **New** examples of GAAP to non-GAAP reconciliations.
- **New** examples of lack of professional judgment in critical areas of the audit and auditing estimates.
- Expanded discussion of the use of accruals and earnings management.
- **New** discussion of revenue recognition standard, *Revenue from Contracts with Customers*
- Detailed examples of financial statement restatements including Hertz Corporation.

Chapter 8

Chapter 8 links back to discussions in Chapters 1 through 7 by incorporating material on “Ethical Leadership.” The purpose is to leave students with a positive message of the importance of being a leader and ethical leadership in building organizational ethics. Leadership in decision-making in accounting, auditing, tax, and advisory services engagements is addressed. If there is one theme that describes what this chapter is about it is: “Businesses don’t fail; leaders do.” The chapter includes the following major topics:

- **New** discussion of audit quality controls, audit leadership, and audit failures.
- Expanded discussion of professional role and leadership.
- Revisiting moral intensity in the context of ethical leadership.
- Expanded discussion of ethical leadership in the practice of public accounting.
- **New** case studies on ethical leadership.
- Implications of ethical leadership for whistleblowing activities.
- Ethical leadership and the GVV technique.
- Ethical leadership competence.

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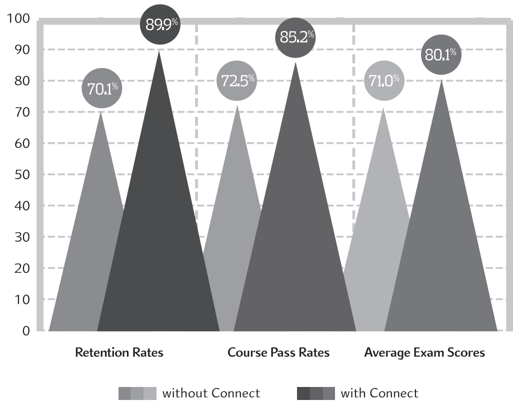

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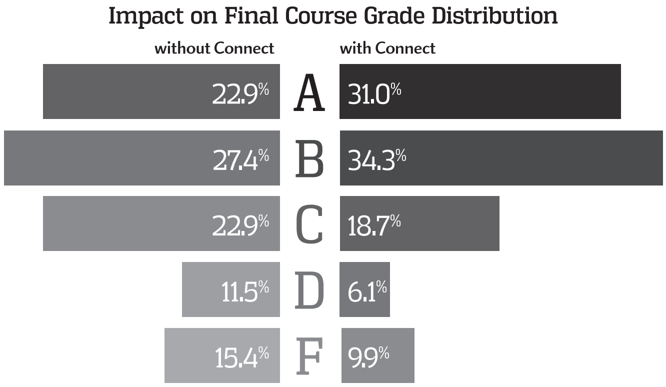

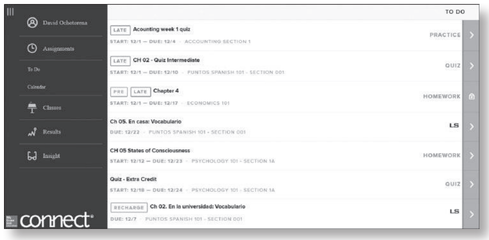

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Finally, we would like to acknowledge the contributions of our students, who have provided invaluable comments and suggestions on the content and use of these cases.

If you have any questions, comments, or suggestions concerning *Ethical Obligations and Decision Making in Accounting,* please send them to Steve Mintz at smintz@calpoly.edu.

Case Descriptions

Case #	Case Name/Description
1-1	**Harvard Cheating Scandal** *Student cheating at Harvard raises questions about responsibilities of instructors and personal responsibilities of students.*
1-2	**Giles and Regas** *Dating relationship between employees of a CPA firm jeopardizes completion of the audit.*
1-3	**Unintended Consequences** *Ethical dilemma of a student who accepts an offer of employment from a firm but, subsequently, receives additional, attractive offers from other firms.*
1-4	**Lone Star School District** *Failure to produce documents to support travel expenditures raises questions about the justifiability of reimbursement claims.*
1-5	**Moral Turpitude** *Accountant gets caught up in a police raid at a client's location and faces disciplinary action for committing an act discreditable to the profession.*
1-6	**Capitalization versus Expensing** *Ethical obligations of a controller when pressured by the CFO to capitalize costs that should be expensed.*
1-7	**Eating Time** *Ethical considerations of a new auditor who is asked to cut down on the amount of time that he takes to complete audit work.*
1-8	**Shifty Industries** *Depreciation calculations and cash outflow considerations in a tax engagement.*
1-9	**Cleveland Custom Cabinets** *Ethical and professional responsibilities of an accountant who is asked to "tweak" overhead to improve reported earnings.*
1-10	**Better Boston Beans** *Conflict between wanting to do the right thing and a confidentiality obligation to a coworker.*

Case #	Case Name/Description
2-1	**A Team Player? (a GVV case)** *Ethical dilemma for audit staff member who discovers a deficiency in inventory procedures but is unable to convince the group to report it.*
2-2	**FDA Liability Concerns (a GVV case)** *Conflict between a chef and CFO over reporting bacteria found in food and FDA inspection results.*
2-3	**Taxes and the Cannabis Business (a GVV case)** *Declaring the appropriate amount of sales revenue from cash transactions in the cannabis business and the impact on taxable income.*
2-4	**A Faulty Budget (a GVV case)** *Ethical and professional responsibilities of an accountant after discovering an error in his sales budget.*
2-5	**Gateway Hospital (a GVV case)** *Behavioral ethics considerations in developing a position on unsubstantiated expense reimbursement claims.*
2-6	**The Normalization of Unethical Behavior: The Harvey Weinstein Case** *Sexual harassment in the movie industry and the media and biases that influence whether such instances are reported.*
2-7	**Milton Manufacturing Company** *Dilemma for top management on how best to deal with a plant manager who violated company policy but at the same time saved it $1.5 million.*
2-8	**Juggyfroot (a GVV case)** *Pressure imposed by a CEO on external accountants to change financial statement classification of investments in securities to defer reporting a market loss in earnings.*
2-9	**Racially Charged Language Inhibits Inclusive Cultures** *Equity, diversity, and inclusion policies (EDI) on college campuses and biases and stereotypes.*

2-10	**WorldCom** *Persistence of internal auditor Cynthia Cooper to correct accounting fraud and implications for Betty Vinson, a midlevel accountant, who went along with the fraud.*

Case #	Case Name/Description
3-1	**The Parable of the Sadhu** *Classic Harvard case about ethical dissonance and the disconnect between individual and group ethics.*
3-2	**Rite Aid Inventory Surplus Fraud** *Dilemma of director of internal auditing whether to blow the whistle under Dodd-Frank on Rite Aid's inventory surplus sales/kickback scheme.*
3-3	**United Thermostatic Controls (a GVV case)** *Acceptability of accelerating the recording of revenue to meet financial analysts' earnings estimates and increase bonus payments.*
3-4	**Franklin Industries' Whistleblowing (a GVV case)** *Considerations of internal accountant how best to voice her values to convince others to act on questionable payments to a related-party entity.*
3-5	**Walmart Inventory Shrinkage (a GVV case)** *Pressure to reduce inventory shrinkage at a Walmart store amidst alleged accounting improprieties and related efforts of the protagonist to voice values.*
3-6	**Full Disclosure: The Case of the Morally Challenged AP Clerk (a GVV case)** *Implications of not reporting embezzlement by an employee to the police in light of the pending initial public offering.*
3-7	**Olympus** *Major corporate scandal in Japan where Olympus committed a $1.7 billion fraud involving concealment of investment losses through fraudulent accounting.*
3-8	**Accountant takes on Halliburton and Wins!** *Violation of confidentiality in a whistleblowing case under SOX after Tony Menendez reported accounting improprieties to the SEC and was retaliated against by Halliburton.*
3-9	**Loyalty to the Boss, Company, and/or the Profession: Whistleblowing as a Lever (a GVV case)** *Improper capitalization of research and development costs and implications for meeting projected earnings per share.*
3-10	**Accountability of Ex-HP CEO in Conflict of Interest Charges** *Sexual harassment charges stemming from conflict of interest between CEO/board chair and outside contractor.*

Case #	Case Name/Description
4-1	**KBC Solutions** *Concerns about professional judgments made by audit senior after the review of workpaper files.*
4-2	**Beauda Medical Center** *Confidentiality obligation of an auditor to a client after discovering a defect in a product that may be purchased by a second client.*
4-3	**Family Games, Inc. (a GVV case)** *Ethical dilemma for a controller being asked to backdate a revenue transaction to increase performance bonuses in order to cover the CEO's personal losses.*
4-4	**A Potential Threat to Professional Judgment?** *Threats to professional judgment because of biased feelings towards client and potential influence on integrity and objectivity, professional skepticism, and independence.*
4-5	**Han, Kang & Lee, LLC (a GVV case)** *Pressure between audit partner who wants the client to write down inventory and other partners that want to keep the client happy.*
4-6	**Tax Shelters** *Ethical dilemma of tax accountant in deciding whether to participate in tax shelter transactions targeted to top management of a client entity in light of cultural influences within the firm.*
4-7	**Romance at EY Creates New Independence Policy** *Threats to independence because of close relationship between EY partner and chief accounting officer of audit client.*

4-8 **Did the CPA Violate any Rules of Conduct?**
Failure of CPA to respond to state board of accountancy investigation into his performance of professional services for a payroll and tax client.

4-9 **Eminent Domain: Whose Rights Should be Protected?**
Enforceability of postemployment protective covenants not to compete based on reasonableness of restrictions.

4-10 **Navistar International**
Confidentiality issues that arise when Navistar management questions the competency of Deloitte & Touche auditors by referring to PCAOB inspection reports and fraud at the company.

Case # **Case Name/Description**

5-1 **Loyalty and Fraud Reporting (a GVV case)**
Employee who embezzles $50,000 seeks out the help of a friend to cover it up. Application of the fraud triangle and GVV.

5-2 **ZZZZ Best**
Fraudster Barry Minkow uses fictitious revenue transactions from nonexistent business to falsify financial statements.

5-3 **Reauditing Financial Statements**
Request to reaudit work of previous auditors.

5-4 **GE Multibillion Insurance Charge**
Threats to viability of insurance business after taking charges to earnings due to underestimating risk.

5-5 **Tax Inversion (a GVV case)**
Questions about the use of IFRS in a consolidation with an Irish entity motivated by tax inversion benefits.

5-6 **Rooster, Hen, Footer, and Burger**
Ethical obligations of a CPA following the discovery of an unreported related party transaction and push back by client entity.

5-7 **Diamond Foods: Accounting for Nuts**
Application of the fraud triangle to assess corporate culture and analysis of fraud detection procedures.

5-8 **Critical Audit Matters or Potentially Damaging Disclosure**
Determination whether to communicate critical audit matters to the audit committee.

5-9 **Weatherford International**
Auditors' failure to detect deceptive income tax accounting, even though client was included in a high-risk category, and restatement of financial statements.

5-10 **Groupon**
Competitive pressures on social media pioneer leads to internal control weakness and financial restatements.

Case # **Case Name/Description**

6-1 **Advanced Battery Technologies: Reverse Merger**
Application of legal standards to assess auditor liability following a reverse merger transaction by a Chinese company.

6-2 **Joker & Wild LLC**
Auditor acceptance of management misrepresentations and alleged malpractice.

6-3 **QSGI, Inc.**
Circumvention of internal controls by client management and false statement to auditors about operating effectiveness.

6-4 ***Anjoorian et al.*: Third-Party Liability**
Application of the foreseeability test, near-privity, and the Restatement approach in deciding negligence claims against the auditor.

6-5 ***Vertical Pharmaceuticals Inc. et al. v. Deloitte & Touche LLP***
Fiduciary duties and audit withdrawal considerations when suspecting fraud at a client.

6-6 **Kay & Lee LLP**
Auditor legal liability when foreseen third party relies on financial statement.

6-7 **TransWays' FCPA Dilemma (a GVV case)**
Assessing whether a payment to a foreign agent constitutes a facilitating payment or bribe under the Foreign Corrupt Practices Act.

6-8 **Disclosing Material Weaknesses in ICFR or Protecting the Firm from Litigation? (a GVV case)**
Identified material weaknesses in internal controls and disclosure in the audit report.

