Ethical Obligations and Decision Making in Accounting

Text and Cases

Sixth Edition

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ETHICAL OBLIGATIONS AND DECISION MAKING IN ACCOUNTING: TEXT AND CASES, SIXTH EDITION

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Praise for Ethical Obligations and Decision Making in Accounting

As an accounting faculty member teaching ethics for the third time, I have to say that my first time using Professor Mintz's ethics textbook has been nothing short of an exhilarating experience. The textbook, in my mind, follows the Goldilocks' Rule—it is "just right" in terms of breadth and depth, striking a nice balance between accounting and business ethics. Given my preference for covering the increasingly important topic of whistleblowing, I was delighted to see real world examples such as Cynthia Cooper at WorldCom and Anthony Menendez at Halliburton, as well as numerous other real-world cases where whistleblowers were involved. The textbook also lends itself to being adapted flexibly depending upon course length and duration (for instance, I taught a one-half semester course). Eureka! I believe I have found the "ideal" textbook for my graduate course, and plan to use it going forward. Thanks to professor Mintz for doing an exceptional job of assembling such a fine textbook on a challenging, complex topic. I look forward to seeing the sixth edition co-authored with Bill Miller.

—Sri Ramamoorti, University of Dayton

There are not a lot of accounting ethics textbooks around that are designed to teach accounting students about ethics that incorporate contemporary accounting practice-related issues; this textbook does a masterful job integrating real-life ethical scenarios into cases that students can relate to and build an ethical foundation as they enter the accounting profession.

—Kevin Jones, University of California Santa Cruz

I have taught courses in Ethics in Accounting for over five years, and for the last several years I have used only the Mintz textbook. It combines ethics theories and case studies, and provides various types of assignment options, such as discussions, case studies, and multiple-choice questions. The textbook is thorough, concise, up-to-date, highly readable, and a superb platform on which to structure a syllabus for ethics in accounting. In particular, the case studies accompanying the lessons allow my students to take the subject matter in any direction—or to whatever depth—they wish.

–-Ana Sturgess, Foothill College

To ensure students gain a thorough understanding of each chapter's content, I utilize the McGraw-Hill Connect software included with the Ethical Obligations and Decision Making in Accounting sixth edition. Prior to class, the students utilize the interactive SmartBook within the McGraw-Hill Connect software to read the material and answer questions to progress through the reading. The result is better prepared students; thus, allowing for more robust case study discussions in the classroom.

—Stacy L. Conrad, University of Texas at San Antonio

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 stimulate a student's growth as a human being, awaken students' interest in ethics, and enhance their appreciation for the importance of ethical behavior. Our goals are to educate accounting students to be future leaders in the accounting profession and guide them along the path of ethical decision-making. We seek to have students gain the ability to not only know what the right thing to do is but have the courage to do it. Above all else, we seek to instill in students the desire to serve the public interest and meet their ethical obligations to society.

> "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 Obispo. 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 and then again in 2018. 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 "ethics sage," "workplaceethicsadvice," and "higheredethicswatch."

Courtesy of William F. Miller

William F. Miller, EdD, CPA, CGMA, is a professor of accounting of the Accounting & Finance Department from the College of Business, University of Wisconsin, Eau Claire. Dr. Miller received his EdD from the University of Saint Thomas, Saint Paul, Minnesota. He also has over 23 years of professional accounting experience and maintains an active consulting practice. He has authored or co-authored over 20 publications, including a book on Giving Voice to Values in Accounting, and has won the Institute of Management Accountants Carl Menconi Ethics Case writing competition three times (2011, 2012, and 2015), and won the American Accounting Association's Public Interest Section best contribution to teaching award in 2015.

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

Foreword

By Mary C. Gentile, PhD

Creator/Director, Giving Voice To Values

University of Virginia Darden School of Business

Steven M. Mintz and William F. Miller's latest edition (and 6th) of *Ethical Obligations and Decision Making in Accounting: Text and Cases* is a comprehensive, readable, practical, fresh, and even inspiring text for students of accounting.

The authors cover all the relevant and even required bases for accounting ethics education—an accessible and clear introduction to ethical reasoning; the inclusion of recent and important insights from psychology and behavioral ethics; an impressive set of actual case studies—both short scenarios focused primarily on ethical challenges and longer cases that more clearly integrate values conflicts with financial analysis; discussions of ethical issues at both the organizational as well as the individual levels; examples of classic auditing ethics issues as well as reflection on the most current topics including the influence of social media, equity, diversity and inclusion, and so on—as well as review questions, assessments and all the other ancillary materials that any faculty member could desire.

However, one of the most compelling aspects of this impressive text is the fact that it goes well beyond simply raising awareness of all the ethical risks and choice points an accounting professional may face and providing analytical tools and lenses to aid in rigorously and consistently thinking through them. These are, of course, critical and required objectives for any accounting ethics educational experience. However, necessary as they are, they are not sufficient. Truly preparing future accountants for responsible and ethical practice also requires attention to questions of action: that is, developing the skills, competencies, literal scripts, confidence, and the habit of acting effectively on values-based positions. For this reason, I am pleased and proud to see that Mintz and Miller have thoroughly integrated the "Giving Voice to Values"[1] (GVV) pedagogy into their text.

"Giving Voice to Values" is an innovative approach to values-driven leadership development in business education and the workplace. Drawing on actual experience and scholarship, GVV fills a long-standing critical gap in the development of values-centered leaders. GVV is not about persuading people to be more ethical. Rather GVV starts from the premise that most of us already want to act on our values, but that we also want to feel that we have a reasonable chance of doing so effectively and successfully. This pedagogy and curriculum are about raising those odds. Rather than a focus on ethical *analysis*, the Giving Voice to Values (GVV) curriculum focuses on ethical *implementation* and asks the question: "What if I were going to act on my values? What would I say and do? How could I be most effective?"

GVV was developed for use in graduate business education and the goal was always to create a pedagogy and curriculum that would not be restricted to general ethics courses, but rather that lent itself to all the core functions of business and could easily and effectively be integrated into an accounting or a finance or a marketing or an operations course. The field of Accounting has been one of the most receptive to this approach and the authors of this text have played a major part in that integration. They have piloted the use of GVV in accounting teaching; researched and published on its impact; and built it into past texts. This latest edition is the most expansive and complete manifestation of that integration to date.

