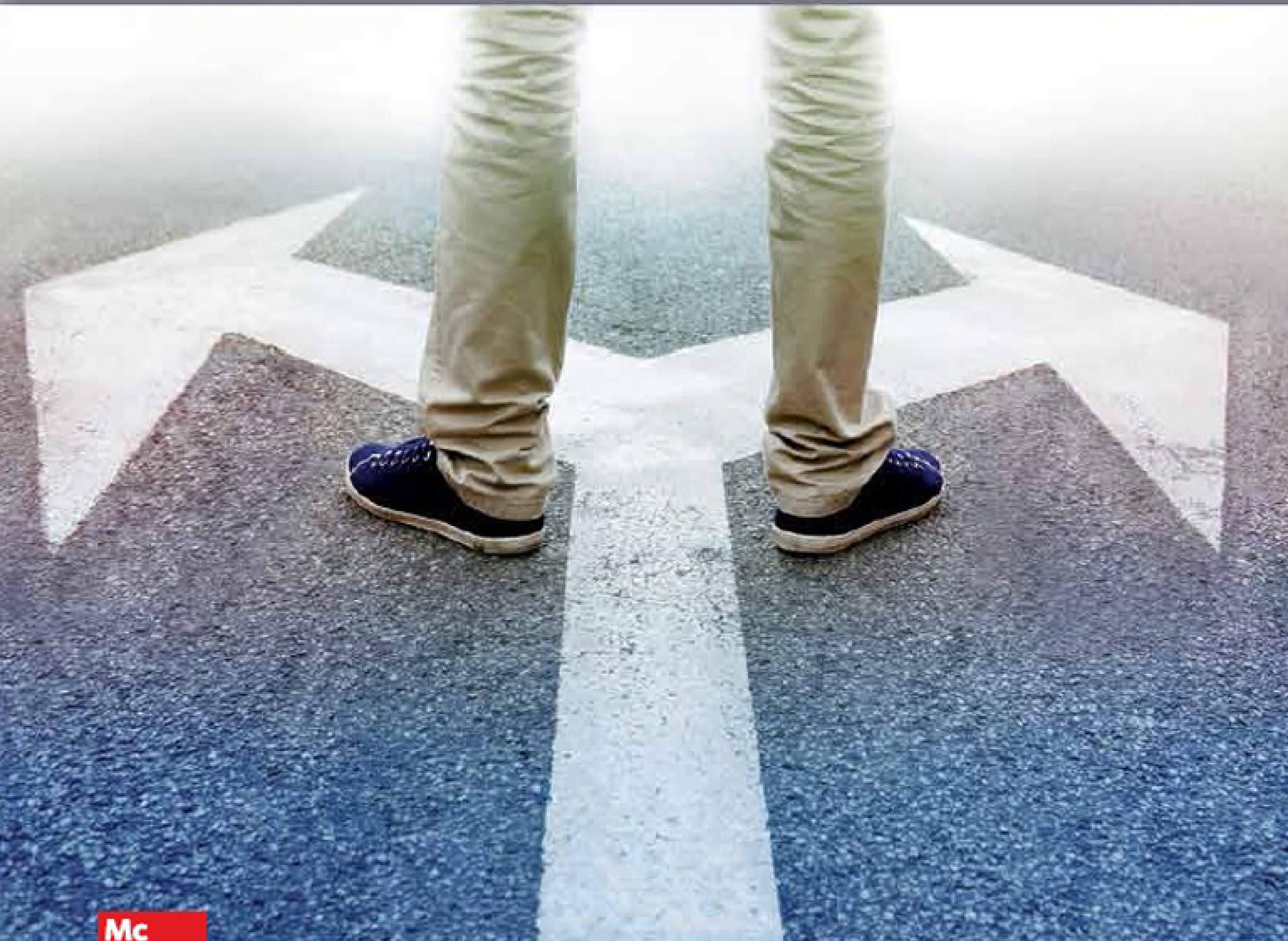
Ethical Obligations and Decision Making in ACCOUNTING

TEXT AND CASES

Fourth Edition



McGraw Hill Education

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Text and Cases

Fourth Edition

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ETHICAL OBLIGATIONS AND DECISION MAKING IN ACCOUNTING: TEXT AND CASES,
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Dedication

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

What Aristotle meant by this statement is intelligence that is not informed by our hearts--by compassion--is not really intelligent at all. We strive in this book not only to educate accounting students to be future leaders in the accounting profession but to stimulate your ethical perception and cultivate virtue thereby awakening your sense of duty and obligation to the public interest.

About the Authors

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

Roselyn E. Morris, Ph.D., CPA, is a professor of accounting in the Accounting Department at the McCoy College of Business, Texas State University–San Marcos. Dr. Morris received her Ph.D. in business administration from the University of Houston. She is a past president of the Accounting Education Foundation and chair of the Qualifications Committee of the Texas Board of Public Accountancy. Dr. Morris has received the Outstanding Educator Award from the Texas Society of CPAs.

Both Professors Mintz and Morris have developed and teach an accounting ethics course at their respective universities.

Preface

Ethical Obligations and Decision Making in Accounting was written to guide students through the minefields of ethical conflict in meeting their responsibilities under the professions' codes of conduct. Our book is devoted to helping students cultivate the ethical commitment needed to ensure that their work meets the highest standards of integrity, independence, and objectivity. An expanded discussion of professional judgment highlights the challenges to ethical decision-making for internal accountants and auditors, and external auditors. We hope that this book and classroom instruction will work together to provide the tools to help students to make ethical judgments and carry through with ethical actions.

The fourth edition of *Ethical Obligations and Decision Making in Accounting: Text and Cases* incorporates a behavioral perspective into ethical decision-making that encourages students to get in touch with their values and learn how to voice them in the workplace when conflicts arise and ethical dilemmas exist. We build on traditional philosophical reasoning methods by taking the process one step further, that is, to convert ethical intent into ethical action. The "Giving Voice to Values" (GVV) approach provides this link. If accounting professionals are successful in voicing values in a way that encourages doubters and detractors to join the effort, then there may be no need for whistle-blowing. We also connect many of the issues discussed in the book with a new final chapter on "Ethical Leadership."

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

- encouraging students to make decisions in accordance with prescribed values, attitudes, and behaviors
- providing a framework for ethical reasoning, knowledge of professional values and ethical standards
- prescribing attributes for exercising professional skepticism and behavior that is in the best interest of the investing and consuming public and the profession.

What's New in the 4th Edition?