Case #	Case Name/Description
6-9	***Miller Energy Resources, Inc.*** *PCAOB investigation of KPMG and an audit partner for conducting a materially deficient audit and related legal liability.*
6-10	***In re Puda Coal Securities*** *Court opinion stating auditors' reports are opinions based on considerable subjective judgments and are not certifications.*

Case #	Case Name/Description
7-1	**Nortel Networks** *Use of reserves and revenue recognition techniques to manage earnings.*
7-2	**Solutions Network, Inc. (a GVV case)** *Ethical challenges of a controller in voicing values when the company uses round-trip transactions to meet earnings targets.*
7-3	**Allergan: Mind the GAP** *Disagreements with the SEC about presentation of non-GAAP metrics in financial reports and press releases.*
7-4	**The Potential Darkside of Using Non-GAAP Metrics (a GVV case)** *Acceptability of presenting multiple non-GAAP measures to "better" explain financial results and provide useful information to users of financial reports.*
7-5	**Dell Computer** *Use of "cookie-jar" reserves to smooth net income and meet financial analysts' earnings projections.*
7-6	**TierOne Bank** *Failure of KPMG to exercise due care and proper professional judgment in gathering supporting evidence for loan loss estimates.*
7-7	**Non-GAAP Metric Disclosure by General Electric: Value Added, Red Herring, or Red Flag?** *Confusing disclosures of non-GAAP metrics by GE and SEC comment letter about inconsistencies with GAAP and potentially misleading information.*
7-8	**Monsanto Company Roundup** *Improper accounting for rebates offered to product distributors and retailers; auditing of restated financial statements.*
7-9	**The North Face, Inc.** *Questions about revenue recognition on barter transactions and the role of Deloitte & Touche in its audit of the client.*
7-10	**Beazer Homes** *Use of cookie jar reserves to manage earnings and meet EBIT targets.*

Case #	Case Name/Description
8-1	**Research Triangle Software Innovations (a GVV case)** *Advisory services staff member recommends the software package of an audit client to another client and deals with push back from her supervisor who is pushing the firm's package; issues related to leadership and application of GVV in resolving the matter.*
8-2	**New Leadership at General Electric** *Discussions about corporate culture, leadership style, and disappointing operating results in conference calls with financial analysts and investors.*
8-3	**KPMG Tax Shelter Scandal** *Major tax shelter scandal case involving KPMG that explores ethical standards in tax practice and in developing tax positions on tax shelter products in a culture that promoted making sales at all costs.*
8-4	**Krispy Kreme Doughnuts, Inc.** *Questions about ethical leadership and corporate governance at Krispy Kreme, and audit by PwC, with respect to the company's use of round-trip transactions to inflate revenues and earnings to meet or exceed financial analysts' EPS guidance.*
8-5	**Audit of Friars for Life** *Questionable decisions by auditors and client pressure that raises issues about future audits.*

Major Cases: See this section at the back of the book for details.

Brief Contents

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Chapter 1

Ethical Reasoning: Implications for Accounting

Learning Objectives

After studying Chapter 1, you should be able to:

LO 1-1 Explain how integrity enables a CPA to withstand pressures and avoid subordination of judgment.
LO 1-2 Discuss the relationship between ethics, morals, values, and legal obligations.
LO 1-3 Describe how the pillars of character support ethical decision making.
LO 1-4 Differentiate between moral philosophies and their effect on ethical reasoning in accounting.
LO 1-5 Describe the regulatory system in accounting and how professional accountants serve the public interest.
LO 1-6 Discuss the Principles section of the AICPA Code of Professional Conduct.
LO 1-7 Explain what is meant by an act discreditable to the profession.
LO 1-8 Apply the IMA Statement of Ethical and Professional Practice and ethical reasoning methods to a case study.

Ethics Reflection

What is Your Ethics IQ?

Your Ethics IQ measures your level of ethics intelligence. This is not an exact science but does provide insight into your ability to reason through ethical dilemmas and make the right choice. The concept of an "Ethics IQ" has been discussed by Bruce Weinstein, The Ethics Guy.[1]

Answer these questions honestly. Otherwise, you will not know where you stand at the beginning of this course. Each question below has three possible answers. Each question is scored from 1 (least appropriate) to 3 (most appropriate). The scores are totaled and an Ethics IQ will be provided by your instructor.

Grab a pen and paper and let's get started!

Choose the "best" answer for each question.

Questions:

1. You are in line to check out at your favorite bagel store when the customer in front of you reaches for cream cheese in a container in a refrigerated area. You notice she drops a $20 bill. She just paid for her food and left the store. You're late for work already and your boss is a stickler for punctuality. What would you do assuming you can catch up with the customer?
    a. Pocket the $20.
    b. Tell the cashier and give him the $20 to return to the customer who is a regular.
    c. Chase down the customer and return the $20.
2. You are a student in Government 101 and are scheduled to take an essay final at 2:00 pm. While online, you notice a friend of yours in the 9:00 am section shared an Instagram photo of the essay questions. You are spending the time between 10:00 a.m. and 2:00 pm in your study group. You need to ace this class to graduate with honors. What would you do?
    a. Use the posting to prepare for the exam but don't tell the group members about it.
    b. Inform the group members and use the posted information to prepare for the exam.
    c. Ignore the posting.
3. You have discovered through a reliable third party that your best friend is cheating on his wife. Your wife asks whether you know anything about it after seeing your friend with another woman at a restaurant. What would you do?
    a. Confide in her that the cheating is going on.
    b. Deny you know anything about it.
    c. Tell her your friend hasn't said anything to you about it.
4. Your boss comes on to you at work. He constantly asks about your dating life and if you're seeing anyone regularly. He regularly stares at you. His behavior makes

you feel uncomfortable. But, you are up for a promotion and he has the final say. What would you do?
   a. Ignore it, at least until you get the promotion.
   b. Tell him his behavior is unwanted and you feel uncomfortable.
   c. Inform the Human Resources Department.
5. Your best friend was diagnosed with cancer a year ago. You have seen him deteriorate and deal with excruciating pain since then. His doctor can't prescribe marijuana, which might alleviate the pain, because it is illegal to do so in your state. You are thinking about crossing state lines and buying marijuana in a neighboring state where it is legal to buy marijuana for medical and recreational purposes, but it is illegal to cross back into your state under the federal Controlled Substances Act. What would you do?
   a. Cross state lines into a state where buying and using marijuana is permitted and give it to your friend.
   b. Don't cross state lines because it is illegal under the federal Controlled Substances Act.
   c. Tell your friend to move to a state that has medical marijuana laws.
6. You work for a small business and do a lot of travel and entertaining of potential clients. The company issues a credit card for all employees to simplify the accounting function. The card is to be used solely for business expenses. One day while on an out-of-town trip and after business hours, you use the business card to go to the spa to get a massage to alleviate painful arthritis, a problem you have been dealing with for years. What would you do when questioned about this charge by the Accounting Department?
   a. Explain that the out-of-town trip included a five-hour flight that created stress for your osteoarthritis condition. The massage is a legitimate business expense and should be reimbursed.
   b. Explain to the responsible person in the Accounting Department that you know it is a personal expense but ask that it be reimbursed this one time since you have a cash flow problem.
   c. Offer to reimburse the company for the massage.
7. You have just been fired from your job. On the way out, you contemplate downloading some proprietary information about a new R&D project of your employer. You worked on the project so figure you had a right to do so. What would you do?
   a. Don't download the information.
   b. Download the information about the project.
   c. Ask your employer for permission to download the information.
8. You are one of five workers on a team that performs financial calculations for your company. In advance of a meeting between the team and your supervisor, you discover a member of the team, who is your boyfriend, made a mistake in a calculation. The mistake made it look like the company was making more money than it was. What would you do assuming you are convinced the mistake was an honest one?
   a. Ignore it: You don't want to get your friend in trouble.
   b. Speak to your friend: Give him the opportunity to correct the mistake.
   c. Inform the supervisor since it's your job to report what you have observed.

9. You manage a group of six employees. One day one of those employees calls in sick. Later that day you notice the employee posted photos at a restaurant to Instagram. What would you do?
   a. Speak to the employee the next day when she comes to work.
   b. Let it go and say nothing.
   c. Fire the employee.
10. You are a manager at a fast food restaurant and monitor your employee's social media posts on company equipment. You just read a Facebook post by an employee who commented that the working conditions were oppressive. Other employees commented; some agreeing and others disagreeing. Assuming you work in an "at will" employment state (either the employer or the employee may terminate employment at any time). What would you do?
    a. Fire the employee who posted the critical comments.
    b. Ignore the comments.
    c. Meet with the employee(s) to discuss the comments.

> Have the courage to say no. Have the courage to face the truth. Do the right thing because it is right. These are the magic keys to living your life with integrity.
>
> *Source: W. Clement Stone (1902–2002)*

This quote by William Clement Stone, a businessman, philanthropist, and self-help book author, underscores the importance of integrity in decision making. Notice that the quote addresses integrity in one's personal life. That is because one has to act with integrity when making personal decisions in order to be best equipped to act with integrity on a professional level. Integrity, indeed all of ethics, is not a spigot that can be turned on or off depending on one's whims or whether the matter at hand is personal or professional. As the ancient Greeks knew, we learn how to be ethical by practicing and exercising those virtues that enable us to lead a life of excellence.

In accounting, internal accountants and auditors may be pressured by superiors to manipulate financial results. The external auditors may have to deal with pressures imposed on them by clients to put the best face on the financial statements regardless of whether they conform to generally accepted accounting principles (GAAP). It is the ethical value of integrity that provides the moral courage to resist the temptation to stand by silently while a company misstates its financial statement amounts.

Integrity: The Basis of Accounting

LO 1-1

Explain how integrity enables a CPA to withstand pressures and avoid subordination of judgment.

According to Mintz (1995), "Integrity is a fundamental trait of character that enables a CPA to withstand client and competitive pressures that might otherwise lead to the subordination of judgment."[2] A person of integrity will act out of moral principle and not expediency. That person will do what is right, even if it means the loss of a job or client. In accounting, the public interest (i.e., investors and creditors) always must be placed ahead of one's own self-interest or the interests of others, including a supervisor or client.

Integrity means that a person acts on principle—a conviction that there is a right way to act when faced with an ethical dilemma. For example, assume that your tax client fails to inform you about an amount of earned income for the year, and you confront the client on this issue. The client tells you not to record it and reminds you that there is no W-2 or 1099 form to document the earnings. The client adds that you will not get to audit the company's financial statements anymore if you do not adhere to the client's wishes. Would you decide to "go along to get along"? If you are a person of integrity, you should not allow the client to dictate how the tax rules will be applied in the client's situation. You are the professional and know the tax regulations best, and you have an ethical obligation to report taxes in accordance with the law. If you go along with the client and the Internal Revenue Service (IRS) investigates and sanctions you for failing to follow the IRS Tax Code, then you may suffer irreparable harm to your reputation. An important point is that a professional must never let loyalty to a client cloud good judgment and ethical decision making.

WorldCom: Cynthia Cooper: Hero and Role Model

Cynthia Cooper's experience at WorldCom illustrates how the internal audit function should work and how a person of integrity can put a stop to financial fraud. It all unraveled in April and May 2002 when Gene Morse, an auditor at WorldCom, couldn't find any documentation to support a claim of $500 million in computer expenses. Morse approached Cooper, the company's director of internal auditing and Morse's boss, who instructed Morse to "keep going." A series of obscure tips led Morse and Cooper to suspect that WorldCom was cooking the books. Cooper formed an investigation team to determine whether their hunch was right.

In its initial investigation, the team discovered $3.8 billion of misallocated expenses and phony accounting entries.[3] Cooper approached the chief financial officer (CFO) Scott Sullivan, but was dissatisfied with his explanations. The chief executive officer (CEO) of the company, Bernie Ebbers, had already resigned under pressure from WorldCom's board of directors, so Cooper went to the audit committee. The committee interviewed Sullivan about the accounting issues and did not get a satisfactory answer. Still, the committee was reluctant to take any action. Cooper persisted anyway. Eventually, one member of the audit committee told her to approach the outside auditors to get their take on the matter. Cooper gathered additional evidence of fraud, and ultimately KPMG, the firm that had replaced Arthur Andersen—the auditors during the fraud—supported Cooper. Sullivan was asked to resign, refused to do so, and was fired.[4]

One tragic result of the fraud and cover-up at WorldCom is the case of Betty Vinson. It is not unusual for someone who is genuinely a good person to get caught up in fraud. Vinson, a former WorldCom mid-level accounting manager, went along with the fraud because her superiors told her to do so. She was convinced that it would be a one-time action. It rarely works that way, however, because once a company starts to engage in accounting fraud, it feels compelled to continue the charade into the future to keep up the appearance that each period's results are as good as or better than prior periods. The key to maintaining one's integrity and ethical perspective is not to take the first step down the proverbial *ethical slippery slope*.