The goal here is for accounting students to not only understand the importance of ethical responsibility in their profession but to feel empowered and skillful enough to act on that insight. Through pre-scripting, rehearsal, and peer coaching, students normalize the voicing and enacting of values-based positions in their accounting careers but also learn how to frame their commitments in ways that are more likely to influence their intended audiences whether that may be a manager, a colleague, or a client. They anticipate the sorts of objections or "Reasons & Rationalizations" they are likely to encounter and pre-script effective ways to respond and neutralize them. And by having these conversations with their peers, they develop a comfort and confidence with this sort of discussion. Rather than merely a set of "thou shalt not's," ethical accounting becomes a process of innovation and of efficacy. They develop a "habit" of enacting their values, a "moral muscle memory."

Mintz and Miller have taken the core GVV concepts and put the accounting "meat on the bones." They have gone beyond ethical exhortations to the use of accounting vocabulary and frameworks and analytics to build persuasive action plans for values-driven practice. And rather than simply preaching to students and then pretending they can or will act ethically, these authors appeal to the professional aspirations their students already possess and provide them with the guidance and the practice to act on those aspirations successfully. This approach cannot *make* a future accountant act ethically but it goes a long way toward enabling them to know they truly have a choice and toward building their habit of making the ethical one.

[1] www.GivingVoiceToValues.org, www.MaryGentile.com

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 and ethical reasoning standards of conduct that have stood the test over time. Our book is devoted to helping students cultivate the ethical commitment needed to ensure that their work meets the highest standards of integrity, independence, objectivity, and professional skepticism. We hope that this book and classroom instruction will work together to provide the tools to inspire students to act in accordance with the rules and professional standards of behavior in everything they do. Here is a brief overview of enhancements to the sixth edition. Additional details follow.

Ethics Education

Most states require a CPA applicant to complete a professional ethics exam before licensure. The exam is often administered online at home and a passing score is considered a 90 percent or better. This exam generally must be completed within two years of passing the CPA Exam. Check your State Board for details.

Virtually, all states require continuing education in ethics after licensure. Generally, four hours are required every two years to include a course on state regulatory requirements. Some states allow a course on ethical reasoning.

Increasingly, more states are requiring a specific number of units in ethics education at the university level as a condition of licensing. For example, the Texas State Board of Accountancy says about course content that it must include: a framework of ethical reasoning, professional values, and attitudes for exercising professional skepticism and other behavior that is in the best interest of the public and profession. The course should provide a foundation for ethical reasoning and include the core values of integrity, objectivity, and independence. The California Board of Accountancy requires 10-semester hours of ethics study, three of which must be in a standalone Accounting Ethics course that addresses accounting ethics or accountants' professional responsibilities.

Overview of Sixth Edition

The sixth edition continues the trend of addressing societal ethics and civility in light of recent developments in the areas of equity, diversity, and inclusion. Students need to know about societal ethics issues along with those in business and accounting. One goal of our book is to develop the whole person and enhance their ethical decision-making skills in all aspects of their life—personal and professional. The "Giving Voice to Values" technique has a prominent role in the sixth edition to guide students on what they can do to counteract the pressures of top management to deviate from ethical and philosophical norms of behavior. GVV cases are clearly marked so instructors can easily determine whether to assign them in a given chapter.

The culture of an organization provides the foundation for ethical decisions in accounting. Accountants and auditors do not work in a vacuum. Instead, they are part of a larger organization within which ethical decisions are made. The sixth edition digs deeper into organizational ethics issues including corporate governance and discusses the link between internal controls over financial reporting and the role and responsibilities of accounting professionals. Ethical leadership concerns are addressed as well.

Ethics in the accounting profession is evolving. Independence issues are at the forefront of the discussions because of concerns that auditors are not paying enough attention to the importance of having an independent audit. The sixth edition addresses dozens of situations where auditor independence was questioned by the SEC in its regulatory actions. The Public Company Accounting Oversight Board has been concerned that independence impairments, along with integrity and a lack of professional skepticism, have led to high rates of audit deficiencies identified in PCAOB inspections of the Big Four.

The sixth edition has expanded coverage of accounting fraud and earnings management. Pressure to meet financial analysts' earnings projections and internal estimates of earnings and earnings per share create challenges for accounting professionals who must retain their integrity and professional skepticism as required by the AICPA Code of Professional Conduct.

There are many new cases in the book to diversify coverage and expand on what it takes to make ethical decisions and how to voice one's values when conflicts exist between what the organization wants to report and what the organization should report by following prescribed ethical standards. The reality is that the SEC and other regulatory bodies may investigate when material misstatements in the financial statements go undetected or organizations engage in earnings management through fraudulent accounting and financial reporting.

The book has been designed to meet the standards for ethical behavior by accounting professionals embodied in the AICPA Code and state board of accountancy regulations 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 decision making;
- Prescribing attributes for exercising professional skepticism and behavior that is in the best interest of the investing and consuming public and the profession;
- Putting the interests of the public ahead of those of an organization and self-interest; and
- Instilling the desire to do the right thing and adhere to the standards set forth in the AICPA Code.

Accounting students should strive to be the best accounting professionals possible. To that end, we seek to instill a sense of ethics and professionalism in everything they do.

What's New in the Sixth Edition?

In response to feedback and guidance from numerous accounting ethics faculty, the authors have made many important changes to the sixth 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

New to the sixth edition is the inclusion of five comprehensive discussion questions in addition to the 20 end-of-chapter discussion questions. The comprehensive questions were designed with three objectives in mind: (1) covering more than one topic in a discussion question; (2) adding to the discussion of chapter material by linking back to a topic covered in a previous chapter; and (3) requiring students to incorporate philosophical reasoning in answering a discussion question.

Ten cases 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 sixth 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 fourth and fifth editions not carried over to the sixth 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.

Suggestions for Classroom Discussion

In addition to the customary pedagogical techniques of straight lecturing and class discussions, the authors have used the following techniques:

- Dividing students into groups to resolve ethical dilemmas posed by the facts of a case and discussing the resolution in class.
- Having students create their own case study and make a video to explain how to resolve the ethical dilemma.
- Requiring a role-playing exercise to practice responding to ethical dilemmas posed in case studies. This is particularly useful in Giving Voice to Values cases.
- Have students write a blog on an ethical issue and submit it for grading purposes. In the past, Professor Mintz has worked with instructors to review the blogs and decide whether it is appropriate for posting on his *Ethics Sage* blog site.
- Assign end-of-course projects where students work independently to write up the answers to cases and submit them for grading. The major cases have been used for this purpose.