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

- **Connect is available for the first time** 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.
- **Giving Voice to Values (GVV)** approach is explained in Chapter 2 and used throughout the text. GVV is an innovative pedagogical method that complements the traditional philosophical reasoning

approaches to ethical decision-making by emphasizing developing the capacity to express one's values in a way that positively influences others. The technique is used post-decision-making and is based on developing and fine-tuning an action plan using scripting and rehearsal. It is ideal for role-playing exercises.

- **International** auditing and ethics issues are incorporated into existing chapters.
- Added five new **Discussion Questions** to each chapter as well as revised questions with more current topics and issues.
- Replaced many of the **cases** with more current and topical issues. Eighteen of the 76 cases have been specifically developed to enable students to practice the "Giving Voice to Values" technique in the context of the decision-making model.
- **Expanded the discussion of whistleblowing obligations** of accounting professionals in Chapter 3 including guidelines for reporting under Dodd-Frank and the AICPA rules of conduct.
- Added a comprehensive section on **professional judgment** in accounting and auditing to Chapter 4 and models for making judgments and exercising professional skepticism.
- Updated Chapter 4 to incorporate the **Revised AICPA Code of Professional Conduct**.
- **Expanded** the discussion of the PCAOB inspection process in Chapters 5 and 6 for audits of companies listing stock in the U.S., including Chinese companies and audit deficiencies noted in inspections of U.S. companies.
- Updated case examples used throughout the text to describe **earnings management** techniques with expanded coverage in Chapter 7.
- New Chapter 8 on **"Ethical Leadership"** that ties together many of the topics in the chapters in the text. Ethical leadership is explored in the context of making ethical decisions and judgments in the performance of professional accounting services.
- Improved and expanded the scope of major cases that can be used as an end-of-course project to enhance the experiences of upper-division undergraduates and graduate students.
- Revised and greatly enhanced **Instructor's Resource Materials** and supplements.

Chapter 1

- **New** discussion of the use of social networks and social media communications, personal responsibility, and workplace ethics.
- Expanded discussion of moral philosophies and implications for ethical reasoning in accounting and auditing.
- Expanded discussion of the Principles of the AICPA Code of Professional Conduct, the public interest obligation, and regulation in the accounting profession.

Chapter 2

- **New** discussion of moral intensity and influence on ethical decision making.
- **New** discussion of Kidder's Ethical Checkpoints and link to moral action.
- Expanded discussion of Behavioral Ethics and cognitive development.
- **New** and comprehensive discussion of the **GVV** technique that provides a mechanism for students to act on ethical intent. Chapter 2 discusses the foundation of the approach including examples on applying the methodology. There are **five cases** in the chapter to engage students in discussions of the **GVV** approach to ethical action. Subsequent chapters also contain cases with a **GVV** dimension.

Chapter 3

- **New** section on "Organizational Ethics and Leadership."
- **New** discussion of "Character and Leadership in the Workplace."
- Updated results from the National Business Ethics Survey, Association of Certified Fraud Examiners Global Survey, and KPMG Integrity Survey.
- Expanded discussion of financial statement fraud schemes.
- **New** discussion of the morality of whistleblowing.
- Added discussion of major whistleblower case of *Anthony Menendez v. Halliburton, Inc.*
- Expanded discussion of Dodd-Frank provisions for whistleblowing by internal accountants and auditors, and external auditors including when external auditors can blow the whistle on their audit firms.
- Expanded discussion of subordination of judgment rules and their application to whistleblowing.

Chapter 4

- **Extensive new discussion** of professional judgment in accounting.
- Added an explanation of KPMG Professional Judgment Framework.
- Expanded discussion of professional skepticism.
- **New** discussion of professionalism and commercialism.
- **Comprehensive** discussion of the **Revised AICPA Code of Professional Conduct** including: Conceptual Framework for Members in Public Practice and Conceptual Framework for Members in Business.
- **New** discussion of ethical conflict requirements and decision-making model under the Revised Code.
- Expanded discussion of AICPA Conceptual Framework for Independence Standards.
- Expanded discussion of integrity and subordination of judgment rules.
- **New** discussion of confidentiality and disclosing fraud.
- Expanded discussion of ethics in tax practice.
- Expanded discussion of "Insider Trading" cases against CPAs.
- **New** discussion of Global Code of Ethics.

Chapter 5

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

Chapter 6

- **New** cases that explore in depth legal obligations of accountants and auditors.
- Expanded discussion of auditor legal liabilities.
- Expanded section on legal liabilities under Sarbanes-Oxley.
- **New** discussion of International Financial Reporting Standards and international enforcement.
- **New** discussion of principles versus rules-based standards and SEC position on objectives-oriented standards.
- **New** section on "Compliance and Management by Values."
- **New** section on "Global Ethics, Fraud, and Bribery" and the Foreign Corrupt Practices Act.
- Expanded discussion on regulatory issues and PCAOB inspections.

Chapter 7

- **New** section on "Non-Financial Measures of Earnings."
- Expanded discussion of earnings management and professional judgment.
- Expanded discussion of the use of accruals and earnings management.
- Introductory discussion of new revenue recognition standard.
- Detailed examples of financial statement restatements of Hertz Corporation and Cubic Corporation, and CVS-Caremark merger.

Chapter 8 – New Chapter on Ethical Leadership

Chapter 8 links back to discussions in Chapters 1 through 7 by incorporating material on "Ethical Leadership." The purpose is to leave students with a positive message of the importance of being a leader and ethical leadership in building organizational ethics. Leadership in decision-making in accounting, auditing, tax, and advisory services engagements is addressed. The chapter includes 20 discussion questions and 6 new cases. The chapter includes the following major topics:

- Discussion of moral decision-making and leadership.
- Exploring different types of leaders: authentic leaders, transformational leadership, followership and leadership, and how social learning theory influences leadership.
- Revisiting moral intensity in the context of ethical leadership.
- Ethical leadership and internal audit function.
- Ethical leadership and tax practice.
- Gender influences in leadership.
- Causes of leadership failures.
- Case studies on ethical leadership.
- Implications of ethical leadership for whistleblowing activities.
- Values-based leadership.
- Ethical leadership and the GVV technique.
- Ethical leadership competence.