Vinson pleaded guilty in October 2002 to participating in the financial fraud at the company. She was sentenced to five months in prison and five months of house arrest. Vinson represents the typical "pawn" in a financial fraud: an accountant who had no interest or desire to commit fraud but got caught up in it when Sullivan, her boss, instructed her to make improper accounting entries. The rationalization by Sullivan that the company had to "make the numbers appear better than they really were" did nothing to ease her guilty conscience. Judge Barbara Jones, who sentenced Vinson, commented that "Ms. Vinson was among the least culpable members of the conspiracy at WorldCom. . . . Still, had Vinson refused to do what she was asked, it's possible this conspiracy might have been nipped in the bud."[5]

Accounting students should reflect on what they would do if they faced a situation similar to the one that led Vinson to do something that was out of character. Once she agreed to go along with making improper entries, it was difficult to turn back. The company could have threatened to disclose her role in the original fraud and cover-up if Vinson then acted on her beliefs. From an ethical (and practical) perspective it is much better to just do the right thing from the very beginning, so that you can't be blackmailed or intimidated later.

Vinson became involved in the fraud because she had feared losing her job, her benefits, and the means to provide for her family. She must live with the consequences of her actions for the rest of her life. On the other hand, Cynthia Cooper, on her own initiative, ordered the internal investigation that led to the discovery of the $11 billion fraud at WorldCom. Cooper did all the right things to bring the fraud out in the open. Cooper received the Accounting Exemplar Award in 2004 given by the Public Interest Section of the American Accounting Association and was inducted into the American Institute of Certified Public Accountants (AICPA) Hall of Fame in 2005.

Cooper truly is a positive role model. She discusses the foundation of her ethics that she developed as a youngster because of her mother's influence in her book *Extraordinary Circumstances: The Journey of a Corporate Whistleblower.* Cooper says: "Fight the good fight. Don't ever allow yourself to be intimidated. . . . Think about the consequences of your actions. I've seen too many people ruin their lives."[6]

Religious and Philosophical Foundations of Ethics

Virtually all the world's major religions contain in their religious texts some version of the Golden Rule: "Do unto others as you would wish them to do unto you." In other words, we should treat others the way we would want to be treated. This is the basic ethic that guides all religions. If we believe honesty is important, then we should be honest with others and expect the same in return. One result of this ethic is the concept that every person shares certain inherent human rights, which will be discussed later in this chapter.

We can think of the Golden Rule as a formal principle that serves as the general basis for other principles (duties) we have in an ethical system. Exhibit 1.1 provides some examples of the universality of the Golden Rule in world religions provided by the character education organization Teaching Values.[7]

Greek Ethics

The origins of Western philosophy trace back to the ancient Greeks, including Socrates, Plato, and Aristotle. The ancient Greek philosophy of virtue deals with questions such as: What is the best sort of life for human beings to live? Greek thinkers saw the attainment of a good life as the *telos,* the end or goal

EXHIBIT 1.1 The Universality of the Golden Rule in the World Religions

Religion	Expression of the Golden Rule	Citation
Christianity	All things whatsoever ye would that men should do to you, Do ye so to them; for this is the law and the prophets.	Matthew 7:12
Confucianism	Do not do to others what you would not like yourself. Then there will be no resentment against you, either in the family or in the state.	Analects 12:2
Buddhism	Hurt not others in ways that you yourself would find hurtful.	Uda–navarga 5,1
Hinduism	This is the sum of duty, do naught onto others what you would not have them do unto you.	Mahabharata 5, 1517
Islam	No one of you is a believer until he desires for his brother that which he desires for himself.	Sunnah
Judaism	What is hateful to you, do not do to your fellow man. This is the entire Law; all the rest is commentary.	Talmud, Shabbat 3id
Taoism	Regard your neighbor's gain as your gain, and your neighbor's loss as your own loss.	Tai Shang Kan Yin P'ien
Zoroastrianism	That nature alone is good which refrains from doing to another whatsoever is not good for itself.	Dadisten-I-dinik, 94, 5

of human existence. For most Greek philosophers, the end is *eudaimonia,* which is usually translated as "happiness." However, the Greeks thought that the end goal of happiness meant much more than just experiencing pleasure or satisfaction. The ultimate goal of happiness was to attain some objectively good status, the life of excellence. The Greek word for excellence is *arete,* the customary translation of which is "virtue." Thus for the Greeks, "excellences" or "virtues" were the qualities that made a life admirable or excellent. They did not restrict their thinking to characteristics we regard as moral virtues, such as courage, justice, and temperance that are learned primarily through habit and practice, but included others we think of as intellectual virtues, such as wisdom, which governs ethical behavior and understanding. The combination of these virtues are necessary to achieve moral excellence.[8]

The Language of Ethics

LO 1-2

Discuss the relationship between ethics, morals, values, and legal obligations.

The term *ethics* is derived from the Greek word *ethikos,* which itself is derived from the Greek word *ethos,* meaning "character." Morals is from the Latin word *moralis,* meaning "customs," with the Latin word *mores* being defined as "manners, morals, or ethics."

In philosophy, ethical behavior is that which is "good." The Western tradition of ethics is sometimes called "moral philosophy." The field of ethics or moral philosophy involves developing, defending, and recommending concepts of right and wrong behavior. These concepts do not change as one's desires and motivations change. They are not relative to the situation. They are immutable.

In a general sense, ethics (or moral philosophy) addresses fundamental questions such as: How should I live my life? That question leads to others, such as: What sort of person should I strive to be? What values are important? What standards or principles should I live by?[9] There are various ways to define the concept of ethics. The simplest may be to say that ethics deals with "right" and "wrong." However, it is difficult to judge what may be right or wrong in a particular situation without some frame of reference.

Gaa and Thorne define ethics as "the field of inquiry that concerns the actions of people in situations where these actions have effects on the welfare of both oneself and others."[10] We adopt that definition and emphasize that it relies on ethical reasoning to evaluate the effects of actions on others–*the stakeholders.*

Ethics deals with well-based standards of how people ought to act, does not describe the way people actually act, and is prescriptive, not descriptive. Ethical people always strive to make the right decision in all circumstances. They may not always succeed, but their intentions are good ones. They do not rationalize their actions based on their own perceived self-interests and take responsibility for those actions. The best way to understand ethics may be to differentiate it from other concepts.

Difference between Ethics and Morals

Ethics and morals relate to "right" and "wrong" conduct. While they are sometimes used interchangeably, they are different. Ethics is concerned with how we should live, generally, while morality is about a certain proper subset of how we ought to live. One way of understanding the difference is to think of it this way. Ethics leans towards decisions based upon individual character, and the more subjective understanding of right and wrong by individual, whereas morals emphasizes the widely-held communal or societal norms about right and wrong.[11]

Ethics also refers to rules provided by an external source, such as codes of conduct for a group of professionals (i.e., CPAs), or for those in a particular organization. Morals refers to an individual's own principles regarding right and wrong and may be influenced by a religion or societal mores. Ethics tends to be more practical than morals, conceived as shared principles promoting fairness in social and business interactions. For example, a CEO involved in a sex scandal may involve a moral lapse, while a CEO misappropriating money from a company she is supposed to lead according to prescribed standards of behavior is an ethical problem. These terms are close and often used interchangeably, and both influence ethical decision making. In this text we oftentimes use the terms synonymously while acknowledging differences do exist.

Values and Ethics

Values are basic and fundamental beliefs that guide or motivate attitudes or actions. We conceive of it as something that is important to an individual (personal values) and to a community (professional values). In accounting, the values of the profession are embedded in its codes of ethics that guide the actions of accountants and auditors in meeting their professional responsibilities.

In accounting, the values of the profession include independence, integrity, objectivity, professional skepticism, and due care. They define what it means to be a professional and provide a framework for the enforceable rules of professional conduct that are designed to serve the public interests above all else.

Values are concerned with how a person behaves in certain situations and is predicated on personal beliefs that may or may not be ethical, whereas ethics is concerned with how a moral person should behave to act in an ethical manner. A person who values prestige, power, and wealth is likely to act out of self-interest, whereas a person who values honesty, integrity, and trust will typically act in the best interests of others. It does not follow, however, that acting in the best interests of others always precludes acting in one's own self-interest. Indeed, the Golden Rule prescribes that we should treat others the way we want to be treated.

The Golden Rule is best seen as a consistency principle, in that we should not act one way toward others but have a desire to be treated differently in a similar situation. In other words, it would be wrong to think that separate standards of behavior exist to guide our personal lives but that a different standard (a lower one) exists in business.

Ethics and Laws

Laws are a collection of rules and regulations that come with penalties and punishments if not followed. Ethics, on the other hand, is a collection of societal or professional norms of behavior that are based on moral principles and values. Ethics is what should be done whereas laws deal with behavior that is compelled. Contrary to popular belief, we can and do legislate ethics. We have laws against stealing, kidnapping, etc., which are based on ethical standards. In accounting, we legislate ethics through a system of ethical duties established in state board of accountancy rules.

Being ethical is not the same as following the law. Although ethical people always try to be law-abiding, there may be instances where their sense of ethics tells them it is best not to follow the law. These situations are rare and should be based on sound ethical reasons.

> Assume that you are driving at a speed of 45 miles per hour (mph) on a two-lane divided roadway (double yellow line) going east. All of a sudden, you see a young boy jump into the road to retrieve a ball. The boy is close enough to your vehicle so that you know you cannot continue straight down the roadway and stop in time to avoid hitting him. You quickly look to your right and notice about 10 other children off the road. You cannot avoid hitting 1 or more of them if you swerve to the right to avoid hitting the boy in the middle of the road. You glance to the left on the opposite side of the road and notice no traffic going west or any children off the road. What should you do?
>
> **Ethical Perspective**
>
> If you cross the double yellow line that divides the roadway, you have violated the motor vehicle laws. We are told never to cross a double yellow line and travel into oncoming traffic. But the ethical action would be to do just that, given that you have determined it appears to be safe. It is better to risk getting a ticket than hit the boy in the middle of your side of the road or those children off to the side of the road.

There is a concept known as "ethical legalism," which holds that if an intended action is legal, it is, therefore ethical. However, there are situations where doing the right thing may not be the legal thing, and vice versa.

During the pre-Civil War years in the U.S., the law did not prohibit slavery and slaves were considered personal property. Yet, few would say it was an ethical practice. Similarly, lying or betraying the confidence of a friend is not illegal, but most people would consider it unethical. The contrary is true as well. The law also prohibits acts that some groups would perceive as ethically neutral behavior—behavior that is ethically permissible but not itself ethical. For instance, speeding is illegal, but many people do not have an ethical conflict with exceeding the speed limit.

Laws and Ethical Obligations

Benjamin Disraeli (1804–1881), the noted English novelist, debater, and former prime minister, said, "When men are pure, laws are useless; when men are corrupt, laws are broken." A person of goodwill honors and respects the rules and laws and is willing to go beyond them when circumstances warrant. As indicated by the previous quote, such people do not need rules and laws to guide their actions. They always try to do the right thing. On the other hand, the existence of specific laws prohibiting certain behaviors will not stop a person who is unethical (e.g., does not care about others) from violating those laws. Just think about a Ponzi scheme, such as the $65 billion one engaged in by Bernie Madoff, whereby he duped others to invest with him by promising huge returns that, unbeknownst to each individual investor, would come from additional investments of scammed investors and not true returns.

Laws create a minimum set of standards. Ethical people often go beyond what the law requires because the law cannot cover every situation a person might encounter. When the facts are unclear and the legal issues uncertain, an ethical person should decide what to do on the basis of well-established standards of ethical behavior. This is where moral philosophies come in and, for accountants and auditors, the ethical standards of the profession.

Ethical people often do less than is permitted by the law and more than is required. A useful perspective is to ask these questions:

- What does the law require of me?
- What do ethical standards of behavior demand of me?
- How should I act to conform to both?

The Moral Point of View

When the rules are unclear, an ethical person looks beyond his/her own self-interest and evaluates the interests of the stakeholders potentially affected by the action or decision. Ethical decision making requires that a decision maker be willing, at least sometimes, to take an action that may not be in his/her best interest. This is known as the "moral point of view."