Ethics IQ Test

An ethics IQ test appears at the end of Chapter 1. This was in the "Ethics Reflection" in the fifth edition. We felt having a different ethics reflection in the sixth edition would allow us to provide students with a better introduction to chapter one material. The IQ questions are designed to engage students in topics they care about such as sexual harassment, the use of marijuana, and dangers of posting material on social media. Instructors can use this test in the first few classes to get a sense of where students stand in their ability to identify and resolve ethical dilemmas. There is a scoring system to aid in this process.

Chapter-by-Chapter Enhancements

Chapter 1 Ethical Reasoning: Implications for Accounting

- Enhanced discussion of the difference between morals, ethics, and values.
- Expanded coverage of moral courage including a hazing incident at Louisiana State University.
- **New** case on "Operation Varsity Blues" where wealthy and well-connected parents made payments to a middleman to facilitate admission of their kids to prestigious colleges and universities.
- **New** case on "Getting Called Out on Social Media" that addresses the realities of the cancel culture.

Chapter 2 Cognitive Processes and Ethical Decision Making in Accounting

- Reorganization of the chapter to provide a roadmap to making ethical decisions in accounting.
- **New** section on What Makes for an Ethical Organization that addresses issues related to ethical culture and equity, diversity, and inclusion.
- Enhanced discussion of behavioral ethics and additional focus on the role of cognitive biases play in ethical decision making.
- Enhanced discussion of the GVV technique. Chapter 2 discusses the foundation of the approach including examples on applying the methodology. There are 18 GVV cases in the book.
- **New** case on equity, diversity, and inclusion surrounding automated screening of new hire candidates.
- Major update to case on the role of incrementalism in ethical decision making in accounting.

Chapter 3 Organizational Ethics and Corporate Governance

- Updated results from the Association of Certified Fraud Examiners 2020 Global Survey of Fraud.
- **New** discussion of conscious capitalism.
- **New** case on the fraud at Theranos that developed a blood testing system to facilitate obtaining the results at a cheaper cost only to find out the system did not work as intended.
- **New** case on the toxic sales culture at Wells Fargo that led to a massive fraud.
- Expanded coverage of corporate social responsibility including *sexual harassment.*
- **New** case about the cheating scandal at KPMG where partners cheated on an internal training exam to get credit for a continuing education course.

Chapter 4 AICPA Code of Professional Conduct

- Expanded coverage of independence including a new requirement in the United Kingdom to have accounting firms split off their consultancy services and auditing services into separate operating entities and implications for the SEC.
- **New** discussion of the loosening of independence rules by the SEC to focus more attention on objectivity and impartiality and less on strict independence.
- Expanded coverage of ethics in tax practice.
- **New** discussion of the expanded quality control requirements implemented by the Public Company Accounting Oversight Committee (PCAOB).
- **New** case on sexual harassment charges at Ernst & Young.
- **New** case where PricewaterhouseCoopers mischaracterized its nonaudit services to skirt the requirement not to perform certain nonaudit services for audit clients.

Chapter 5 Fraud in the Financial Statements and Auditor Responsibilities

- Expanded coverage of PCAOB's requirement for auditors to communicate in the audit report critical audit matters (CAMs) or state that none were determined to exist.
- **New** section on the use of automation, analytics, and artificial intelligence in the audit function.
- Expanded discussion of PCAOB audit inspection process and high rate of deficiencies of audit firms.
- **New** case on the allegations raised that Ernst & Young failed to detect fraudulent bank confirmations in its audit of Wirecard.
- **New** case on the risks surrounding the integration of audit analytic techniques into audit procedures.
- Major update to cases surrounding the uncovering of related party transactions and other fraudulent activities by an external auditor.

Chapter 6 Motivation for Fraudulent Financial Reporting

- The material in Chapter 7 of the fifth edition has been divided into two chapters. Chapter 6 discusses the motivation for fraudulent financial reporting, while Chapter 7 addresses the consequences of earnings management.
- **New** section on red flags and detecting fraudulent financial reporting.
- **New** section on using financial statement analysis to detect fraud.
- **New** case on fraud at BMW NA due to inaccurate disclosures of its retail vehicle sales volume in the United States.

Chapter 7 Consequences of Earnings Management: The Need for Ethical Leadership in Accounting

- Expanded discussion of restatements of financial statements and differences between a revising financial statements and reissuing them.
- **New** discussion of financial statement restatements including material misstatements at Kraft Heinz triggered by operational issues.
- **New** section on SEC clawbacks of executive compensation that are triggered by financial statement restatements.
- **New** section on the implications of financial statement restatements for corporate governance.
- **New** section on ethical leadership that has been condensed from the material in Chapter 8 of the fifth edition.
- **New** case that addresses issues related to the coronavirus pandemic including “PPP Loans: Free Money at a Cost.”
- **New** case on professional skepticism and managing consensus earnings projections.
- **New** case about the fraud at Theranos that expands on the case in Chapter 3 by addressing failures in corporate governance and a lack of ethical leadership, all of which was triggered by a toxic corporate culture.

Chapter 8 Auditors’ Legal Liabilities and Defenses

- The contents in this chapter in the sixth edition come from Chapter 7 of the fifth edition.
- Added exhibits to simplify learning of legal concepts.
- **New** section on income tax fraud versus tax negligence.
- **New** case that explores the legal liabilities of Alexion company because of improper payments made by its Turkish subsidiary to foreign government officials to gain new business and related failure of the internal controls.
- **New** case that addresses revenue recognition fraud caused by the structure of agreements with distributors of vaccines used to treat infectious diseases.

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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 and/or Bill Miller at millerwf@uwec.edu.

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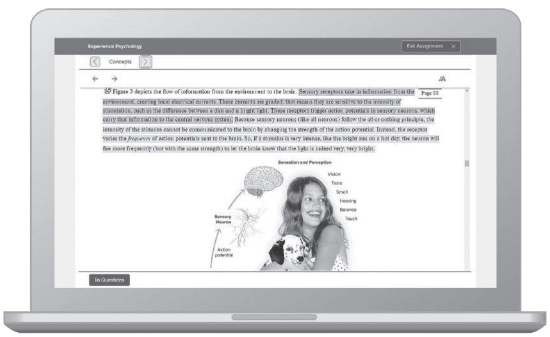

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- Jordan Cunningham,
  Eastern Washington University

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Case Descriptions

Chapter 1 Ethical Reasoning: Implications for Accounting

Case # Case Name/Description

1-1 Operation Varsity Blues
Rich and well-connected parents make improper payments to a middleman to gain admission to choice colleges for their kids.