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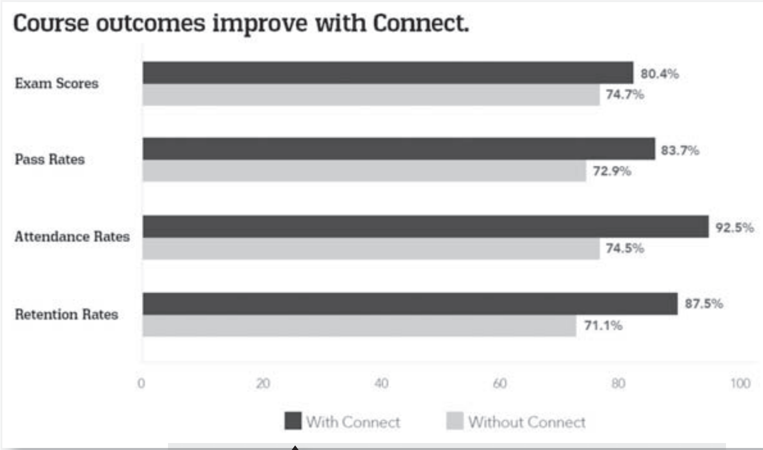

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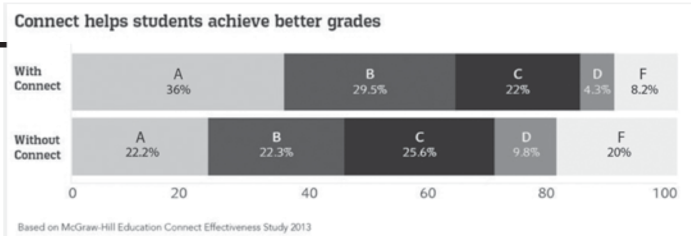

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Acknowledgments

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

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

Case Descriptions

Case #	Case Name/Description
1-1	**Harvard Cheating Scandal** *Student cheating at Harvard raises questions about responsibilities of instructors and student personal responsibilities.*
1-2	**Giles and Regas** *Dating relationship between employees of a CPA firm jeopardizes completion of the audit.*
1-3	**NYC Subway Death: Bystander Effect or Moral Blindness** *Real-life situation where onlookers did nothing while a man was pushed to his death off a subway platform.*
1-4	**Lone Star School District** *Failure to produce documents to support travel expenditures raises questions about the justifiability of reimbursement claims.*
1-5	**Reneging on a Promise** *Ethical dilemma of a student who receives an offer of employment from a firm that he wants to work for, but only after accepting an offer from another firm.*
1-6	**Capitalization versus Expensing** *Ethical obligations of a controller when pressured by the CFO to capitalize costs that should be expensed.*
1-7	**Eating Time** *Ethical considerations of a new auditor who is asked to cut down on the amount of time that he takes to complete audit work.*
1-8	**Shifty Industries** *Depreciation calculations and cash outflow considerations in a tax engagement.*
1-9	**Cleveland Custom Cabinets** *Ethical and professional responsibilities of an accountant who is asked to "tweak" overhead to improve reported earnings.*
1-10	**Better Boston Beans** *Conflict between wanting to do the right thing and a confidentiality obligation to a coworker.*

Case #	Case Name/Description
2-1	**A Team Player (a GVV case)** *Ethical dilemma for audit staff member who discovers a deficiency in inventory procedures but is unable to convince the group to report it. Application of Giving Voice to Values approach.*
2-2	**FDA Liability Concerns (a GVV case)** *Conflict between a chef and CFO over reporting bacteria found in food and FDA inspection results. Application of GVV approach.*
2-3	**The Tax Return (a GVV case)** *Tax accountant's ethical dilemma when asked by her supervisor to ignore reportable lottery winnings. Application of GVV approach.*
2-4	**A Faulty Budget (a GVV case)** *Ethical and professional responsibilities of an accountant after discovering an error in his sales budget. Application of GVV approach.*
2-5	**Gateway Hospital (a GVV case)** *Behavioral ethics considerations in developing a position on unsubstantiated expense reimbursement claims. Application of GVV approach.*
2-6	**LinkedIn and Shut Out** *Small business owner's inability to gain support from LinkedIn after a contact in his professional network scams him out of $30,000.*
2-7	**Milton Manufacturing Company** *Dilemma for top management on how best to deal with a plant manager who violated company policy but at the same time saved it $1.5 million.*

2-8 Juggyfroot
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 Phar-Mor
SEC investigation of Phar-Mor for overstating inventory and misuse of corporate funds by the COO.

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

Case # Case Name/Description

3-1 The Parable of the Sadhu
Classic Harvard case about ethical dissonance and the disconnect between individual and group ethics.

3-2 Rite Aid Inventory Surplus Fraud
Dilemma of director of internal auditing whether to blow the whistle under Dodd-Frank on Rite Aid's inventory surplus sales/kickback scheme.

3-3 United Thermostatic Controls (a GVV case)
Acceptability of accelerating the recording of revenue to meet financial analysts' earnings estimates and increase bonus payments.

3-4 Franklin Industries' Whistleblowing (a GVV case)
Considerations of internal accountant how best to voice her values to convince others to act on questionable payments to a related-party entity.

3-5 Walmart Inventory Shrinkage (a GVV case)
Pressure to reduce inventory shrinkage at a Walmart store amidst alleged accounting improprieties and related efforts of the protagonist to voice values.

3-6 Bennie and the Jets (a GVV case)
Ethical and professional obligations in reporting accounting wrongdoing to higher-ups in the organization.

3-7 Olympus
Major corporate scandal in Japan where Olympus committed a $1.7 billion fraud involving concealment of investment losses through fraudulent accounting.

3-8 Accountant takes on Halliburton and Wins!
Violation of confidentiality provision in a whistleblowing case under SOX after Bob Menendez reported retaliation by Halliburton subsequent to informing the audit committee of improper revenue recognition policies using bill-and-hold transactions.

3-9 Bhopal, India: A Tragedy of Massive Proportions
Evaluation of the decision-making process before, during, and after the leak of a toxic chemical that killed or injured thousands.

3-10 Accountability of Ex-HP CEO in Conflict of Interest Charges
Sexual harassment charges stemming from conflict of interest between CEO/board chair and outside contractor.

Case # Case Name/Description

4-1 KBC Solutions
Concerns about professional judgments made by audit senior after the review of workpaper files.

4-2 Beauda Medical Center
Confidentiality obligation of an auditor to a client after discovering a defect in a product that may be purchased by a second client.

4-3 Family Games, Inc.
Ethical dilemma for a controller being asked to backdate a revenue transaction to increase performance bonuses in order to cover the CEO's personal losses.

4-4 Commercialism and Professionalism (a GVV case)
Ethical considerations in an alternative practice structure due to threats to independence; using GVV to resolve conflict.

4-5 Han, Kang & Lee, LLC
Pressure between audit partner who wants the client to write down inventory and other partners that want to keep the client happy.

4-6 Tax Shelters
Ethical dilemma of tax accountant in deciding whether to participate in tax shelter transactions targeted to top management of a client entity in light of cultural influences within the firm.