Sometimes people believe that the ends justify the means. In ethics it all depends on one's motives for acting. If one's goals are good and noble, and the means we use to achieve them are also good and noble, then the ends do justify the means. However, if one views the concept as an excuse to achieve one's goals through any means necessary, no matter how immoral, illegal, or offensive to others the means may be, then that person is attempting to justify the wrongdoing by pointing to a good outcome regardless of ethical considerations such as how one's actions affect others. The process you follow to decide on a course of action is just as important, if not more important, than achieving the end goal. If this were not true from a moral point of view, then we could rationalize all kinds of actions in the name of achieving a desired goal, even if that goal does harm to others while satisfying our personal needs and desires.

Imagine that you work for a CPA firm and are asked to evaluate three software packages for a client. Your boss tells you that the managing partners are pushing for one of these packages, which just happens to be the firm's internal software. Your initial numerical analysis of the packages based on functionality, availability of upgrades, and customer service indicates that a competitor's package is better than the firm's software. Your boss tells you, in no uncertain terms, to redo the analysis. You know what she wants. Even though you feel uncomfortable with the situation, you decide to "tweak" the numbers to show a preference for the firm's package. The end result desired in this case is to choose the firm's package. The means to that end was to alter the analysis, an unethical act because it is dishonest and unfair to the other competitors (not to mention the client) to change the objectively determined results. In this instance, ethical decision making requires that we place the client's interests (to get the best software package for his needs) above those of the firm (to get the new business and not upset the boss).

Moral Relativism

Moral relativism is the view that moral or ethical statements, which vary from person to person, are all equally valid and no one's opinion of right and wrong is actually better than any others.[12] In moral relativism, there is no ultimate standard of good or evil, so every judgment about right and wrong is purely a product of a person's preferences and environment.

Moral relativism moves away from the notion there are fixed standards of behavior based on moral principles and toward a subjective approach to decision making. In this view, morals depends on one's culture, religion, place, and time in which they occur. Three examples are ethical relativism, cultural relativism, and situation ethics.

Ethical Relativism

Moral relativism and *ethical relativism* are often thought of as the same concept. *Ethical relativism* is the philosophical view that what is right or wrong and good or bad is not absolute but variable and relative, depending on the person, circumstances, or social situation. Slavery is a good example of ethical relativism, an immoral act that some might feel is ethically acceptable.

Relativists point to certain beliefs in making their case.[13]

- What's right for you may not be what's right for me.
- What's right for my culture won't necessarily be what's right for your culture.
- No moral principles are true for all people at all times and in all places.

Cultural Relativism

Ethical relativism holds that morality is relative to the norms of one's culture. That is, whether an action is right or wrong depends on the moral norms of the society in which it is practiced. The same action may be morally right in one society but be morally wrong in another. If cultural relativism is correct, then there can be no common framework for resolving moral disputes or for reaching agreement on ethical matters among members of different societies.

A basic tenet of cultural relativism is that one cannot fully understand certain actions or customs without also understanding the culture from which those actions are derived. A good example is bull fighting, a traditional spectacle of Spain, Portugal, and some Latin American countries. Proponents claim it is a cultural art form. The highly-regarded American novelist, Ernest Hemingway, said about bull fighting that it is "a decadent art in every way. . .[and] if it were permanent it could be one of the major arts."[14] The opposite view shared by many cultures is bullfighting is an indecent form of torture. Is one view right and the other wrong? It depends on your perspective.

Most ethicists reject the theory of moral relativism. Some philosophers criticize it because if it is true then one must obey the norms of one's society and to diverge from them is to act immorally. This means if I am a member of a society that believes sexist practices are morally permissible, then I must accept those practices as morally right. Such a view promotes social conformity and leaves no room for moral reform or improvement in a society.[15]

Just imagine we are back in 1920 before the Congressional ratification of the 19th Amendment to the U.S. Constitution that gave women the right to vote. If I were a firm believer in women's suffrage then, under cultural relativism, I must accept the fact that before that time it was morally appropriate that women were denied the right to vote.

Situation Ethics

Situation ethics, a term first coined in 1966 by an Episcopalian priest, Joseph Fletcher, is a body of ethical thought that takes normative principles—like the virtues, natural law, and Kant's categorical imperative that relies on the universality of actions—and generalizes them so that an agent can "make sense" out of one's experience when confronting ethical dilemmas. Unlike ethical relativism that denies universal moral principles, claiming the moral codes are strictly subjective, situational ethicists recognize the existence of normative principles but question whether they should be applied as strict directives (i.e., imperatives) or, instead, as guidelines that agents should use when determining a course of ethical conduct. In other words, situationists ask: Should these norms, as generalizations about what is desired, be regarded as intrinsically valid and universally obliging of all human beings? For situationists, the circumstances surrounding an ethical dilemma can and should influence an agent's decision-making process and may alter an agent's decision when warranted. Thus, situation ethics holds that "what in some times and in some places is ethical can be in other times and in other places unethical."[16]

A classic case of situation ethics is that of Anne Frank and her Jewish family that was hiding in a sealed off area in the home of a Christian family in Amsterdam to escape Nazi terror back in World War II. They were able to live in secrecy for two years during which time the family lied to the Nazi soldiers about the family's whereabouts. The Frank's were ultimately captured along with several others and all but Otto Frank were put to death at the concentration camps. Following the war, Otto returned to Amsterdam where he retrieved the diary Anne had kept of their ordeal. He honored her wishes by getting the diary published for all the world to read. Just imagine what might have happened if the family had told the truth in this situation.

Student Cheating

Another danger of situational ethics is it can be used to rationalize cheating. Cheating in general is at epidemic proportions in society. The *2012 Report Card on the Ethics of American Youth,* conducted by the Josephson Institute of Ethics, found that of 23,000 high school students surveyed, 51% admitted to having cheated on a test during 2012, 55% admitted to lying, and 20% admitted to stealing. Of 23,000 students surveyed, 45% of males and 28% of females agreed that a person must lie and cheat "at least occasionally" to succeed. Twenty percent of males and 10% of females also believe "it is not cheating if everyone is doing it."[17]

Who is to Blame?

Cheating in college has been prevalent for some time. The rate of students who admit to cheating at least once in their college careers has held steadily around 75% since the first major survey on cheating in higher education in 1963.[18]

Students give many reasons for cheating including:[19]

- Increasingly competitive atmosphere
- Culture that is accepting of cheating
- Everyone does it
- Institutional indifference
- Lack of understanding what cheating is
- Pursuit of self-interest.

A survey of college students reported in Campus Technology on February 23, 2017, indicates there are a variety of ways students use to cheat including:[20]

- Plagiarism from internet sources (79%)
- Copied text from somebody else's assignment (76%)
- Used mobile devices to cheat during class (72%)
- Purchased custom term papers or essays online (42%)
- Had a "service" take their online classes for them (28%).

Interestingly, only 12% of students said they'd never cheat because of ethics.

There is a relativistic element to cheating, and students clearly invoke self-interest to rationalize their actions. Arizona State University conducted a survey of 2,000 students and found the following circumstances were most likely to lead to cheating:[21]

- A scholarship was at risk (38%)
- Facing disqualification from the university or program of study (35%)
- Ran out of time on an assignment (30%)
- To maintain a grade point average (28%).

Students were less inclined to cheat just because other students are doing it (15%) or the professor ignores it (20%).

The results of the study indicate that Arizona State faculty were not entirely blameless for the existence of cheating. The institution was concerned that 16% of instructors didn't discuss academic integrity even once in class. Another concern is the difficulty of reporting violations and determining penalties and many faculty's reluctance to formally document a breach because of the time investment it requires. These issues are being addressed by the university.

A disturbing trend is the availability of electronic access to a variety of online resources including the solutions manual and test bank questions. Instructors have historically relied on these resources to assess student learning. All that may be assessed now is whether an otherwise unproductive student has suddenly become productive as a result of acquiring instructor's resource materials or accessing previous exams. Here, students are to blame for irresponsible behavior and basically cheat themselves out of learning materials needed in the workplace and for the CPA Exam. Faculty are not blameless since many do not change exams from term to term and turn a blind eye to what they know goes on in virtually every college and university today.

There have been a number of well-publicized cheating scandals at colleges and universities these past few years including in 2012 at Harvard University where dozens of students were forced to withdraw from the university after a cheating scandal in a class that gave a take-home exam. Students collaborated with other students by sharing notes or sitting in on sessions with the same teaching assistants. The university called them out for violating its academic policy against discussing the exam with others. The students blamed the professor for a lack of clear directions while others lauded students for their collaboration.

Student Cheating at the University of North Carolina

If you're a college sports fan, by now you have probably heard about the paper-class scandal that we call "Tar Heel Gate" in which 3,100 student-athletes at the University of North Carolina in Chapel Hill (UNC) were essentially allowed to take classes without attending classes and given grades good enough to keep them eligible to play men's football and basketball during a 20-year period.

For five years, UNC had insisted the paper classes were the doing of one rogue professor: the department chair of the African-American studies program, Julius Nyang'oro. However, an independent report found that five counselors actively used paper classes, calling them "GPA boosters," and that at least two counselors suggested to a professor the grade an athlete needed to receive to be able to continue to play.

Many of the academic-athletic staff who were named and implicated were also named by university learning specialist Mary Willingham. Willingham said that she had worked with dozens of athletes who came to UNC and were unable to read at an acceptable level, with some of them reading on par with elementary schoolchildren. She also said there were many members of the athletic staff who knew about the paper classes, and her revelations contradicted what UNC had claimed for years—that Nyang'oro acted alone in providing the paper classes.

Willingham went public with detailed allegations about paper classes and, after an assault on her credibility by the university, filed a whistleblower lawsuit. In March 2015, UNC announced it would pay Willingham $335,000 to settle her suit.

In an unusual twist to the story, the director of UNC's Parr Center for Ethics, Jeanette M. Boxill, was accused of steering athletes into fake classes to help them maintain their eligibility with the NCAA. Moreover, she covered up her actions after the fact. Boxill violated the most basic standards of academic integrity.

The motivating factor at UNC was to keep student athletes eligible so that the sports programs would continue to excel and promote and publicize the school, not to mention earn millions of dollars in advertising. The investigation was completed in October 2017 and while the NCAA did not dispute that UNC was guilty of running one of the worst academic fraud schemes in college sports history, it did not impose any penalties because "no rules were broken." How could that be? Well, the panel that investigated the case determined that it could not punish the university or its athletic program because the paper classes were not available exclusively to athletes. Other students at UNC had access to the fraudulent classes, too.[22]

The NCAA's decision defies logic and sets the bar low for ethics in college sports. We believe the ruling was influenced by the fact that UNC is one of only four Division I Men's Basketball programs to have ever achieved 2,000 victories and UNC has won seven men's college basketball national championships including in 2017.

An ethical analysis of the paper class scandal shows that UNC suffered from ethical blindness. It failed to see the ethical violations of its actions in establishing a route for student-athletes to remain academically eligible. It acted in its own self-interest regardless of the impact of its behavior on the affected parties. The blind spots occurred because of a situational ethic whereby those who perpetrated the fraud and covered it up came to believe their actions were for the greater good of those involved in the athletic program and the UNC community. Honesty was ignored, integrity was not in the picture, and the athletes were not provided with the education they deserved.

Social Media Ethics

The Ethics Resource Center conducted a survey of social networkers in 2012 to determine the extent to which employees use social networking on the job. The survey points out that social networking is now the norm and that a growing number of employees spend some of their workday connected to a social network. More than 10% are "active social networkers," defined as those who spend at least 30% of their workday linked up to one or more networks.[23]

One concern is whether active social networkers engage in unethical practices through communications and postings on social media sites. Survey respondents say they think about risks before posting online and consider how their employers would react to what they post. But, they do admit to discussing company information online: 60% would comment on their personal sites about their company if it was in the news; 53% share information about work projects once a week or more; greater than one-third say they often comment, on their personal sites, about managers, coworkers, and even clients. The survey concludes that nothing is secret anymore and, unlike in Las Vegas, management must assume that what happens at work does not stay at work and may become publicly known.

An interesting result of the survey is active social networkers are unusually vulnerable to risks because they witness more misconduct and experience more retaliation as a result when they report it than their work colleagues. A majority (56%) of active social networkers who reported misdeeds experienced retaliation compared to fewer than one in five (18%) of other employee groups.