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 Lottery Bonanza
Two friends agree to share lottery winnings 50:50 no matter who wins but after winning, one friend considers backing out of the agreement.

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 Section 179 Deduction for Equipment Purchases
Ethical dilemma for audit firm after its tax client insists on improper depreciation deductions or else lose its audit and lucrative consulting services.

1-9 Cleveland Custom Cabinets
Ethical and professional responsibilities of an accountant who is asked to "tweak" overhead to improve reported earnings.

1-10 Getting Called-Out on Social Media
Calling out a classmate after a disagreement on social justice issues.

Chapter 2 Cognitive Processes and Ethical Decision Making in Accounting

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 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 Not so Diverse, Equitable or Inclusive (a GVV case)
Disproportionally high turnover rates for persons of color and women and the implications for diversity and inclusion.

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 **Chef's Delight: That Slope Looks Slippery (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. Page xiii

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.

Chapter 3 Organizational Ethics and Corporate Governance

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**
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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 Discuss the relationship between ethics, values, and ethical decision making.
LO 1-2 Explain how characteristic traits of behavior influence ethical decision making.
LO 1-3 Differentiate between moral philosophies and their effect on ethical reasoning in accounting.
LO 1-4 Describe how professional accountants serve the public interest and their obligations under the AICPA Code.
LO 1-5 Apply the AICPA Code and ethical reasoning methods to a case study.

Ethics Reflection

Solving Ethical Dilemmas in Accounting

Solving ethical dilemmas in accounting entails defining the relevant moral values that should guide ethical actions, identifying those who are or may be affected by the actions taken, analyzing each possible action using moral reasoning, and coming to a decision.

We might ask which professions rate high in moral values? The annual Gallup Poll on honesty and ethics in the professions rates nurses as #1, with a total score of 85 percent very high and high. This is an interesting result, given our recent battle with the coronavirus and all that nurses had to do. Notably, the 85 percent rating was before the pandemic. Following nurses are engineers (66%), and then medical doctors (65%) and pharmacists (64%), the latter two and nurses are in the helping professions.[1]

Accountants rate relatively high with a total score of 42 percent very high and high. This may seem low but it is not compared to other business professions. Indeed, accounting is rated #1 in that regard, dwarfing bankers with 28 percent and 21 percent for business executives. When we include the 48 percent rating of accountants in ethics and honesty, we might conclude that the total of 90 percent shows the public is satisfied with accountants' commitment to do the right thing.

What makes the accounting profession rated relatively high in the minds of many of the public? Most likely, it is a commitment to moral values in the performance of professional services including:

- Accountability
- Confidentiality
- Due care and competence
- Integrity
- Loyalty
- Reliability
- Trustworthiness

(continued)

continued Ethics Reflection

Integrity is thought to be the whole of ethical behavior. According to Mintz, "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 a 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.

Think about the following as you read the chapter: (1) How do we distinguish right from wrong? (2) What are the characteristic traits of behavior of an ethical person? (3) How do we reason through ethical dilemmas and distinguish between right versus wrong? (4) How can integrity reinforce the ethical reasoning?

> We look for three things when we hire people. We look for intelligence, we look for initiative or energy, and we look for integrity. And if they don't have the latter, the first two will kill you, because if you're going to get someone without integrity, you want them lazy and dumb."[3]
>
> *Source: Warren Buffet*

This quote by Warren Buffet emphasizes the importance of integrity, or principled behavior in those being recruited by his firm. That is because one has to act with integrity when making professional decisions otherwise pressure imposed on a new employee might steer them in the wrong direction.

Some people distinguish between the importance of ethics in their personal lives and professional lives, judging the latter as less important. However, 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. More will be said about this later.

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

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."[4] 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.[5] 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.[6]

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. Indeed, we might ask: Why do good people sometimes do bad things? 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."[7]

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. Therefore, we can say that doing the right thing can have positive consequences for the decision maker.

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."[8]

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.[9]

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

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 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.[10]

The Language of Ethics

LO 1-1

Discuss the relationship between ethics, values, and ethical decision making.

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 behaviors. 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?[11] 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."[12] 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 they take responsibility for those actions. The best way to understand ethics may be to differentiate it from other concepts.

Difference between Morals and Ethics

Ethics and morals relate to "right" and "wrong" conduct. While they are sometimes used interchangeably, there are differences. These differences may seem complicated at first but can be compared to each other to simplify ethical decision-making as shown in **Exhibit 1.2** below.

While morals are concerned with principles of right and wrong in general, ethics are related to right and wrong conduct of an individual in a particular situation. Whereas morals are customs established by a group of individuals, ethics defines the character of the individual. While morals represent what a person, group, or society believes people should do, ethics are guiding principles which help the individual or group decide what is good or bad. Morals are expressed in the form of general rules and statements. Ethics are abstract. They need context to decide what is right or wrong.

Moral principles include the following:

- Always tell the truth
- Do not cheat
- Treat others fairly
- Be kind to others

Ethical guiding principles, which will be discussed further in the next section, include the following:

- Truthfulness
- Honesty
- Integrity

- Fairness
- Respect
- Loyalty

One way of understanding the difference is to think of it this way. Ethics leans toward decisions based upon individual character and the more subjective understanding of right and wrong by individual, whereas morals emphasize the widely held communal or societal norms about right and wrong.[13]

EXHIBIT 1.2 Comparison of Morals and Ethics[14]

BASIS FOR COMPARISON	MORALS	ETHICS
Meaning	Morals are the beliefs of the individual or group as to what is right or wrong	Ethics are the guiding principles that help the individual or group to decide what is good or bad
Application	General principles set by group	Response to a specific situation
Governed By	Social and cultural norms	Individual or legal and professional norms
Deals with	Principles of right and wrong	Right and wrong conduct
Consistency	Morals may differ from society to society and culture to culture	Ethics are generally uniform
Expression	Morals are expressed in the form of general rules and statements	Ethics are abstract

Difference between Values and Morals

Values are basic and fundamental beliefs that govern our actions and represent the intention behind purposeful action. They are the foundation of the choices we make. We conceive of it as something that is important to an individual (personal values), a community (societal values), and to a profession (professional values). Values can be distinguished from morals as described in **Exhibit 1.3** below.

Values have intrinsic worth but are not necessarily universally accepted. For example, the right of free speech that is guaranteed by the U.S. Constitution is a community-wide norm that governs behavior in American society. In other countries, such as North Korea, citizens cannot practice free speech.

Moral values underlie what is considered right and wrong by an individual or community. It is the foundation of a person's ability to judge between right and wrong. 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.