4-7 M&A Transaction
Ethical issues concerning a decision to provide merger and acquisition advisory services for an audit client.

4-8 Valley View Hospital
Ethical obligations of CPA in deciding whether to report a hospital/client for improper Medicare payments to the government because of a faulty Medicare accounting system.

4-9 AOL-Time Warner
Fall out after CFO of AOL blows the whistle on improper round-trip accounting procedures in AOL-Time Warner merger and is investigated himself for his part in the fraud by the SEC.

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

Case # Case Name/Description

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

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

5-3 Imperial Valley Community Bank
Role of professional skepticism in evaluating audit evidence on collectability of loans and going concern assessment.

5-4 Busy Season Planning
Role of review partner in planning an audit.

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

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

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

5-8 Bill Young's Ethical Dilemma
Options of a friend of an auditor advising the auditor following his inappropriate downloading of client information that shows bribery of foreign officials.

5-9 Royal Ahold N.V. (Ahold)
U.S. subsidiary of a Dutch company that used improper accounting for promotional allowances to meet or exceed budgeted earnings targets and questions about professional judgment by auditors.

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

Case #	Case Name/Description
6-1	**Advanced Battery Technologies: Reverse Merger** *Application of legal standards to assess auditor liability following a reverse merger transaction by a Chinese company.*
6-2	**Heinrich Müller: Big Four Whistleblower? (a GVV case)** *Ethical dilemma of tax accountant after finding confidential files of a client engaged in tax avoidance transactions in Liechtenstein in view of a culture of strict loyalty to the firm.*
6-3	**Richards & Co: Year-end Audit Engagement** *Questions about audit procedures used to assess client's improper use of a credit received from a client to prop up revenue in one year while agreeing to repay the supplier in the following year.*
6-4	***Anjoorian et al.:* Third-Party Liability** *Application of the foreseeability test, near-privity, and the Restatement approach in deciding negligence claims against the auditor.*
6-5	***Vertical Pharmaceuticals Inc. et al. v. Deloitte & Touche LLP*** *Fiduciary duties and audit withdrawal considerations when suspecting fraud at a client.*
6-6	**Kay & Lee LLP** *Auditor legal liability when foreseen third party relies on financial statement.*
6-7	**Getaway Cruise Lines: Questionable Payments to do Business Overseas (a GVV case)** *Ethical dilemma of Director of International Accounting in voicing her values with respect to a dispute within the company over how to report "questionable payments" made to a foreign government.*
6-8	**Con-way Inc.** *Auditor legal and audit responsibilities to assess facilitating payments and internal control requirements under the FCPA.*
6-9	***Satyam: India's Enron*** *Questions about corporate culture and fraud risk assessment surrounding CEO's falsification of financial information and misuse of corporate funds for personal purposes.*
6-10	***Autonomy*** *Investigations by U.S. SEC and UK Serious Fraud Office into accounting for an acquisition of a British software maker by Hewlett-Packard (HP).*

Case #	Case Name/Description
7-1	**Nortel Networks** *Use of reserves and revenue recognition techniques to manage earnings.*
7-2	**Solutions Network, Inc. (a GVV case)** *Ethical challenges of a controller in voicing values when the company uses round-trip transactions to meet earnings targets.*
7-3	**GE: "Imagination at Work"** *Assessing whether GE used earnings management techniques to accelerate revenue and meet financial analysts' earnings expectations.*
7-4	**Harrison Industries (a GVV case)** *Challenges faced by first-year accountant in voicing values upon questioning the appropriateness of recording an accrued expense.*
7-5	**Dell Computer** *Use of "cookie-jar" reserves to smooth net income and meet financial analysts' earnings projections.*
7-6	**Tier One Bank** *Failure of KPMG to exercise due care and proper professional judgment in gathering supporting evidence for loan loss estimates.*
7-7	**Sunbeam Corporation** *Use of cookie-jar reserves and "channel stuffing" by a turnaround artist to manage earnings.*

7-8 **Sino-Forest: Accounting for Trees**
Failure of Ernst & Young to follow generally accepted auditing standards and lapses in professional ethics related to Chinese company's nonexistent forestry assets; cultural considerations of doing business in China.

7-9 **The North Face, Inc.**
Questions about revenue recognition on barter transactions and the role of Deloitte & Touche in its audit of the client.

7-10 **Beazer Homes**
Use of cookie jar reserves to manage earnings and meet EBIT targets.

Case # **Case Name/Description**

8-1 **Research Triangle Software Innovations (a GVV case)**
Advisory services staff member recommends the software package of an audit client to another client and deals with push back from her supervisor who is pushing the firm's package; issues related to leadership and application of GVV in resolving the matter.

8-2 **Cumberland Lumber**
Difference of opinion between chief internal auditor and aggressive CFO about recording year-end accruals.

8-3 **Parmalat: Europe's Enron**
Fictitious accounts at Bank of America and the use of nominee entities to transfer debt off the books by an Italian company led to one of Europe's largest fraud cases.

8-4 **KPMG Tax Shelter Scandal**
Major tax shelter scandal case involving KPMG that explores ethical standards in tax practice and in developing tax positions on tax shelter products in a culture that promoted making sales at all costs.

8-5 **Krispy Kreme Doughnuts, Inc.**
Questions about ethical leadership and corporate governance at Krispy Kreme, and audit by PwC, with respect to the company's use of round-trip transactions to inflate revenues and earnings to meet or exceed financial analysts' EPS guidance.

8-6 **Rhody Electronics: A Difficult Client (a GVV case)**
Conflict between audit manager and controller over audit planning and execution and implications for ethical leadership.

Major Cases

Case # **Case Name/Description**

1 **Adelphia Communications Corporation**
SEC action against Deloitte & Touche for failing to exercise the proper degree of professional skepticism in examining complex related-party transactions and contingencies that were not accounted for in accordance with GAAP.

2 **Royal Ahold N.V. (Ahold)**
Court finding that Deloitte & Touche should not be held liable for the efforts of the client to deprive the auditors of accurate information needed for the audit and masking the true nature of other evidence.

3 **Madison Gilmore's Ethical Dilemma (a GVV case)**
Distinguishing between operational and accounting earnings management and efforts of controller to voice values and convince the CFO about inappropriateness of recoding revenue on a bill-and-hold transaction.

4 **Cendant Corporation**
SEC action against Cendant for managing earnings through merger reserve manipulations and improper accounting for membership sales, and questions about the audit of Ernst & Young.