A 2013/14 survey by Proskauer, *Social Media in the Workplace Around the World 3.0,* found that as many as 36% of employers block social media at work—up from 29% in 2012. One in five companies block Facebook, while 15% shut out Twitter and nearly 14% have banned You Tube. Meanwhile, employers who allow free access to all social media sites have dwindled from 53 to 43%.[24]

The survey results indicate that employee misuse of social networking sites can have a potentially costly impact on business with the following concerns raised:

- Misuse of confidential information (80%)
- Misrepresenting the views of the business (71%)
- Inappropriate non-business use (67%)
- Disparaging remarks about the business or employees (64%)
- Harassment (64%)

Our conclusion about using social networking sites at work is that the burden falls both on the employees, who should know better than to discuss company business online where anyone can see it, and employers, who have the responsibility to establish a culture that discourages venting one's feelings about the employer online for all to see. Organizational codes of ethics need to be expanded to create policies for the use of social networking sites, training to reinforce those policies, and consequences for those who violate the policies.

The Six Pillars of Character

LO 1-3

Describe how the pillars of character support ethical decision making.

It has been said that ethics is all about how we act when no one is looking. In other words, ethical people do not do the right thing because someone observing their actions might judge them otherwise, or because they may be punished as a result of their actions. Instead, ethical people act as they do because their "inner voice" or conscience tells them that it is the right thing to do.

Assume that you are leaving a shopping mall, get into your car to drive away, and hit a parked car in the lot on the way out. Let's also assume that no one saw you hit the car. What are your options? You could simply drive away and forget about it, or you can leave a note for the owner of the parked car with your contact information. What would you do and why? Now just imagine your car was hit. Further, it's a brand new car. What would you want the motorist to do and why? The point is The Golden Rule asks us to think about ethics as if we are the recipient of possible unethical behavior.

Virtues or Character Traits

According to "virtue ethics," there are certain ideals, such as excellence or dedication to the common good, toward which we should strive and which allow the full development of our humanity. These ideals are discovered through thoughtful reflection on what we as human beings have the potential to become.

Virtues are attitudes, dispositions, or character traits that enable us to be and to act in ways that develop this potential. They enable us to pursue the ideals we have adopted. Honesty, courage, compassion, generosity, fidelity, integrity, fairness, self-control, and prudence are all examples of virtues in Aristotelian ethics. A quote attributed to Aristotle is, "We are what we repeatedly do. Therefore, excellence is not an act. It is a habit."[25]

The Josephson Institute of Ethics identifies Six Pillars of Character that provide a foundation to guide ethical decision making. These ethical values include trustworthiness, respect, responsibility, fairness, caring, and citizenship. Josephson believes that the Six Pillars act as a multilevel filter through which to process decisions. So, being trustworthy is not enough—we must also be caring. Adhering to the letter of the law is not enough; we must accept responsibility for our actions or inactions.[26]

Trustworthiness

The dimensions of trustworthiness include being honest, acting with integrity, being reliable, and exercising loyalty in dealing with others.

Honesty

Honesty is the most basic ethical value. It means that we should express the truth as we know it and without deception. In accounting, the full disclosure principle supports honesty through transparency and requires that the accounting professional disclose all the information that owners, investors, creditors, and the government need to know to make informed decisions. To withhold relevant information is dishonest.

Let's assume a company is involved in pending litigation where the possibility exists that the litigation will have a material effect on its financial results. Honesty dictates that the lawsuit should be disclosed. Generally accepted accounting principles (GAAP) requires disclosure. If a loss in the case is probable, has a material effect on the financial results, and the company can estimate the amount of the financial loss, then the company should set up a "reserve" for possible losses due to the pending lawsuit typically by setting up a contingent liability on the balance sheet.

Integrity

The integrity of a person is an essential element in trusting that person. MacIntyre, in his account of Aristotelian virtue, states, "There is at least one virtue recognized by tradition which cannot be specified except with reference to the wholeness of a human life—the virtue of integrity or constancy."[27] A person of integrity takes time for self-reflection, so that the events, crises, and challenges of everyday living do not determine the course of that person's moral life. Such a person is trusted by others because that person is true to her word.

Ultimately, integrity means to act on principle rather than expediency. If my superior tells me to do something wrong, I will not do it because it violates the ethical value of honesty. If my superior pressures me to compromise my values just this one time, I will not agree because one time can lead to another and a slide down the proverbial *ethical slippery slope.*

Returning to the lawsuit, let's assume the loss is probable and reasonably estimable and my boss tells me just to disclose it. I know GAAP requires recording in this case so, as a person of integrity, I insist on making the adjustment. I do not want to subordinate my judgment to that of my superior, a violation of integrity.

Reliability

The promises that we make to others are relied on by them, and we have a moral duty to follow through with action. Our ethical obligation for promise keeping includes avoiding bad-faith excuses and unwise commitments. Imagine that you are asked to attend a group meeting on Saturday and you agree to do so. That night, though, your best friend calls and says she has two tickets to the basketball game between the Dallas Mavericks and San Antonio Spurs. The Spurs are one of the best teams in basketball and you don't get this kind of opportunity very often, so you decide to go to the game instead of the meeting. You've broken your promise and acted out of self-interest without regard for the consequences of your actions: Might the group end up with a lower grade because of your decision? Let's assume you call the group leader and say that you can't attend the meeting because you are sick. Now, you've lied as well and have begun the slide down the ethical slippery slope where it will be difficult to climb back to the top.

Loyalty

Loyalty requires that friends not violate the confidence we place in them. In accounting, loyalty requires that we keep financial and other information confidential when it deals with our employer and client. For example, if you are the in-charge accountant on an audit of a client for your CPA firm-employer and you discover that the client is "cooking the books," you shouldn't telephone the local newspaper and tell the story to a reporter. Instead, you should go to your supervisor and discuss the matter and, if necessary, go to the partner in charge of the engagement and tell her. Your ethical obligation is to report what you have observed to your supervisor and let her take the appropriate action. However, the ethics of the accounting profession allow for instances whereby informing those above your supervisor is expected, an act of internal whistleblowing, and, in rare circumstances, going outside the organization to report the wrongdoing. Whistleblowing obligations will be discussed in Chapter 3.

There are limits to the confidentiality obligation. For example, let's assume that you are the accounting manager at a publicly owned company and your supervisor (the controller) pressures you to keep silent about the manipulation of financial information. You then go to the CFO, who tells you that both the CEO and board of directors support the controller. Out of a misplaced duty of loyalty in this situation, you might rationalize your silence as did Betty Vinson. Ethical values sometimes conflict, and loyalty is the one value that should never take precedence over other values such as honesty and integrity. Otherwise, we can imagine all kinds of cover-ups of information in the interest of loyalty or friendship.

Being loyal to one's supervisor even though doubts exist about proper accounting can lead down the ethical slippery slope. If I agree to footnote the lawsuit rather than record the adjustment, then I may feel obligated to do the same next time a similar situation arises. I was complicit the first time and don't want that getting out.

Respect

All people should be treated with dignity. We do not have an ethical duty to hold all people in high esteem, but we should treat everyone with respect, regardless of their circumstances in life. In today's slang, we might say that respect means giving a person "props." The Golden Rule encompasses respect for others through notions such as civility, courtesy, decency, dignity, autonomy, tolerance, and acceptance.[28]

By age 16, George Washington had copied by hand 110 *Rules of Civility & Decent Behavior in Company and Conversation.* They are based on a set of rules composed by French Jesuits in 1595. While many of the rules seem out of place in today's society, Washington's first rule is noteworthy: "Every Action done in Company, ought to be with Some Sign of Respect, to those that are Present."[29]

Why is respect so important to the way we treat individuals? Just think of the words to a 1967 song by the iconic Aretha Franklin: R-E-S-P-E-C-T. Find out what it means to me.

Washington's vernacular was consistent with the times as indicated by the last of his rules: "Labour to keep alive in your Breast that Little Spark of Celestial fire Called Conscience."[30] We have found many definitions of conscience, but the one we like best is posted on Moral Sense. The definition is: "Motivation deriving logically from ethical or moral principles that govern a person's thoughts and actions."[31]

Responsibility

Josephson points out that our capacity to reason and our freedom to choose make us morally responsible for our actions and decisions. We are accountable for what we do and who we are.[32]

The judgments we make in life reflect whether we have acted responsibly. Eleanor Roosevelt, the former first lady, puts it well: "One's philosophy is not best expressed in words; it is expressed in the choices one makes . . . and the choices we make are ultimately our responsibility."[33]

A responsible person carefully reflects on the choices before making a final decision. Imagine if you were given the task by your group to interview five CPAs in public practice about their most difficult ethical dilemma, and you decided to ask one person, who was a friend of the family, about five dilemmas that person faced in the practice of public accounting. Now, even if you made an "honest" mistake in interpreting the requirement, it is clear that you did not exercise the level of care that should be expected in this instance in carrying out the instructions to interview five different CPAs. Responsibility for accounting professionals means:

- To meet one's ethical and professional obligations when performing services for an employer or client but never forgetting that it is the public interest that trumps all other interests.
- To act with due care by gathering and evaluating relevant evidence in an audit and maintaining professional skepticism.
- To accept responsibility of one's actions and be accountable for them.

Fairness

Fairness is a subjective concept but typically involves issues of equality, impartiality, and due process. As Josephson points out, "Fairness implies adherence to a balanced standard of justice without relevance to one's own feelings or inclinations."[34] The problem sometimes is what seems fair to one person or group seems unfair to another.

Let's assume your instructor divides the class into groups for purposes of case studies. Further, your instructor told the case study groups at the beginning of the course that the group with the highest overall numerical average would receive an A, the group with second highest a B, and so on. At the end of the term, the instructor gave the group with the second-highest average—90.5—an A and the group with the highest average—91.2—a B. Perhaps the instructor took subjective factors into account in deciding on the final grading. If your group had the highest average, the members no doubt would find the instructor's decision unfair. However, if the group with the second highest average went well beyond the requirements of the course, that group might find the instructor's decision quite fair.

Fairness in accounting can be equated with objectivity. Objectivity means the financial and accounting information needs to be presented free from bias, that is, consistent with the evidence and not based solely on one's opinion about the proper accounting treatment. Objectivity helps to ensure that financial statements are reliable and verifiable. The purpose of objectivity is to make financial statements more useful to investors and end users.

Caring

The late Edmund L. Pincoffs, a philosopher who formerly taught at the University of Texas at Austin, believed that virtues such as caring, kindness, sensitivity, altruism, and benevolence enable a person who possesses these qualities to consider the interests of others.[35] Such people gain empathy for others. They are able to "walk a mile in someone else's shoes," meaning that before judging another person, you must first understand that person's experiences and thought processes. Josephson believes that caring is the "heart of ethics and ethical decision making."[36]

Let's assume that on the morning of an important group meeting, your child comes down with a temperature of 103 degrees. You call the group leader and say that you can't make it to the meeting. Instead, you suggest that the meeting be taped and you will listen to the discussions later that day and telephone the leader with any questions. The leader reacts angrily, stating that you are not living up to your responsibilities. Assuming that your behavior is not part of a pattern and you have been honest with the leader up to now, you would have a right to be upset with the leader, who seems uncaring. In the real world, emergencies do occur, and placing your child's health and welfare above all else should make sense in this situation to a person of rational thought. You also acted diligently by offering to listen to the discussions and, if necessary, follow up with the leader.

Citizenship

Josephson points out that "citizenship includes civic virtues and duties that prescribe how we ought to behave as part of a community."[37] An important part of good citizenship is to obey the laws, be informed about the issues, volunteer in your community, and vote in elections.

Accounting professionals are part of a community with specific ideals and ethical standards that govern behavior. These include responsibilities to one another to advance the profession and not bring discredit on oneself or others.

Reputation

It might be said that judgments made about one's character contribute toward how another party views that person's reputation. In other words, what is the estimation in which a person is commonly held, whether favorable or not?

Often when we cover up information in the present, it becomes public knowledge later. The consequences at that time are more serious because trust has been destroyed. A good example is Lance Armstrong, who for years denied taking performance-enhancing drugs while winning seven Tour de France titles. In 2012, he finally admitted to doing just that, and as a result, all those titles were stripped away by the U.S. Anti-Doping Agency. Armstrong's reputation took a hit and the admiration many in the public had for him fell by the wayside.