Moral values enable a person to make proper judgments in a specific situation. For example, cheating on a college exam is wrong while studying hard to ace the exam is right. Conversely, if someone values achievement and success over honesty, that person may opt to cheat on the exam in order to achieve the desired result. This relates to which value is "worth more" to the individual.

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 strive to consider the interests of others in deciding what to do. 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.

EXHIBIT 1.3 Comparison of Morals and Values

BASIS FOR COMPARISON	MORALS	VALUES
Meaning	Morals are the beliefs of the individual or group as to what is right or wrong	Values are fundamental beliefs that govern actions
Application	General principles set by group	Beliefs that reflect individual, community, and professional values
Governed By	Social and cultural norms	Individual and professional norms
Consistency	Morals may differ from society to society and culture to culture	Values are specific to an individual or group
Examples	Always tell the truth do not cheat, treat others fairly, be kind to others	Accounting Profession: independence, integrity, objectivity, professional skepticism, due care

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 United States, 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 but 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.

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 your boss 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 their needs) above those of the firm (to get the new business and not upset the boss).

Sometimes a moral point of view, such as cheating is bad, gets obscured by rationalizations by the decision-maker. Two examples are student cheating and social media activities.

Student Cheating

Kessler International surveyed students about cheating that shows students are cheating frequently using a variety of methods, many of which are chosen because of the advent of online schools and mobile devices. In total, Kessler surveyed 300 students from both public and private colleges and universities, including online universities.

The survey found:[15]

- 86 percent of the students surveyed claimed they cheated in some way in school.
- 54 percent of the students surveyed indicated that cheating was OK. Some went so far as to say it is necessary to stay competitive.

- 97 percent of the admitted cheaters say that they have never been identified as cheating.
- 76 percent copied word for word someone else's assignments.
- 79 percent of the students surveyed admitted to plagiarizing their assignments from the Internet or citing sources when appropriate.
- 42 percent indicated that they purchased custom term papers, essays, and thesis online.
- 28 percent indicated that they had a service take their online classes for them.
- 72 percent indicated that they had used their phone, tablet, or computer to cheat in class.
- Only 12 percent indicated that they would never cheat because of ethics.

It is disappointing to find out that only 12 percent used ethics to determine not to cheat. The rest seem oblivious to the fact that cheating is morally wrong. By cheating, students gain an unfair advantage over their honest classmates. Taken to its extreme, cheating your way through college may result in a higher grade point average but you learn less than one who acted morally. How will this help you to pass the certified professional accountant's exam (CPA)? Have you thought about interviewing for a job and starting by having a falsehood on your resume? How would you feel if your employer gives you an assignment, which should be easy for a student with a high GPA, but it is difficult for you because you never honestly studied and learned what the assignment is all about? These are questions that get to the core of ethics—making ethical judgments.

It is worth noting that at the time of this writing, Georgia Tech and Boston University were investigating whether students cheated during at-home online exams amid the COVID-19 pandemic. It appears that some students had others take exams for them and some shared answers to online exams. If students were caught cheating in this way it means they ignored the academic conduct code.

There are those occasions where faculty or the university promotes cheating even though they know it is wrong. A case in point is the so-called paper-class scandal 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.

University of North Carolina athletes weren't the only group benefiting from the 18-year, 3,100-student cheating scandal—fraternity members did, too. More than 700 fraternity brothers, and some sorority sisters, took the no-attendance, no-professor, one-assignment "paper classes" that earned them easy A's and B's. **Exhibit 1.4** provides additional information about the scandal.

EXHIBIT 1.4 Student Cheating Scandal 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." 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.

(continued)

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.[16]

* Source: Marc Tracy, N.C.A.A.: North Carolina Will not Be Punished for Academic Scabdal, October 13, 2017, New York Times, Available at: https://www.nytimes.com/2017/10/13/sports/unc-north-carolina-ncaa.html

An ethical analysis of the scandal at UNC demonstrates ethical blindness. The athletic department and university 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 affected parties including other students who did not benefit from the paper classes. 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.

The UNC situation illustrates an ends-justify-the-means approach to decision making in that some faculty rationalized cheating by saying it was necessary to maintain eligibility for student athletes.

Social Networking

The term “social network” is how we connect to other people using a platform that supports online communication, such as Facebook, Instagram, or Twitter. Video sharing services such as Snapchat and Tiktok are popular among millennials and the Generation Zers. The use of such social networking sites raises many questions that pertain to ethics.

It is not unusual to read critical, harsh, or hurtful comments on social networking sites. The harsh comments may be designed to embarrass someone or make them feel bad about themselves, making the recipient angry. They may want to lash out on social media in revenge. Before you know it the tone of the conversation goes from insulting to abusive.

Taken to an extreme, the harmful comments can lead to real danger including cyberbullying, especially when young adults are the target of the online abusers. Here, the words said take the form of aggressive behavior that is hostile to the recipient. Cyberbullying can lead to depression and even thoughts of suicide.

Today we see examples of calling-out someone on social media or cancelling them. Mintz points out that there is a difference between calling someone out and cancelling them. In the call-out culture a mistake, ill-advised statement, or other expression of one’s views are taken to be a misstep—an error of judgment—that doesn’t define that person. Oftentimes it occurred years ago. It might have been a questionable post on twitter. By calling-out the individual, we allow for the fact that they can learn and do better the next time.[17]

The motivation for cancelling someone is a lack of respect for something they said or did such as making offensive comments toward another. It is much more extreme than just calling them out. It has as its goal embarrassing them in their community. It’s a form of social and cultural boycott driven by “groupthink” that manifests itself through intolerance of others with a point of view that diverges from group norms. Ironically, if a member of the cancelling group does not go along with the prevailing views of the group they may be canceled themselves.

The cancel culture can create an ethical slippery slope event. Where do we draw the line between a statement or action that should be canceled and one that should only be called-out or even ignored?

Cancelling someone promotes intolerance and stifles diversity of speech. It can promote shame and a feeling that one has committed an offense that likely would be universally condemned by offended parties and society in general.

Cancelling is the opposite of being understanding, kind, and compassionate. After all, we should be willing to forgive others if they admit their mistake, are remorseful, make amends, promise not to do again, and change their behavior accordingly.

Examples of the cancel culture range from those who seem to deserve to be expelled from the Hollywood community, such as Harvey Weinstein, to those who make comments offensive to some people or groups. Weinstein, who was accused by more than 40 women of sexual abuse and harassment, exacted sexual favors from actresses in return for stardom.