5 **Vivendi Universal**
Improper adjustments to EBITDA and operating free cash flow by a French multinational company to meet ambitious earnings targets and conceal liquidity problems.

6 **Waste Management**
Failure of Andersen auditors to enforce agreement with the board of directors to adopt proposed adjusting journal entries that were required in restated financial statements.

Brief Contents

Table of Contents

Chapter 5
Fraud in Financial Statements and Auditor Responsibilities 269

Chapter 1

Ethical Reasoning: Implications for Accounting

Learning Objectives

After studying Chapter 1, you should be able to:

LO 1-1 Explain how integrity enables a CPA to withstand pressures and avoid subordination of judgment.

LO 1-2 Discuss the relationship between one's values and ethics, and legal obligations.

LO 1-3 Describe how the pillars of character support ethical decision making.

LO 1-4 Differentiate between moral philosophies and their effect on ethical reasoning in accounting.

LO 1-5 Explain the concept of the public interest in accounting.

LO 1-6 Discuss the Principles section of the AICPA Code of Professional Conduct.

LO 1-7 Apply the IMA Statement of Ethical and Professional Practice to a case study.

Ethics Reflection

Penn State Child Abuse Scandal: A Culture of Indifference

What motivates an otherwise ethical person to do the wrong thing when faced with an ethical dilemma? Why does a good person act wrongly in a particular situation? These are the ethical questions that arise from the Penn State scandal. Football head coach Joe Paterno and administrators at Penn State University looked the other way and failed to act on irrefutable evidence that former assistant coach Jerry Sandusky had molested young boys, an offense for which Sandusky currently is serving a 30- to 60-year sentence. According to the independent report by Louis Freeh that investigated the sexual abuse, the top administrators at Penn State and Joe Paterno sheltered a child predator harming children for over a decade by concealing Sandusky's activities from the board of trustees, the university community, and authorities. They exposed the first abused child to additional harm by alerting Sandusky, who was the only one who knew the child's identity, of what assistant coach Mike McQueary saw in the shower on the night of February 9, 2001.[1] McQueary testified at the June 2012 trial of Sandusky that he observed the abuse[2] and informed Paterno, who reported the incident to his superiors but did not confront Sandusky or report the incident to the board of trustees or the police.[3]

Reasons for Unethical Actions

The report gives the following explanations for the failure of university leaders to take action:

- The desire to avoid the bad publicity
- The failure of the university's board of trustees to have reporting mechanisms in place to ensure disclosure of major risks
- A president who discouraged discussion and dissent
- A lack of awareness of the Clery Act, which requires colleges and universities participating in federal financial aid programs to keep and disclose information about crimes committed on and near their campuses
- A lack of whistleblower policies and protections
- A culture of reverence for the football program that was ingrained at all levels of the campus community

Explanations for Unethical Actions

Former Penn State president Graham Spanier, who was fired by the board of trustees in November 2011, is quoted as discussing in an interview with Jeffrey Toobin of the *New Yorker* about how the university worked that "honesty, integrity, and always doing what was in the *best interests of the university* [italics added] was how everyone agreed to operate and . . . we've always operated as a family. Our personal and social and professional lives were all very intertwined."[4]

A culture that fosters organizational interests to the exclusion of others explains what happened at Penn State, and it happens in other organizations as well, such as Enron and WorldCom. The culture of an organization should be built on ethical values such as honesty, integrity, responsibility, and accountability. While Penn State may have claimed to follow such principles, the reality was that its actions did not match these behavioral norms.

Postscript

The Penn State case just does not seem to go away. Here is a list of actions subsequent to the initial case:

- As of the summer 2015, at least seven civil cases as well as criminal complaints against three former Penn State administrators have been pending.
- In January 2015, the National Collegiate Athletic Association (NCAA) agreed to restore 111 of former head coach Joe Paterno's wins between 1998–2011, making Paterno once again the winningest coach in major college football.
- The Paterno family brought a lawsuit to contest the consent decree's statement that the head coach covered for Sandusky to protect the school's football program.
- The statue of Paterno that was tore down will be replaced by a projected $300,000 life-sized bronze sculpture downtown, about two miles from the original site, after Pennsylvanians overwhelmingly voted to support the school putting the statue out again by a margin of 59 to 25.

Ethical Blind Spots

Leaders of organizations who may be successful at what they do and see themselves as ethical and moral still cultivate a collection of what Max Bazerman and Ann Trebrunsel call *blind spots*.[5] Blind spots are the gaps between who you want to be and the person you actually are. In other words, most of us want to do the right thing—to act ethically—but internal and external pressures get in the way.

As you read this chapter, think about the following questions: (1) What would you have done if you had been in Joe Paterno's position, and why? (2) Which ethical reasoning methods can help me to make ethical decisions in accounting? (3) What are my ethical obligations to the public?

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

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

Joe Paterno and other university leaders did not act with integrity. They let external considerations of reputation and image dictate their internal actions. Ironically, the very factor—reputation—that they guarded so closely was the first to be brought down by the disclosure of a cover-up in the sex scandal case.

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

Integrity: The Basis of Accounting

LO 1-1

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

According to Mintz (1995), "Integrity is a fundamental trait of character that enables a CPA to withstand client and competitive pressures that might otherwise lead to the subordination of judgment."[6] 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.[7] 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.[8]

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

Vinson pleaded guilty in October 2002 to participating in the financial fraud at the company. She was sentenced to five months in prison and five months of house arrest. Vinson represents the typical "pawn" in a financial fraud: an accountant who had no interest or desire to commit fraud but got caught up in it when Sullivan, her boss, instructed her to make improper accounting entries. The rationalization by Sullivan that the company had to "make the numbers appear better than they really were" did nothing to ease her guilty conscience. Judge Barbara Jones, who sentenced Vinson, commented that "Ms. Vinson was among the least culpable members of the conspiracy at WorldCom. . . . Still, had Vinson refused to do what she was asked, it's possible this conspiracy might have been nipped in the bud."[9]

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 American Accounting Association and was inducted into the American Institute of Certified Public Accountants (AICPA) Hall of Fame in 2005.