The reputation of a CPA is critical to a client's trusting that CPA to perform services competently and maintain the confidentiality of client information. One builds "reputational capital" through favorable actions informed by ethical behavior.

Accountants and auditors work years to build a reputation for trust so that clients come to value their services and the public believes in them. Accounting professionals know it takes a person a long time to build a reputation for trust but not very long to destroy it. Just think about the Lance Armstrong situation.

Modern Moral Philosophies

LO 1-4

Differentiate between moral philosophies and their effect on ethical reasoning in accounting.

The ancient Greeks believed that reason and thought precede the choice of action and that we deliberate about things we can influence with our decisions. The ability to reason through ethical conflicts and act on moral intent is a necessary but sometimes insufficient skill to make ethical decisions. This is because, while we believe that we should behave in accordance with certain moral principles, peer pressure, pressure from one's superior(s), and a culture that favors the client's interest above the public interest together create a barrier to acting in accordance with those principles. For example, accountants know inventory obsolescence should be recorded at year-end. But what if the client insists on holding off on the write-down due to concerns about a low level of earnings? Will we stand by our moral principles? Will we satisfy our obligation to honor the public trust? Or will we go along to get along and be a "team player"?

The noted philosopher James Rest points out that moral philosophies present guidelines for "determining how conflicts in human interests are to be settled for optimizing mutual benefit of people living together in groups." However, there is no single moral philosophy everyone accepts.[38]

Moral philosophies provide specific principles and rules that we can use to decide what is right or wrong in specific instances. There are many such philosophies and they are quite complex. We limit the discussion to what is necessary for students to learn in order to apply these methods to a variety of conflict situations that occur in accounting. Later in this chapter we will address the ethical standards embedded in the profession's ethics codes. It is the combination of the two that establish the ethical expectations of the public for the accounting profession. We do not favor any one of these philosophies because there is no one correct way to resolve ethical issues in accounting. Exhibit 1.2 presents the underlying framework for ethical decision-making for each of the moral philosophies.

EXHIBIT 1.2 Understanding Ethics as a Framework for Guiding Behavior

Philosophical Method	**Proponents → Basis for Moral Behavior → Achieving Moral Excellence → End Goal/ Humanity**			
Classic Greek Virtue Ethics	Aristotle, Plato, Socrates	**Virtues** Develop ethical character traits	Develop moral and intellectual virtues	Human excellence/ a life of virtue
Modern Philosophies Deontology (Rights Theory)	Kant	**Moral Principle** Categorical Imperative/ Universality	Satisfying duties to oneself and others	Treat humanity as an end in itself not a means to an end
Teleology (Act Utilitarianism)	Bentham, Mill	**Moral Action** Greatest good for the greatest number	Make decisions that produce the best consequences for oneself and others	Maximize well-being for all concerned
(Rule Utilitarianism)		Actions that conform to general rules		
Egoism (Rational Egoism)	Rand	**Moral Principle** The virtue of rationality	Make decisions that promote one's own interests in accordance with reason	Rational Selfishness
(Enlightened Egoism)	Alexis de Tocqueville	**Moral Concept** Self-interest rightly understood	Pursue self-interest to maximize general prosperity	Allow for the well-being of others in pursuing one's own interest
Justice	Rawls	**Moral Principles** Liberty Principle Difference Principle	Fair treatment: Treat equals, equally; unequals, unequally	Give each person what they deserve

Teleology

In *teleology,* an act is considered morally right or acceptable if it produces some desired result such as pleasure, the realization of self-interest, fame, utility, wealth, and so on. Teleologists assess the moral worth of behavior by looking at its consequences, and thus moral philosophers often refer to these theories as *consequentialism.* Consequentialism is a theory about outcomes, not motives or intentions. Two important teleological philosophies are egoism and utilitarianism.

Egoism

Egoism defines right or acceptable behavior in terms of its consequences for the individual. *Egoists* believe that they should make decisions that maximize their own self-interest, which is defined differently by each individual. In other words, the individual should "[d]o the act that promotes the greatest good for oneself."[39] Many believe that egoistic people and companies are inherently unethical because they ignore the moral point of view: they are short-term-oriented and will take advantage of others to achieve their goals. We discuss three forms of egoism below: ethical egoism, enlightened egoism, and rational egoism.

Ethical Egoism

As a brand of egoism, *ethical egoism* claims that the promotion of one's own good is in accordance with morality. In the strong version, it is held that it is always moral to promote one's own good, and it is never moral not to promote it. In the weak version, even though it is always moral to promote one's own good, it is not necessarily never moral to not. Thus, there are conditions in which the avoidance of personal interest may be a moral action.[40]

The ethical egoist ranks as most important duties that bring the highest payoff to oneself. Standard moral theories determine importance, at least in part, by considering the payoff to those helped. The conclusion is what brings the highest payoff to me will not, necessarily, bring the highest payoff to those helped.[41]

Ethical egoism as a moral theory creates conflicts of interest that are difficult to resolve. It is argued that pursuing my own interest can conflict with another's interest—my actions may bring about a cost to others. Specifically, a critic may contend that personal gain logically cannot be in one's best interest if it entails doing harm to another: doing harm to another would be to accept the principle that doing harm to another is ethical—i.e., one would equate doing harm with one's own best interest. The ethical egoist could logically pursue their interests at the cost of others.[42]

Egoism/ethical egoism is not an acceptable standard for decision making in accounting. How could we justify ignoring the public interest because it is in our own best interest not to go against the client's wishes?

Enlightened Egoism

Enlightened self-interest was discussed by Alexis de Tocqueville in his work *Democracy in America.* The notion he held was that Americans voluntarily join together in associations to further the interests of the group and, thereby, to serve their own interests.[43] This certainly accurately characterizes the role and purpose of the accounting profession.

Alexis de Tocqueville used "self-interest rightly understood" to describe this concept. He combined the right of association with the virtue to do what was right. The following passage from his book sums up the concept of enlightened self-interest:

> The Americans, on the contrary, are fond of explaining almost all of their lives by the principle of interest rightly understood; they show with complacency how an enlightened regard for themselves constantly prompts them to assist each other, and inclines them willingly to sacrifice a portion of their time and property to the welfare of the state.

Enlightened self-interest poses the question of whether or not it is to the advantage of a person to work for the good of all.

Enlightened egoism is one form of egoism that emphasizes more of a direct action to bring about the best interests of society. Enlightened egoists take a long-range perspective and allow for the well-being of others because they help achieve some ultimate goal for the decision maker, although their own self-interest remains paramount. For example, enlightened egoists may abide by professional codes of ethics, avoid cheating on taxes, and create safe working conditions. They do so not because their actions benefit others, but because they help achieve some ultimate goal for the egoist, such as advancement within the firm.[44] In other words, enlightened egoism is advocated as a means rather than an end, based on the belief that for everyone to pursue their own interests will maximize general prosperity.

An enlightened egoist might call management's attention to a coworker who is falsifying the financial reports, but only to protect the company's reputation and thus the egoist's own job security. In addition, an enlightened egoist could become a whistle-blower and report misconduct to the Securities and Exchange Commission (SEC) to receive an award for exposing misconduct.

Let's examine the following example from the perspectives of egoism and enlightened egoism. The date is Friday, January 17, 2019, and the time is 5:00 p.m. It is the last day of fieldwork on an audit, and you are the staff auditor in charge of receivables. You are wrapping up the test of subsequent collections of accounts receivable to determine whether certain receivables that were outstanding on December 31, 2018, and that were not confirmed by the customer as being outstanding, have now been collected. If these receivables have been collected and in amounts equal to the year-end outstanding balances, then you will be confident that the December 31 balance is correct and this aspect of the receivables audit can be relied on. One account receivable for $1 million has not been collected, even though it is 90 days past due. You go to your supervisor and discuss whether to establish an allowance for uncollectibles for part of or the entire amount. Your supervisor contacts the manager in charge of the audit who goes to the CFO to discuss the matter. The CFO says in no uncertain terms that you should not record an allowance of any amount. The CFO does not want to reduce earnings below the current level because that will cause the company to fail to meet financial analysts' estimates of earnings for the year. Your supervisor informs you that the firm will go along with the client on this matter, even though the $1 million amount is material. In fact, it is 10% of the overall accounts receivable balance on December 31, 2018.

The junior auditor faces a challenge to integrity in this instance. The client is attempting to circumvent GAAP. The ethical obligation of the staff auditor is not to subordinate judgment to others' judgment, including that of top management of the firm. Easier said than done, no doubt, but it is the standard of behavior in this situation.

If you are an egoist, you might conclude that it is in your best interests to go along with the firm's position, to support the client's presumed interests. After all, you do not want to lose your job. An enlightened egoist would consider the interests of others, including the investors and creditors, but still might reason that it is in her long-run interests to go along with the firm's position to support the client because she may not advance within the firm unless she is perceived to be a team player. Moreover, you don't want the firm to lose a client if it does not go along with the client's wishes. While the interests of others are seen as a means to an end—maximize one's own self-interests—enlightened egoism has value in accounting decision making because the public interest can (and should) be considered in evaluating the competing interests in the course of maximizing one's own interests.

Rational Egoism

Rational egoism is a particular brand of ethical egoism that claims the promotion of one's own interest is always in accordance with reason. Rational egoism, also called rational selfishness, is the principle that an action is rational if and only if it maximizes one's self-interest. One of the most well-known proponents of rational egoism is the contemporary philosopher Ayn Rand (1905–1982).

Rand's philosophy is an ethics of choice, guided by reason, with human survival as its goal. This is diametrically opposed to altruism. Altruism, according to Rand, is a morality of the past. It is irrational to expect people to be motivated to act in whole or in part for the sake of another's interest(s). According to Rand, humans must choose their own values, goals, and actions in order to maintain their lives. Without the ability to choose, there could be no morality because morality deals only with issues open to man's choice (i.e., to his free will).

In Rand's *The Virtue of Selfishness: A New Concept of Egoism,* rationality is conceived of as man's basic virtue, the source of all other virtues. The virtue of rationality means the recognition and acceptance of reason as one's only source of knowledge, one's only judge of values, and one's only guide to action. It means a commitment to the reality of one's existence, i.e., to the principles that all of one's goals, values, and actions take place in reality and, therefore, that one must never place any value or consideration whatsoever above one's "perception of reality."[45]

It is popular today to link Rand's philosophy with the basic tenets of capitalism. She describes the capitalist system as the essence of individualism with a laissez-faire attitude in which the function of government is solely to protect individual rights, including property rights. The idea is for the government to have a hands-off approach and let each individual act in their rational self-interest and somehow this will lead to the ultimate best interests of society. Thus, Rand had a vision of capitalism as a moral ideal. Of course, this is a controversial issue today as many critics talk about the evils of capitalism and the unequal distribution of resources and wealth born out of a pursuit of self-interest mentality of corporations and well-heeled individuals.

Writing a column for the Public Broadcasting System, Denise Cummins examines why Rand's popularity among young adults continues to grow. They seem to be drawn to Rand's philosophy of unfettered self-interest. When questioned about their beliefs, some have said it taught them to rely on no one but themselves. Others believe it to be an idealized version of core American ideals: freedom from tyranny, hard work, and individualism. On this view, "It promises a better world if people are simply allowed to pursue their own self-interest without regard to the impact of their actions on others. After all, others are simply pursuing their own self-interest as well."[46]

The problem we see with Rand in the accounting arena is it is a profession where one's individual values need to conform to the profession's ethical standards and, if they do not, the individual runs the risk of acting in her own best interests but not the public interest. Moreover, individual's may have a different perception of reality and those perceptions may change with each new situation. Actions become more relativistic and this makes it difficult to have a consistent set of ethical standards such as exists in the AICPA Code of Professional Conduct (AICPA Code). The reality for accounting students to consider in evaluating Rand's philosophy is the ethical standards of the accounting profession are not up for debate.

Utilitarianism

Like egoism, *Utilitarianism* is concerned with consequences, but unlike the egoist, the utilitarian seeks to make decisions which bring about the greatest good for the greatest number of people. Utilitarians believe they should make decisions that result in the greatest total *utility* or the greatest benefit for all those affected by a decision.[47]

Utilitarians follow a relatively straightforward method for deciding the morally correct course of action for any particular situation. First, they identify the various courses of action that they could perform. Second, they determine the utility of the consequences of all possible alternatives and then select the one that results in the greatest net benefit. In other words, they identify all the foreseeable benefits and harms (consequences) that could result from each course of action for those affected by the action, and then choose the course of action that provides the greatest benefits after the costs have been taken into account.[48] Given its emphasis on evaluating the benefits and harms of alternatives on stakeholders, utilitarianism requires that people look beyond self-interest to consider impartially the interest of all persons affected by their actions.