Many well-known people have been cancelled because of racist tweets including actor Kevin Hart and television star Rosanne Barr. While these abhorrent comments may justify cancelling the offender, a valid question is: How far should we go to cancel someone? After all, the right to free speech is guaranteed by the U.S. Constitution. However, this raises the ethical point that just because someone has a right to do or say something that doesn't mean it is the right thing to do.

The Six Pillars of Character

LO 1-2

Explain how characteristic traits of behavior influence 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? Would your action change if your son or daughter were in the car? 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."[18]

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.[19]

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. There are two elements of honesty: (1) not making a statement that deceives others, or a lie of commission, and (2) failing to mention something that someone has a right to know or purposefully leaving it out, which is a lie by omission.

Some people believe "white lies" are acceptable behavior when it is a lie about a small or unimportant matter that someone tells to avoid hurting another person. For example, someone gives you a gift for your birthday you don't like. Do you say you don't like it or something such as "Thanks for the thoughtful gift?" Here, we could justify the latter because kindness and caring about the other person outweighs being truthful. So, two of these values may conflict and a decision made which is more important. The danger of telling a white lie is we may have to perpetuate the lie or continue to create more lies to cover our tracks.

Integrity

The integrity of a person is an essential element in trusting that person. 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 their 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.*

Reliability

The promises that we make to others are relied on by them, and we have a moral duty to follow through with action. A reliable person can be counted on because they are dependable and always try to do the right thing. Our ethical obligation for promise keeping includes avoiding bad-faith excuses and unwise commitments. For example, you should not agree to go out on a date with someone and then back away because something better comes up.

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 all the way up to the partner in charge of the engagement and tell them. Your ethical obligation is to report what you have observed to your supervisor and let them 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. Here ethical values conflict. 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.

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.[20]

Respect is an element of the cancel culture. When someone acts in an offensive way it could lead to the loss of respect and being cancelled. On the other hand, we should respect those who have earned our admiration by doing things that conform to the ethical values.

It seems more and more today that we are having trouble talking to each other in a civil manner. Arguments break out because of differences of opinion. Name calling is on the rise. We, must, as a society, learn how to disagree with each other without being disagreeable.

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.[21]

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." We should never blame another person for our failings in life. We need to accept responsibility for our 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."[22]

The problem sometimes is what seems fair to one person or group seems unfair to another. For example, if a department head has limited funds for bonuses and chooses one group of people over another, those passed over may think they have been unfairly treated while those receiving bonuses believe they deserved it.

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.[23] 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."[24]

Kind people are willing to go out of their way to help others and they do not expect anything in return. The act itself is enough and can enhance their feeling of self-worth. One form of kindness is a random act of kindness that is unplanned; they are spontaneous. You may do them because of the way you feel at the moment. For example, you may offer to cover the shift of a coworker who just found out their child is sick and needs to be picked up at school.

Citizenship

Josephson points out that "citizenship includes civic virtues and duties that prescribe how we ought to behave as part of a community."[25] An important part of good citizenship is to obey the laws, be informed about the issues, volunteer in your community, and vote in elections.

Another important part of citizenship is to act in the common good. A good example is the call to action to wear a mask and practice social distancing during the recent COVID-19 pandemic. We were not only doing it for ourselves but for the health and welfare of others in our community.

Civility is an important part of being a good citizen. It is much more than acting politely and respectfully toward others. It means to avoid harmful actions toward others. Verbal or physical attacks on others, cyber bullying, rudeness, religious intolerance, discrimination, and vandalism are just some of the acts that are generally considered acts of incivility. By acting civilly toward other, we can foster civic discourse in society.

The 2019 annual poll on civility in society by Weber Shandwick continues to show that a vast majority of Americans—93 percent—identify incivility as a problem in society, with most classifying it as a "major" problem (68%). According to the poll, the consequences of incivility include: (1) cyberbullying (89%); (2) harassment (88%); (3) violent behavior (88%); (4) hate crimes (88%); (5) intimidation and threats (87%); (6) intolerance (87%); (7) people feeling less safe in public places (87%); (8) discrimination and unfair treatment of certain groups of people (84%); (9) less community engagement (79%); and (10) feelings of isolation and loneliness (78%).[26]

Virtues such as respect, kindness, caring, empathy, and responsibility are all elements of a civil society. Those who practice it would never engage in these acts and should speak out when others do as well.

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.

There is a saying that it takes a long time to build a reputation for trust but not very long to lose it. Lance Armstrong is a case in point.

Moral Courage

Moral Courage means to act for moral reasons and stand up for what you believe regardless of any negative consequences for yourself, such as ridicule, punishment, loss of job, or social status.

A good example of when it would have been important to act with moral courage is the hazing incident that occurred at Louisiana State University in the 2018 fall semester. Members of Delta Kappa Epsilon forced pledges to lie in piles of broken glass, kicked them with steel-toed boots, urinated on them, and committed acts of abuse.

Imagine you are a fraternity brother witnessing these incidents. Recognizing the dangers to the pledges, you want to do something about it but are concerned about the reaction of your fraternity brothers. If you act at that moment, you may suffer abuse either verbal or physical. If you fail to act, then you have given in to fear of the consequences rather than doing the right thing. If you act with moral courage, you would do something about the situation while also minimizing the risk of harm to yourself.

So, what are your choices? Speaking to the brothers and discussing the dangers is a start. You could report it to the university administration if the brothers fail to act. Much like whistleblowing, the first attempt should be to take care of the matter internally among those involved. If that does not work, reporting the matter to the Interfraternity Council might be the next step even though it involves external whistleblowing where you could be labeled disloyal. But remember loyalty should never be used to mask higher ethical values such as caring and concern for others and one's responsibility to right a wrong.

Modern Moral Philosophies

LO 1-3

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 dilemmas 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 R. 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.[27]

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 1.5** presents the underlying framework for ethical decision making for each of the moral philosophies. It describes how each method is used to make ethical judgments. Students should use this exhibit as a road map to ethical decision making as it simplifies the discussion in the text of complex philosophical issues.

EXHIBIT 1.5 Understanding Ethics as a Framework for Guiding Behavior

Philosophical Method	**Proponents → Basis for Moral Behavior → Achieving Moral Excellence → End Goal**			
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	Make decisions that produce the best consequences for oneself and others without violating certain 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

(continued)

Philosophical Method	Proponents → Basis for Moral Behavior → Achieving Moral Excellence → End Goal			
(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 "[do] the act that promotes the greatest good for oneself."[28] 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. It may or may not be moral to never promote it based on the version used. Thus, there are conditions in which the avoidance of personal interest may be a moral action.[29]

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.[30]

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—that is, one would equate doing harm with one's own best interest. The ethical egoist could logically pursue their interests at the cost of others.[31]

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.[32] 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.