Cooper truly is a positive role model. She discusses the foundation of her ethics that she developed as a youngster because of her mother's influence in her book *Extraordinary Circumstances: The Journey of a Corporate Whistleblower.* Cooper says: "Fight the good fight. Don't ever allow yourself to be intimidated. . . . Think about the consequences of your actions. I've seen too many people ruin their lives."[10]

Religious and Philosophical Foundations of Ethics

Virtually all the world's great 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. Exhibit 1.1 provides some examples of the universality of the Golden Rule in world religions provided by the character education organization Teaching Values.[11]

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 7:1
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 fellowman. 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

Integrity is the key to carrying out the Golden Rule. A person of integrity acts with truthfulness, courage, sincerity, and honesty. Integrity means to have the courage to stand by your principles even in the face of pressure to bow to the demands of others. As previously mentioned, integrity has particular importance for certified public accountants (CPAs), who often are pressured by their employers and clients to give in to their demands. The ethical responsibility of a CPA in these instances is to adhere to the ethics of the accounting profession and not to subordinate professional judgment to the judgment of others. Integrity encompasses the whole of the person, and it is the foundational virtue of the ancient Greek philosophy of virtue.

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, but included others we think of as nonmoral, such as wisdom.[12]

Modern philosophies have been posited as ways to living an ethical life. Unlike virtue theory that relies on both the characteristics of a decision and the person making that decision, these philosophies rely more on methods of ethical reasoning, and they, too, can be used to facilitate ethical decision making. We review these philosophies later in the chapter.

What Is Ethics?

LO 1-2
Discuss the relationship between one's values and ethics, and legal obligations.

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

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

In a general sense, ethics (or moral philosophy) addresses fundamental questions such as: How should I live my life? That question leads to others, such as: What sort of person should I strive to be? What values are important? What standards or principles should I live by?[13] 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.

In addition, the ethical standards for a profession, such as accounting, are heavily influenced by the practices of those in the profession, state laws and board of accountancy rules, and the expectations of society. 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."[14] We adopt that definition and emphasize that it relies on ethical reasoning to evaluate the effects of actions on others—*the stakeholders.*

Difference between Ethics and Morals

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

Another important distinction can be thought of this way: When we form a moral judgment, we are employing moral standards—principles against which we compare what we see in order to form a conclusion. Such judgments might be about particular conduct, which includes a person's actions, or it might be about a person's character, which includes their attitudes and beliefs. Ethics, on the other hand, involve the study and application of those standards and judgments which people create or are established by organizations. So, we could say that ethics are the operational side of morality.

Norms, Values, and the Law

Ethics deal 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 do not rationalize their actions based on their own perceived self-interests. Ethical decision making entails following certain well-established norms of behavior. The best way to understand ethics may be to differentiate it from other concepts.

Values and Ethics

Values are basic and fundamental beliefs that guide or motivate attitudes or actions. In accounting, the values of the profession are embedded in its codes of ethics that guide the actions of accountants and auditors in meeting their professional responsibilities.

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

The Golden Rule requires that we try to understand how our actions affect others; thus, we need to put ourselves in the place of the person on the receiving end of the action. The Golden Rule is best seen as a consistency principle, in that we should not act one way toward others but have a desire to be treated differently in a similar situation. In other words, it would be wrong to think that separate standards of behavior exist to guide our personal lives but that a different standard (a lower one) exists in business.

Laws versus Ethics

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.

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 one engaged in by Bernie Madoff, whereby he duped others to invest with him by promising huge returns that, unbeknownst to each individual investor, would come from additional investments of scammed investors and not true returns.

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

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

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

The Gray Area

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. Nothing could be further from the truth. The process you follow to decide on a course of action is more important than achieving the end goal. If this were not true from a moral point of view, then we could rationalize all kinds of actions in the name of achieving a desired goal, even if that goal does harm to others while satisfying our personal needs and desires.

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

Ethical Relativism

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. Ethical relativism holds that morality is relative to the norms of one's culture. That is, whether an action is right or wrong depends on the moral norms of the society in which it is practiced. The same action may be morally right in one society but be morally wrong in another. For the ethical relativist, there are no universal moral standards—standards that can be universally applied to all peoples at all times. The only moral standards against which a society's practices can be judged are its own. If ethical 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.

Most ethicists reject the theory of ethical relativism. Some claim that while the moral practices of societies may differ, the fundamental moral principles underlying these practices do not. For example, there was a situation in Singapore in the 1990s where a young American spray-painted graffiti on several cars. The Singaporean government's penalty was to "cane" the youngster by striking him on the buttocks four times. In the United States, some said it was cruel and unusual punishment for such a minor offense. In Singapore, the issue is that to protect the interests of society, the government treats harshly those who commit relatively minor offenses. After all, it does send a message that in Singapore, this and similar types of behavior will not be tolerated. While such a practice might be condemned in the United States, most people would agree with the underlying moral principle—the duty to protect the safety and security of the public (life and liberty concerns). Societies, then, may differ in their application of fundamental moral principles but agree on the principles.

Moral Relativism in Accounting

Accountants record and report financial truths. Their conduct is regulated by state boards of accountancy, professional codes of behavior, and moral conventions directed towards fairness and accountability. However, moral dilemmas and conflicts of interest inevitably arise when determining how best to present financial information. Betty Vinson is a case in point. She rationalized that in her circumstances going along with the improper accounting was justified because if Scott Sullivan, one of the foremost chief financial officers in the country, thought the accounting was all right, who was she to question it. After all, ethical judgments can be subjective and, perhaps, this was one of those situations. Clearly, Vinson suffered from moral blindness because she failed to consider the negative effects on shareholders and other stakeholders and moral failings of Sullivan's position. There was a gap between the person she truly was and how she acted in the WorldCom fraud brought about by pressures imposed on her by Sullivan.

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."[15] A problem with a situation ethics perspective is that it can be used to rationalize actions such as those in the Penn State scandal.

Student Cheating

Another danger of situational ethics is it can be used to rationalize cheating. Cheating in general is at epidemic proportions in society. The *2012 Report Card on the Ethics of American Youth,* conducted by the Josephson Institute of Ethics, found that of 43,000 high school students surveyed, 51 percent admitted to having cheated on a test during 2012, 55 percent admitted to lying, and 20 percent admitted to stealing.[16]

Cheating in college is prevalent as well. The estimates of number of students engaging in some form of academic dishonesty at least once ranges from 50 to 70 percent.[17] In 1997, McCabe and Treviño surveyed 6,000 students in 31 academic institutions and found contextual factors, such as peer influence, had the most effect on student cheating behavior.[18] Contextual appropriateness, rather than what is good or right, suggests that situations alter cases, thus changing the rules and principles that guide behavior.[19]

It used to be that professors only had to worry about students copying from each other during exams and on assignments handed in, as well as bringing "notes" to an exam that are hidden from view. Plagiarizing also has been a concern. In extreme cases, students might gain unauthorized access to exams. A persistent problem has been access to past exams that some professors use over again. Here, the individual professor needs to take responsibility for changing exams and not blame students for behaviors that, while unethical, could be prevented by actions of the professor.