The utilitarian theory was first formulated in the eighteenth century by the English writer Jeremy Bentham (1748–1832) and later refined by John Stuart Mill (1806–1873). Bentham sought an objective basis that would provide a publicly acceptable norm for determining what kinds of laws England should enact. He believed that the most promising way to reach an agreement was to choose the policy that would bring about the greatest net benefits to society once the harms had been taken into account. His motto became "the greatest good for the greatest number." Over the years, the principle of utilitarianism has been expanded and refined so that today there are many different variations of the principle. Modern utilitarians often describe benefits and harms in terms of satisfaction of personal preferences or in purely economic terms of monetary benefits over monetary costs.[49]

Utilitarians differ in their views about the kind of question we ought to ask ourselves when making an ethical decision. Some believe the proper question is: What effect will my doing this action in this situation have on the general balance of good over evil? If lying would produce the best consequences in a particular situation, we ought to lie.[50] These *act-utilitarians* examine the specific action itself, rather than the general rules governing the action, to assess whether it will result in the greatest utility. For example, a rule in accounting such as "don't subordinate judgment to the client" would serve only as a general guide for an act-utilitarian. If the overall effect of giving in to the client's demands brings net utility to all the stakeholders, then the rule is set aside.

Rule-utilitarians, on the other hand, claim that we must choose the action that conforms to the general rule that would have the best consequences. For the rule-utilitarian, actions are justified by appealing to rules such as "never compromise audit independence." According to the rule-utilitarian, an action is selected because it is required by the correct moral rules that everyone should follow. The correct moral rules are those that maximize intrinsic value and minimize intrinsic disvalue. For example, a general rule such as "don't deceive" (an element of truthfulness) might be interpreted as requiring the full disclosure of the possibility that the client will not collect on a material, $1 million receivable. A rule-utilitarian might reason that the long-term effects of deceiving the users of financial statements are a breakdown of the trust that exists between the users and preparers and auditors of financial information.

In other words, we must ask ourselves: What effect would everyone's doing this kind of action (subordination of judgment) have on the general balance of good over evil? So, for example, the rule "to always tell the truth" in general promotes the good of everyone and therefore should always be followed, even if lying would produce the best consequences in certain situations. Notwithstanding differences between act- and rule-utilitarians, most hold to the general principle that morality must depend on balancing the beneficial and harmful consequences of conduct.[51]

While utilitarianism is a very popular ethical theory, there are some difficulties in relying on it as a sole method for moral decision making because the utilitarian calculation requires that we assign values to the benefits and harms resulting from our actions. But it is often difficult, if not impossible, to measure and compare the values of certain benefits and costs. Let's go back to our receivables example. It would be difficult to quantify the possible effects of going along with the client. How can a utilitarian measure the costs to the company of possibly having to write off a potential bad debt after the fact, including possible higher interest rates to borrow money in the future because of a decline in liquidity? What is the cost to one's reputation for failing to disclose an event at a point in time that might have affected the analysis of financial results? On the other hand, how can we measure the benefits to the company of *not* recording the allowance? Does it mean the stock price will rise and, if so, by how much?

Deontology

The term *deontology* is derived from the Greek word *deon,* meaning "duty." *Deontology* refers to moral philosophies that focus on the rights of individuals and on the intentions associated with a particular behavior, rather than on its consequences.

Deontologists believe that moral norms establish the basis for action. Deontology differs from rule-utilitarianism in that the moral norms (or rules) are based on reason, not outcomes. Fundamental to deontological theory is the idea that equal respect must be given to all persons.[52] In other words, individuals have certain inherent rights and I, as the decision maker, have a duty (obligation, commitment, or responsibility) to respect those rights.

Philosophers claim that rights and duties are correlative. That is, my rights establish your duties and my duties correspond to the rights of others. The deontological tradition focuses on duties, which can be thought of as establishing the ethical limits of my behavior. From my perspective, duties are what I owe to others. Other people have certain claims on my behavior; in other words, they have certain rights against me.[53]

As with utilitarians, deontologists may be divided into those who focus on moral rules and those who focus on the nature of the acts themselves. In *act deontology,* principles are or should be applied by individuals to each unique circumstance allowing for some space in deciding the right thing to do. *Rule deontologists* believe that general moral principles determine the relationship between the basic rights of the individual and a set of rules governing conduct. It is particularly appropriate to the accounting profession, where the Principles of the AICPA Code support the rights of investors and creditors to receive accurate and reliable financial information and the duty of CPAs to meet their obligations to these users, so we emphasize rule deontology in this book.

Unlike utilitarians, deontologists argue there are things we should not do, even to maximize utility. We should not deceive investors and creditors by going along with improper accounting even if it enables a client to gain needed financing, expand operations, add jobs to the payroll, and, ultimately, earn greater profit for the company. To do so would violate the rights of investors and creditors to full and fair financial information to assist in their decision-making needs (i.e. buy/sell stock, loan money/don't loan).

Rule deontologists believe that conformity to general moral principles based on logic determines ethicalness. Examples include Kant's categorical imperative, discussed next, and the Golden Rule.

Rights Principles

A *right* is a justified claim on others. For example, if I have a right to freedom, then I have a justified claim to be left alone by others. Turned around, I can say that others have a duty or responsibility to leave me alone.[54] In accounting, because investors and creditors have a right to accurate and complete financial information, I have the duty to ensure that the financial statements "present fairly" the financial position, results of operations, and changes in cash flows.

Formulations of *rights theories* first appeared in the seventeenth century in writings of Thomas Hobbes and John Locke. One of the most important and influential interpretations of moral rights is based on the work of Immanuel Kant (1724–1804), an eighteenth-century philosopher. Kant maintained that each of us has a worth or dignity that must be respected. This dignity makes it wrong for others to abuse us or to use us against our will. Kant expressed this idea as a moral principle: Humanity must always be treated as an end, not merely as a means. To treat a person as a mere means is to use her to advance one's own interest. But to treat a person as an end is to respect that person's dignity by allowing each the freedom to choose for himself.[55]

An important contribution of Kantian philosophy is the so-called categorical imperative: "Act only according to that maxim by which you can at the same time will that it should become universal law."[56] The "maxim" of our acts can be thought of as the intention behind our acts. The maxim answers the question: What am I doing, and why? In other words, moral intention is a driver of ethical action. The categorical imperative is a useful perspective: How would I want others to decide the issue in similar situations for similar reasons? If I can confidently answer that question, then my decision would meet the universality standard.

Kant believed that truth telling could be made a universal law, but lying could not. If we all lied whenever it suited us, rational communication would be impossible. Thus, lying is unethical. Imagine if every company falsified its financial statements. It would be impossible to evaluate the financial results of one company accurately over time and in comparison to other companies. The financial markets might ultimately collapse because reported results were meaningless, or even misleading. This condition of universality, not unlike the Golden Rule, prohibits us from giving our own personal point of view special status over the point of view of others. It is a strong requirement of impartiality and equality for ethics.[57]

One problem with deontological theory is that it relies on moral absolutes—absolute principles and absolute conclusions. Kant believed that a moral rule must function without exception. The notions of rights and duties are completely separate from the consequences of one's actions. This could lead to making decisions that might adhere to one's moral rights and another's attendant duties to those rights, but which also produce disastrous consequences for other people. For example, imagine if you were the person hiding Anne Frank and her family in the attic of your home and the Nazis came banging at the door and demanded, "Do you know where the Franks are?" Now, a strict application of rights theory requires that you tell the truth to the Nazi soldiers. However, isn't this situation one in which an exception to the rule should come into play for humanitarian reasons?

Whenever we are confronted with a moral dilemma, we need to consider whether the action would respect the basic rights of each of the individuals involved. How would the action affect the well-being of those individuals? Would it involve manipulation or deception—either of which would undermine the right to truth that is a crucial personal right? Actions are wrong to the extent that they violate the rights of individuals.[58]

Sometimes the rights of individuals will come into conflict, and one has to decide which right has priority. There is no clear way to resolve conflicts between rights and the corresponding moral duties to respect those rights. One of the most widely discussed cases of this kind is taken from William Styron's novel *Sophie's Choice.* Sophie and her two children are at a Nazi concentration camp. A guard confronts Sophie and tells her that one of her children will be allowed to live and one will be killed. Sophie must decide which child will be killed. She can prevent the death of either of her children, but only by condemning the other to be killed. The guard makes the situation even more painful for Sophie by telling her that if she chooses neither, then both will be killed. With this added factor, Sophie has a morally compelling reason to choose one of her children. But for each child, Sophie has an equally strong reason to save him or her. Thus, the same moral precept gives rise to conflicting obligations.[59]

Now, we do not face such morally excruciating decisions in accounting (thank goodness). However, we may have to differentiate between the rights of one party versus another and should rely on our duties/obligations to each under the Principles in the AICPA Code that are discussed later.

Justice

Justice is usually associated with issues of rights, fairness, and equality. A just act respects your rights and treats you fairly. Justice means giving each person what she or he deserves. *Justice* and *fairness* are closely related terms that are often used interchangeably, although differences do exist. While *justice* usually has been used with reference to a standard of rightness, *fairness* often has been used with regard to an ability to judge without reference to one's feelings or interests.

Justice as Fairness

John Rawls (1921–2002) developed a conception of justice as fairness using elements of both Kantian and utilitarian philosophy. He described a method for the moral evaluation of social and political institutions this way.[60]

> Imagine that you have set for yourself the task of developing a totally new social contract for today's society. How could you do so fairly? Although you could never actually eliminate all of your personal biases and prejudices, you would need to take steps at least to minimize them. Rawls suggests that you imagine yourself in an original position behind a veil of ignorance. Behind this veil, you know

> nothing of yourself and your natural abilities, or your position in society. You know nothing of your sex, race, nationality, or individual tastes. Behind such a veil of ignorance all individuals are simply specified as rational, free, and morally equal beings. You do know that in the "real world," however, there will be a wide variety in the natural distribution of natural assets and abilities, and that there will be differences of sex, race, and culture that will distinguish groups of people from each other.

Rawls says that behind the veil of ignorance the only safe principles will be fair principles, for you do not know whether you would suffer or benefit from the structure of any biased institutions. The safest principles will provide for the highest minimum standards of justice in the projected society.

Rawls argues that in a similar manner, the rational individual would only choose to establish a society that would at least conform to the following two rules:

1. *Each person is to have an equal right to the most extensive basic liberty compatible with similar liberty for others.*
2. *Social and economic inequalities are to be arranged so that they are both:*
   (a) reasonably expected to be to everyone's advantage and
   (b) attached to positions and offices open to all.

The first principle—often called the *Liberty Principle*—is very Kantian in that it provides for basic and universal respect for persons as a minimum standard for all just institutions. But while all persons may be morally equal, we also know that in the "real world" there are significant differences between individuals that under conditions of liberty will lead to social and economic inequalities.

The second principle—called the *Difference Principle*—permits such inequalities and even suggests that it will be to the advantage of all (similar to the utility principle), but only if they meet the two specific conditions. Thus the principles are not strictly egalitarian, but they are not laissez-faire either. Rawls is locating his vision of justice in between these two extremes.

When people differ over what they believe should be given, or when decisions have to be made about how benefits and burdens should be distributed among a group of people, questions of justice or fairness inevitably arise. These are questions of *distributive justice.*[61]

The most fundamental principle of justice, defined by Aristotle more than 2,000 years ago, is that "equals should be treated equally and unequals unequally." In other words, individuals should be treated the same unless they differ in ways that are relevant to the situation in which they are involved. The problem with this interpretation is in determining which criteria are morally relevant to distinguish between those who are equal and those who are not. It can be a difficult theory to apply in business if, for example, a CEO of a company decides to allocate a larger share of the resources than is warranted (justified), based on the results of operations, to one product line over another to promote that operation because it is judged to have more long-term expansion and income potential. If I am the manager in charge of the operation getting fewer resources but producing equal or better results, then I may believe that my operation has been (I have been) treated unfairly. On the other hand, it could be said that the other manager deserves to receive a larger share of the resources because of the long-term potential of that other product line. That is, the product lines are not equal; the former deserves more resources because of its greater upside potential.