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.[33] 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.

Let's examine the following example from the perspectives of egoism and enlightened egoism. The date is Friday, January 17, 2021, 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, 2020, 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.

However, 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 percent of the overall accounts receivable balance on December 31, 2020.

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 their long-run interests to go along with the firm's position to support the client because they may not advance within the firm unless they are 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 requiring a decision (i.e., the use of 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, that is, 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."[34]

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.

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 their own best interests but not the public interest. Moreover, individuals 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 that bring about the greatest good for the greatest number of people affected by a decision.[35]

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.[36] 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). As their basis for moral behavior evolved over the years, Utilitarians differed 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.[37] 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. 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? 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. 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. 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.[38]

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.[39] 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.[40]

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. 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.[41] 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.

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 them 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 themself.[42]

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."[43] 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.[44]

One problem with deontology is when the rights of two groups conflict. For example, it is still legal for a private golf club to permit one group to join, such as men, but deny the same right to others, namely women. A private membership club, as it is sometimes called, is one that is explicitly *not* open to the public. In these situations, either club's rights are violated or individual rights are violated by not being allowed to join. Here, social or personal costs must be identified and weighed; rights cannot be the only consideration when making ethical choices.

In accounting, 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. But, never forget that the rights of investors and creditors must come first and not be masked by perceived obligations to ourselves and others.

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 they deserve. *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 based on Liberty and Difference principles.[45]

Rawls argues that 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 rules. 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.*[46]

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. However, 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.

For purposes of future discussions about ethical decision making, we elaborate on the concept of *procedural justice.* Procedural justice is the idea that fairness in the processes should resolve disputes and allocate resources. 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.[47] 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

One of the differences between virtue theory and the other moral philosophies is that virtue theory focuses on both the person engaging in the act and the act itself, whereas the latter focuses only on the act. 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.[48]

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.[49] 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 1.6**. We elaborate on these judgments throughout the book. Students should use this exhibit as a road map to how ethical decisions should be made as it simplifies the discussion in the text of complex ethical reasoning methods.

EXHIBIT 1.6 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

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.[50] 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 depend 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.[51]

- 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

Cultural 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 bullfighting, 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 bullfighting that it is "a decadent art in every way. . .[and] if it were permanent it could be one of the major arts."[52] 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.[53]

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."[54]

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. Imagine if you were the person hiding Anne Frank and her family. One day Nazi soldiers came banging on your door and demanded, "Do you know where the Frank's are? A strict application of rights theory requires that you tell the truth. However, isn't this situation one in which an exception to the rule should come into play for humanitarian reasons? In other words, situational ethics is looking past the standard of right and wrong and performing what the circumstances demand.

The Public Interest in Accounting

LO 1-4

Describe how professional accountants serve the public interest and their obligations under the AICPA Code.

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). Since it is impracticable to review all 55 state board rules, and many of them are similar, we will refer to the ethics standards of the American Institute of Certified Professional Accountants (AICPA) in **Chapter 4** to illustrate those rules.

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.[55] 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.[56]

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.[57]

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 431,000 members in 130 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 125,000 members from organizations of all sizes and structure, including family-run businesses, private firms, not-for-profit organizations, government and academic institutions, small and large publicly traded companies, and multi-national corporations. The IMA represents itself as The Association of Accountants and Financial Professionals in Business. Its Statement of Ethical 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 1.7**.

EXHIBIT 1.7 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 member 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

IMA members have a responsibility to comply with and uphold the standards of Competence, Confidentiality, Integrity, and Credibility. Failure to comply may result in disciplinary action.

I. Competence

1. Maintain an appropriate level of professional leadership and expertise by enhancing 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. Recognize and help manage risk.

II. Confidentiality

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

III. Integrity

1. Mitigate actual conflicts of interest. Regularly communicate with business associates to avoid apparent conflicts of interest. Advise all parties of any potential conflicts of interest.
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.
4. Contribute to a positive ethical culture and place integrity of the profession above personal interests.

(continued)

IV. Credibility

1. Communicate information fairly and objectively.
2. Provide all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, analyses, or recommendations.
3. Report any delays or deficiencies in information, timeliness, processing, or internal controls in conformance with organization policy and/or applicable law.
4. Communicate professional limitations or other constraints that would preclude responsible judgment or successful performance of an activity.

Resolving Ethical Issues

In applying the Standards of Ethical Professional Practice, the member may encounter unethical issues or behavior. In these situations, the member should not ignore them, but rather should actively seek resolution of the issue. In determining which steps to follow, the member should consider all risks involved and whether protections exist against retaliation.

When faced with unethical issues, the member should follow the established policies of their organization, including use of an anonymous reporting system if available.

If the organization does not have established policies, the member should consider the following courses of action:

- The resolution process could include a discussion with the member's immediate supervisor. If the supervisor appears to be involved, the issue could be presented to the next level of management.
- IMA offers an anonymous helpline that the member may call to request how key elements of the *IMA Statement of Ethical Professional Practice* could be applied to the ethical issue.
- The member should consider consulting their own attorney to learn of any legal obligations, rights, and risks concerning the issue.

If resolution efforts are not successful, the member may wish to consider disassociating from the organization.

Other professional organizations include The Institute of Internal Auditors (IIA), Association of Certified Fraud Examiners (ACFE), and The International Federation of Accountants IFAC. Similar to the IMA code, internal auditors are held to standards that address their competence, integrity, and objectivity (credibility). 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.

Regulation in the accounting profession is a necessary but insufficient condition to ensure ethical and professional behavior occurs; ethics education on an ongoing basis is an essential ingredient through ethics courses in college and in continuing professional education. The key is to develop an ethical culture to support ethical behavior by setting an ethical tone at the top. This will be further explored in **Chapters 2** and **3**.

AICPA Code of Conduct

Principles in the Code

The Principles of the AICPA Code are aspirational statements that form the foundation for the Code's enforceable rules. The Principles guide members in the performance of their professional responsibilities and call for an unyielding commitment to honor the public trust, even at the sacrifice of personal benefits. While CPAs cannot be legally held to the Principles, they do represent the expectations for CPAs on the part of the public in the performance of professional services. In this regard, the Principles are based on values of the profession and traits of character (virtues) that enable CPAs to meet their obligations to the public.