Now, with the advent of electronic access to a variety of online resources, term papers can be acquired or other people found to write them for a student. A disturbing trend is the availability of the solutions manual and test bank questions online. Instructors have historically relied on these resources to assess student learning. All that may be assessed now is whether an otherwise unproductive student has suddenly become productive as a result of acquiring instructor's resource materials or accessing previous exams. Here, students are to blame for irresponsible behavior and basically cheat themselves out of learning materials needed in the workplace and for the CPA Exam.

Other forms of e-cheating include using cell phones to store data and cameras to zoom in and take pictures of test questions and then posting them on Web sites where other students can access the questions for later testing. Programmable calculators have been used for awhile to store information pertinent to potential test questions. In a study of cheating in business schools, of the 40 percent of students who indicated they used various electronic methods of cheating, 99 percent indicated from occasional use up to half the time.[20]

A comprehensive study of 4,950 students at a small southwestern university identified neutralizing techniques to justify violations of accepted behavior. In the study, students rationalized their cheating behavior without challenging the norm of honesty. The most common rationale was denial of responsibility (i.e., circumstances beyond their control, such as excessive hours worked on a job, made cheating okay in that instance). Then, they blamed the faculty and testing procedures (i.e., exams that try to trick students rather than test knowledge). Finally, the students appealed to a higher loyalty by arguing that it is more important to help a friend than to avoid cheating. One student blamed the larger society for his cheating: "In America, we're taught that results aren't achieved through beneficial means, but through the easiest means." The authors concluded that the use of these techniques of neutralization conveys the message that students recognize and accept cheating as an undesirable behavior but one that can be excused under certain circumstances, reflecting a situational ethic.[21]

Student Cheating at the University of North Carolina

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

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

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

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

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

Although different in kind, Tar Heel Gate and the abuse scandal at Penn State have one common element: protecting the sports programs. At UNC, the goal 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 NCAA investigation of the program is ongoing. In June 2015, five charges were leveled against UNC including a lack of institutional control for poor oversight of an academic department popular with athletes and the counselors who advised them. In August 2015, UNC notified the NCAA's enforcement staff that it identified two new pieces of information regarding NCAA violations, including a lack of institutional control when it allowed athletes to participate in years' worth of phony paper courses.

The university's own report on the matter is highly critical of a program that knowingly steered about 1,500 athletes toward no-show courses that never met and were not taught by any faculty members, and in which the only work required was a single research paper that received a high grade no matter the content. Still, the only sanction imposed by the board of Southern Association of Colleges and Schools' Commission on Colleges was a one-year probation. The board stopped short of imposing the harshest penalty, which would have blocked the country's oldest public university from receiving federal funds, including student loan proceeds. We believe this is a slap on the wrist for such gross violations and the accrediting agency should be ashamed.

The violations of ethics by UNC raise many important questions. How could such a reputable college sports program get away with the behavior for 20 years? Who was responsible for keeping a watchful eye out for violations of NCAA rules? Where were the managers of the affected sport programs; what did they know; when did they know it; what actions, if any, did they take?

UNC suffered from ethical blindness. It failed to see the ethical violations of its actions in establishing a route for student-athletes to remain academically eligible. It acted in its own self-interest regardless of the impact of its behavior on the affected parties. The blind spots occurred because of a situational ethic whereby those who perpetrated the fraud and covered it up came to believe their actions were for the greater good of those involved in the athletic program and the UNC community, much like at Penn State, but failed to see the effects of their actions on other stakeholders including other colleges that were at a competitive disadvantage. Honesty was ignored, integrity was not in the picture, and the athletes were not provided with the education they deserved. Ironically, in the end the very stakeholders who allegedly would benefit the greatest from student-athletes taking paper classes suffered the most.

Student Cheating and Workplace Behavior

Some educators feel that a student's level of academic integrity goes hand in hand with a student's ethical values on other real-world events that present ethical challenges.[22] In other words, developing a sound set of ethical standards in one area of decision making, such as personal matters, will carry over and affect other areas such as workplace ethics.

Some educators believe that ethics scandals in the business world can be attributed to the type of education that graduates of MBA programs obtained in business schools.[23] In 2006, McCabe, Butterfield, and Treviño reported on their findings regarding the extent of cheating among MBA students compared to nonbusiness graduate students at 32 universities in the United States and Canada. The authors found that 56 percent of business students admitted to cheating, versus 47 percent of nonbusiness students.[24]

Several researchers have examined student cheating in college and the tendency of those students to cheat in the workplace. Lawson surveyed undergraduate and graduate students enrolled in business schools and found a strong relationship between "students' propensity to cheat in an academic setting and their attitude toward unethical behavior in the business world."[25] Another study looked at the issue of graduate students cheating versus workplace dishonesty. Sims surveyed MBA students and found that students who engaged in behaviors considered severely dishonest in college also engaged in behaviors considered severely dishonest at work.[26]

If students who cheat in the university setting subsequently cheat in the workplace, then ethics education is all the more important. Once a student rationalizes cheating by blaming others or circumstances, it is only a small step to blaming others in the workplace for one's inability to get things done or unethical behavior.

Social Networkers and Workplace Ethics

The Ethics Resource Center conducted a survey of social networkers in 2012 to determine the extent to which employees use social networking on the job. The survey points out that social networking is now the norm and that a growing number of employees spend some of their workday connected to a social network. More than 10 percent are "active social networkers," defined as those who spend at least 30 percent of their workday linked up to one or more networks.[27]

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

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

An encouraging result is that effective training on the use of social networks and an ongoing commitment to an ethical culture in which employees act with integrity can mitigate the risks presented by social networking at work. The survey found that in companies with both social networking policies and training, employees are more aware of what they post, think more carefully about the implications of online activity, and spend less of their worktime online. Moreover, where policies are in place, half of the social networkers say it is unacceptable to publicly post comments about their company even when they do not identify it. Without policies, only 40 percent say such posts are unacceptable. In companies with social networking policies, 88 percent consider their employer's reaction before making work-related posts, compared to the 76 percent in companies without such policies.[28]

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

Cultural Values

Between 1967 and 1973, Dutch researcher Geert Hofstede conducted one of the most comprehensive studies of how values in the workplace are influenced by culture. Using responses to an attitude study of approximately 116,000 IBM employees in 39 countries, Hofstede identified four cultural dimensions that can be used to describe general similarities and differences in cultures around the world: (1) individualism, (2) power distance, (3) uncertainty avoidance, and (4) masculinity.[29] In 2001, a fifth dimension, long-term orientation—initially called Confucian dynamism—was identified.[30] More recently, a sixth variable was added—indulgence versus restraint—as a result of Michael Minkov's analysis of data from the World Values Survey.[31] Exhibit 1.2 summarizes the five dimensions from Hofstede's work for Japan, the United Kingdom, and the United States, representing leading industrialized nations; and the so-called BRIC countries (Brazil, Russia, India, and China), which represent four major emerging economies.[32]