Justice as fairness is the basis of the objectivity principle in the AICPA Code that establishes a standard of providing unbiased financial information. In our discussion of ethical behavior in this and the following chapters, questions of fairness will be tied to making objective judgments. Auditors should render objective judgments about the fair presentation of financial results. In this regard, auditors should act as impartial arbiters of the truth, just as judges who make decisions in court cases should.

For purposes of future discussions about ethical decision making, we elaborate on the concept of *procedural justice.* When there is strong employee support for decisions, decision makers, organizations, and outcomes, procedural justice is less important to the individual. In contrast, when employees' support for decisions, decision makers, organizations, or outcomes is not very strong, then procedural justice becomes more important.[62] Consider, for example, a potential whistleblower who feels confident about bringing her concerns to top management because specific procedures are in place to support that person. Unlike the Betty Vinson situation at WorldCom, an environment built on procedural justice supports the whistleblower, who perceives the fairness of procedures used to make decisions.

Virtue Ethics

Virtue considerations apply both to the decision maker and to the act under consideration by that party. This is one of the differences between virtue theory and the other moral philosophies that focus on the act. Virtue theory focuses on both the person engaging in the act and the act itself. This philosophy is called *virtue ethics,* and it posits that what is moral in a given situation is not only what conventional morality or moral rules require but also what a well-intentioned person with a "good" moral character would deem appropriate.

Virtue theorists place less emphasis on learning rules and instead stress the importance of developing *good habits of character,* such as kindness. Plato emphasized four virtues in particular, which were later called *cardinal virtues:* wisdom, courage, temperance, and justice. Other important virtues are fortitude, generosity, self-respect, good temper, and sincerity. In addition to advocating good habits of character, virtue theorists hold that we should avoid acquiring bad character traits, or vices, such as cowardice, insensibility, injustice, and vanity. Virtue theory emphasizes moral education because virtuous character traits are developed in one's youth. Adults, therefore, are responsible for instilling virtues in the young.

The philosopher Alasdair MacIntyre states that the exercise of virtue requires "a capacity to judge and to do the right thing in the right place at the right time in the right way." Judgment is exercised not through a routinizable application of the rules, but as a function of possessing those dispositions/tendencies (i.e. virtues) that enable choices to be made about what is good for people and by holding in check desires for something other than what will help achieve this goal.[63]

At the heart of the virtue approach to ethics is the idea of "community" and all who practice in it. MacIntyre relates virtues to the rewards of a practice. He differentiates between the external rewards of a practice (such as money, fame, and power) and the internal rewards, which relate to the intrinsic value of a particular practice. MacIntyre points out that every practice requires a certain kind of relationship between those who participate in it. The virtues are the standards of excellence that characterize relationships within the practice. To enter into a practice is to accept the authority of those standards, obedience to the rules, and commitment to achieve the internal rewards.[64] The accounting profession is a community with standards of excellence embodied in state board rules of conduct and the AICPA Code.

We have emphasized moral intent as an essential ingredient of ethical behavior. Moral intent is necessary to deal with the many conflicts in accounting among the interests of employers, clients, and the public interest. We realize that for students, it may be difficult to internalize the concept that, when forced into a corner by one's supervisor to go along with financial wrongdoing, you should stand up for what you know to be right, even if it means losing your job. However, ask yourself the following questions: Do I even want to work for an organization that does not value my professional opinion? If I go along with it this time, might the same demand be made at a later date? Will I begin to slide down that ethical slippery slope where there is no turning back? How much is my reputation for honesty and integrity worth? Would I be proud if others found out what I did (or didn't do)? To quote the noted Swiss psychologist and psychiatrist, Carl Jung: "You are what you do, not what you say you'll do."

By way of summarizing the material in this section, we present an analysis of ethical reasoning methods that form the basis for ethical judgments and related implementation issues in Exhibit 1.3. We elaborate on these judgments throughout the book.

EXHIBIT 1.3 Ethical Reasoning Method Bases for Making Ethical Judgments

	Teleology				Deontology	Justice	Virtue Ethics
	Egoism	**Enlightened Egoism**	**Utilitarianism**		**Rights Theory**		
Ethical Judgments	Defines "right" behavior by consequences for the decision maker.	Considers well-being of others within the scope of deciding on a course of action based on self-interest.	Evaluates consequences of actions (harms and benefits) on stakeholders.		Considers "rights" of stakeholders and related duties to them. Treats people as an end and not merely as a means to an end. *Universality Perspective:* Would I want others to act in a similar manner for similar reasons in this situation?	Emphasizes rights, fairness, and equality. Those with equal claims to justice should be treated equally; those with unequal claims should be treated unequally.	Only method where ethical reasoning methods—"virtues" (internal traits of character)—apply both to the *decision maker* and the decision. Judgments are made not by applying rules, but by possessing those traits that enable the decision maker to act for the good of others. Similar to Principles of AICPA Code and IMA standards.
			Act Evaluate whether the intended *action* provides the greatest net benefits.	*Rule* Select the action that conforms to the correct *moral rule* that produces the greatest net benefits.			
Problems with Implementation	Fails to consider interests of those affected by the decision.	Interests of others are subservient to self-interest.	Can be difficult to assign values to harms and benefits.		Relies on moral absolutes—no exceptions; need to resolve conflicting rights.	Can be difficult to determine the criteria to distinguish equal from unequal claims.	Virtues may conflict, requiring choices to be made.

Regulation and the Public Interest in Accounting

LO 1-5

Describe the regulatory system in accounting and how professional accountants serve the public interest.

Regulation of the Accounting Profession

Professions are defined by the knowledge, skills, attitudes, behaviors, and ethics of those in the (accounting) profession. Regulation of a profession is a specific response to the need for certain standards to be met by the members of the profession. The accounting profession provides an important public service through audits and other assurance services (together, attest services) and those who choose to join the community pledge to act in the public interest.

Regulations exist to address the knowledge imbalance between the client and the provider of services, who has professional expertise. Regulation also helps when there are significant benefits or costs from the provision of accountancy services that accrue to third parties, other than those acquiring and producing the services.

In the United States, the state boards of accountancy are charged with protecting the public interest in licensing candidates to become CPAs. The behavior of licensed CPAs and their ability to meet ethical and professional obligations is regulated by the state boards. Regulatory oversight is based on the statutorily defined scope of practice of public accountancy. There are 55 state boards (50 states, plus the District of Columbia, Guam, Commonwealth of Northern Mariana Islands, Puerto Rico, and the U.S. Virgin Islands).

The National Association of State Boards of Accountancy (NASBA) provides a forum for discussion of the different state board requirements to develop an ideal set of regulations in the Uniform Accountancy Act. The NASBA Center for the Public Trust advances ethical leadership in business, institutions and organizations. It does this, in part, through training and a certification program that teaches how to recognize ethical issues, resolve dilemmas and create an atmosphere that promotes positive ethical behavior.

The Public Interest in Accounting

Following the disclosure of numerous accounting scandals in the early 2000s at companies such as Enron and WorldCom, the accounting profession, professional bodies, and regulatory agencies turned their attention to examining how to rebuild the public trust and confidence in financial reporting. Stuebs and Wilkinson point out that restoring the accounting profession's public interest focus is a crucial first step in recapturing the public trust and securing the profession's future.[65] Copeland believes that in order to regain the trust and respect the profession enjoyed prior to the scandals, the profession must rebuild its reputation on its historical foundation of ethics and integrity.[66]

The CPA license has "public" in its title to remind all that the primary obligation of CPAs is to the public interest. Keeping the public interest in mind helps a CPA determine dilemmas such as: who is the primary client—the public, company, management, or shareholders; to whom ethical loyalty is owed; when services and clients present conflicts of interests; and when confidentiality must be upheld. The Principles in the AICPA Code state that "members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism" (AICPA 0.300.030.01, 2014). The responsibility to the public overrides the responsibilities to the clients or those who hire and pay them. The public interest includes those who rely on financial statements for lending, investing, and pension decisions.[67]

Ethics and Professionalism

The accounting profession is a community with values and standards of behavior. These are embodied in the various codes of conduct in the professional bodies, including the AICPA. The AICPA is a voluntary association of CPAs with more than 418,000 members in 143 countries, including CPAs in business and industry, public accounting, government, education, student affiliates, and international associates. CPA state societies also exist in the United States. Even though regulation of the profession and licensing is through state boards and state board rules of conduct, the AICPA Code of Professional Conduct is typically recognized as having accepted standards of behavior.

The Institute of Management Accountants (IMA) has a global network of accountants and financial professionals with more than 75,000 members in 140 countries. The IMA Statement of Ethical and Professional Practice provides guidelines for ethical conduct and is unique in that it provides guidelines to resolve ethical conflicts. The IMA standards appear in Exhibit 1.4.

EXHIBIT 1.4 Institute of Management Accountants Statement of Ethical Professional Practice

Members of IMA shall behave ethically. A commitment to ethical professional practice includes overarching principles that express our values, and standards that guide our conduct.

Principles

IMA's overarching ethical principles include: Honesty, Fairness, Objectivity, and Responsibility. Members shall act in accordance with these principles and shall encourage others within their organizations to adhere to them.

Standards

A member's failure to comply with the following standards may result in disciplinary action.

I. Competence

Each member has a responsibility to:

1. Maintain an appropriate level of professional expertise by continually developing knowledge and skills.
2. Perform professional duties in accordance with relevant laws, regulations, and technical standards.
3. Provide decision support information and recommendations that are accurate, clear, concise, and timely.
4. Recognize and communicate professional limitations or other constraints that would preclude responsible judgment or successful performance of an activity.

II. Confidentiality

Each member has a responsibility to:

1. Keep information confidential except when disclosure is authorized or legally required.
2. Inform all relevant parties regarding appropriate use of confidential information. Monitor subordinates' activities to ensure compliance.
3. Refrain from using confidential information for unethical or illegal advantage.

III. Integrity

Each member has a responsibility to:

1. Mitigate actual conflicts of interest, regularly communicate with business associates to avoid apparent conflicts of interest. Advise all parties of any potential conflicts.

(*Continued*)

2. Refrain from engaging in any conduct that would prejudice carrying out duties ethically.
3. Abstain from engaging in or supporting any activity that might discredit the profession.

IV. Credibility

Each member has a responsibility to:

1. Communicate information fairly and objectively.
2. Disclose all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, analyses, or recommendations.
3. Disclose delays or deficiencies in information, timeliness, processing, or internal controls in conformance with organization policy and/or applicable law.

Resolution of Ethical Conduct

In applying the Standards of Ethical Professional Practice, you may encounter problems identifying unethical behavior or resolving an ethical conflict. When faced with ethical issues, you should follow your organization's established policies on the resolution of such conflict. If these policies do not resolve the ethical conflict, you should consider the following courses of action:

1. Discuss the issue with your immediate supervisor except when it appears that the supervisor is involved. In that case, present the issue to the next level. If you cannot achieve a satisfactory resolution, submit the issue to the next management level. If your immediate superior is the chief executive officer or equivalent, the acceptable reviewing authority may be a group such as the audit committee, executive committee, board of directors, board of trustees, or owners. Contact with levels above the immediate superior should be initiated only with your superior's knowledge, assuming he or she is not involved. Communication of such problems to authorities or individuals not employed or engaged by the organization is not considered appropriate, unless you believe there is a clear violation of the law.
2. Clarify relevant ethical issues by initiating a confidential discussion with an IMA Ethics Counselor or other impartial advisor to obtain a better understanding of possible courses of action.
3. Consult your own attorney as to legal obligations and rights concerning the ethical conflict.

The Institute of Internal Auditors (IIA) is an international professional association representing the internal audit profession with more than 185,000 members in 170 countries. Similar to the IMA code, internal auditors are held to standards that address their competence, integrity, and objectivity (credibility), as you can see by Exhibit 1.5. Both codes contain a provision for confidentiality because internal accountants and auditors gain access to sensitive financial and operating information that should not be disclosed because it might negatively affect the company's financial and operating positions. Note that the ethics guidelines of the IMA and IIA are virtually the same except for the resolution of conflicts in the IMA standards.

EXHIBIT 1.5 The Institute of Internal Auditors Code of Ethics

Principles

Internal auditors are expected to apply and uphold the following principles:

1. **Integrity**
   The integrity of internal auditors establishes trust and thus provides the basis for reliance on their judgment.
2. **Objectivity**
   Internal auditors exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgments.

(*Continued*)