The Principles include (1) Responsibilities, (2) The Public Interest, (3) Integrity, (4) Objectivity and Independence, (5) Due Care, and (6) Scope and Nature of Services.[58]

The umbrella statement in the Code is that the overriding responsibility of CPAs is to exercise sensitive professional and moral judgments in all activities. By linking professional conduct to moral judgment, the AICPA Code recognizes the importance of moral reasoning in meeting professional obligations.

The second principle defines the public interest to include "clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of CPAs to maintain the orderly functioning of commerce."[57] This principle calls for resolving conflicts between these stakeholder groups by recognizing the primacy of a CPA's responsibility to the public as the way to best serve clients' and employers' interests. In discharging their professional responsibilities, CPAs may encounter conflicting pressures from each of these groups. According to the public interest principle, when conflicts arise, the actions taken to resolve them should be based on integrity, guided by the precept that when CPAs fulfill their responsibilities to the public, clients' and employers' interests are best served.

As a principle of CPA conduct, integrity recognizes that the public trust is served by (1) being honest and candid within the constraints of client confidentiality, (2) not subordinating the public trust to personal gain and advantage, (3) observing both the form and spirit of technical and ethical standards, and (4) observing the principles of objectivity and independence and of due care.

Objectivity requires that all CPAs maintain a mental attitude of impartiality and intellectual honesty and be free of conflicts of interest in meeting professional responsibilities. Objectivity pertains to all CPAs in their performance of all professional services. Independence applies only to CPAs who provide attestation services, not tax and advisory/consulting services. The audit opinion is relied on by external users—investors and creditors—thereby triggering the need to be independent of the client entity to enhance assurances. In tax and advisory engagements, the service is provided primarily for the client (internal user) so that the CPA might become involved in some relationships with the client that might otherwise impair audit independence but do not come into play when providing nonattest services; nonattest services do require objectivity in decision making and the exercise of due care.

The due care standard calls for continued improvement in the level of competency and quality of services by (1) performing professional services to the best of one's abilities, (2) carrying out professional responsibilities with concern for the best interests of those for whom the services are performed, (3) carrying out those responsibilities in accordance with the public interest, (4) following relevant technical and ethical standards, and (5) properly planning and supervising engagements. A key element of due care is professional skepticism, which means to have a questioning mind and critical assessment of audit evidence.

The importance of the due care standard is as follows. Imagine if a CPA were asked to perform an audit of a school district and the CPA never engaged in governmental auditing before and never completed a course of study in governmental auditing. While the CPA or CPA firm may still obtain the necessary skills to perform the audit—for example, by hiring someone with the required skills—the CPA/firm would have a hard time supervising such work without the proper background and knowledge.

Recall from the introduction that accountants are rated high in honesty and ethics. There is no doubt that part of the reason is a commitment to professionalism through the AICPA Code. Beyond that, regardless of the form of practice all accounting professionals should be able to apply moral reasoning to resolve ethical dilemmas that may exist between accountants and auditors, and top management and clients in order to act in the public interest.

Application of Ethical Reasoning in Accounting

LO 1-5

Apply the Principles of the AICPA Code of Conduct and ethical reasoning methods to a case study.

In this section, we discuss the application of ethical reasoning to a common dilemma faced by accountants. The case deals with the classic example of prematurely recording revenue to inflate earnings and make it look as though the company is doing better than it really is.

3D Printing Case Study

3D Printing, a privately held company, was formed in March 2020 after a successful Kickstarter funding campaign. The project to develop the first jet fusion printer brought in $1.1 million, 10 percent above its goal. The company has struggled through its first full year of operations and is now preparing its financial statements for fiscal year end September 30, 2021. Kyle Bloom is the chief executive officer (CEO) of the company. He reports to a 12-member board of directors. Madison Rose is the chief financial officer (CFO). She holds the CPA certificate.

Kyle is meeting with Madison on October 5, 2021, to review the financial statements. The key issue being discussed is recording revenue on a $200,000 order from A-1 Printers. It seems the product won't be shipped until October 15, 2021, yet Kyle wants Madison to include the $200,000 in the current year earnings since that amount was received on September 30, 2021.

The following is an overview of the October 5 meeting.

Kyle:	Madison, you have to include the $200,000 from A-1 Printers in revenue for this year
Madison:	I can't. Generally Accepted Accounting Principles (GAAP) require at least shipment of the product to A-1 as of September 30
Kyle:	You know we will ship the product in ten days. What's the big deal? You know our Kickstarter funds have run out so I'm in negotiations with our bank to borrow $10 million for continued expansion of our product line. Omitting the $200,000 means our net income will be $50,000, 80 percent below the target we announced. There's no way we'll get the loan. Production will be halted and layoffs will begin
Madison:	I understand and don't want to be held responsible for missing our targets. Still, it's better to take the hit to earnings now and record the revenue next year when it can put us over the top with respect to targeted earnings
Kyle:	I'll worry about next year, next year. If you prefer, we can adjust out the $200,000 in the first quarter of fiscal year 2022 as a prior period adjustment to retained earnings
Madison:	Has the board of directors approved it?
Kyle:	Don't worry about the board. I'll take care of them

At this point, the meeting broke up and Madison was told to make the adjustment and include the $200,000 revenue this year. The last thing Kyle said to Madison was that she is expected to be a team player.

What should Madison do?

Principles of the AICPA Code of Professional Conduct

Madison is an internal accountant so the independence standard doesn't apply.

Objectivity requires that Madison should make decisions impartially and based on professional standards, and not allow herself to be pressured by Kyle. She knows that recording premature revenue in the current fiscal year is wrong under GAAP.

Integrity requires that Madison should not subordinate her judgment to that of Kyle regardless of the personal and professional costs. If she gives in to Kyle now, then further down the line he may expect her to do the same. She may wind up sliding down the ethical slippery slope where there is no turning back.

Ethical Reasoning Methods

<u>Categorical Imperative:</u> (Rights Theory): Madison knows that Kyle's proposed revenue recognition is not a universally accepted method. It accelerates revenue into an earlier period than justified. She would not want (or expect) other accountants to record the revenue as proposed, so why should she? Kyle is promoting an "ends justify the means" approach to decision making (consequentialism) in that the revenue needs to be recorded in fiscal year ended 2021 to obtain the needed financing regardless of the method used to do it. The Public Interest is represented by current investors and creditors, and the bank financing the $10 million. They have an ethical right to receive accurate and reliable financial statements and Madison has an ethical duty to see to it that the financial statements do just that.