EXHIBIT 1.2 Hofstede's Cultural Dimensions*

	Countries/Scores						
Cultural Variables	**Brazil**	**Russia**	**India**	**China**	**Japan**	**U.K.**	**U.S.**
Power Distance (PDI)	69	93	77	80	54	35	40
Individualism (IDV)	38	39	48	20	46	89	91
Masculinity (MAS)	49	36	56	66	95	66	62
Uncertainty Avoidance (UAI)	76	95	40	30	92	35	46
Long-Term Orientation (LTO)	65	N/A	61	118	80	25	29

* High scores indicate a propensity toward the cultural variable; low scores indicate the opposite.

Individualism (IDV) focuses on the degree that the society reinforces individual or collective achievement and interpersonal relationships. In individualist societies (high IDV), people are supposed to look after themselves and their direct family, while in collectivist societies (low IDV), people belong to “in-groups” that take care of them in exchange for loyalty. Imagine, for example, you are the manager of workers from different cultures and cheating/unethical behavior occurs in the workplace. A work group with collectivist values such as China and Japan (low IDV) might be more prone to covering up the behavior of one member of the group in order to “save face”, whereas in the United Kingdom and United States (high IDV), there is a greater likelihood of an individual blowing the whistle.

Uncertainty Avoidance (UAI) is another cultural value that has important implications for workplace behavior, as it describes the tolerance for uncertainty and ambiguity within society. A high UAI ranking indicates that a country has a low tolerance of uncertainty and ambiguity. Such a society is likely to institute laws, rules, regulations, and controls to reduce the amount of uncertainty. A country such as Russia has a high UAI, while the United States and United Kingdom have lower scores (low UAI), indicating more tolerance for a variety of opinions. One implication is the difficulty of doing business in a country like Russia, which has strict rules and regulations about what can and cannot be done by multinational enterprises.

Other variables have important implications for workplace behavior as well, such as the Power Distance index (PDI), which focuses on the degree of equality between people in the country’s society. A high PDI indicates inequalities of wealth and power have been allowed to grow within society, as has occurred in China and Russia as they develop economically. Long-term orientation (LTO) versus short-term orientation has been used to illustrate one of the differences between Asian cultures, such as China and Japan, and the United States and United Kingdom. In societies like China and Japan, high LTO scores reflect the values of long-term commitment and respect for tradition, as opposed to low-LTO countries, such as the United Kingdom and United States, where change can occur more rapidly. Time can often be a stumbling block for Western-cultured organizations entering the China market. The length of time it takes to get business deals done in China can be two or three times that in the West. One final point is to note that Brazil and India show less variability in their scores than other countries, perhaps reflecting fewer extremes in cultural dimensions.

Our discussion of cultural dimensions is meant to explain how workers from different cultures *might* interact in the workplace. The key point is that cultural sensitivity is an essential ingredient in establishing workplace values and may affect ethical behavioral patterns.

The Six Pillars of Character

LO 1-3
Describe how the pillars of character support ethical decision making.

It has been said that ethics is all about how we act when no one is looking. In other words, ethical people do not do the right thing because someone observing their actions might judge them otherwise, or because they may be punished as a result of their actions. Instead, ethical people act as they do because their “inner voice” or conscience tells them that it is the right thing to do. Assume that you are leaving a shopping mall, get into your car to drive away, and hit a parked car in the lot on the way out. Let’s also assume that no one saw you hit the car. What are your options? You could simply drive away and forget about it, or you can leave a note for the owner of the parked car with your contact information. What would you do and why? Your actions will reflect the character of your inner being.

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.”[33]

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.[34]

Trustworthiness

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

Honesty

Honesty is the most basic ethical value. It means that we should express the truth as we know it and without deception. In accounting, the full disclosure principle supports transparency and requires that the accounting professional disclose all the information that owners, investors, creditors, and the government need to know to make informed decisions. To withhold relevant information is dishonest. Transparent information is that which helps one understand the process followed to reach a decision. In other words it supports an ethical ends versus means belief.

Let’s assume that you are a member of a discussion group in your Intermediate Accounting II class, and in an initial meeting with all members, the leader asks whether there is anyone who has not completed Intermediate I. You failed the course last term and are retaking it concurrently with Intermediate II. However, you feel embarrassed and say nothing. Now, perhaps the leader thinks that this point is important because a case study assigned to your group uses knowledge gained from Intermediate I. You internally justify the silence by thinking: Well, I did complete the course, albeit with a grade of F. This is an unethical position. You are rationalizing silence by interpreting the question in your own self-interest rather than in the interests of the entire group. The other members need to know whether you have completed Intermediate I because the leader may choose not to assign a specific project to you that requires the Intermediate I prerequisite knowledge.

Integrity

The integrity of a person is an essential element in trusting that person. MacIntyre, in his account of Aristotelian virtue, states, “There is at least one virtue recognized by tradition which cannot be specified except with reference to the wholeness of a human life—the virtue of integrity or constancy.”[35] A person of integrity takes time for self-reflection, so that the events, crises, and challenges of everyday living do not determine the course of that person’s moral life. Such a person is trusted by others because that person is true to her word.

Ultimately, integrity means to act on principle rather than expediency. If my superior tells me to do something wrong, I will not do it because it violates the ethical value of honesty. If my superior pressures me to compromise my values just this one time, I will not agree. I have the courage of my convictions and am true to the principles of behavior that guide my actions.

Going back to the previous example, if you encounter a conflict with another group member who pressures you to plagiarize a report available on the Internet that the two of you are working on, you will be acting with integrity if you refuse to go along. You know it’s wrong to plagiarize another writer’s material. Someone worked hard to get this report published. You would not want another person to take material you had published without permission and proper citation. Why do it to that person, then? If you do it simply because it might benefit you, then you act out of self-interest, or egoism, and that is wrong.

Reliability

The promises that we make to others are relied on by them, and we have a moral duty to follow through with action. Our ethical obligation for promise keeping includes avoiding bad-faith excuses and unwise commitments. Imagine that you are asked to attend a group meeting on Saturday and you agree to do so. That night, though, your best friend calls and says he has two tickets to the basketball game between the Dallas Mavericks and San Antonio Spurs. The Spurs are one of the best teams in basketball and you don't get this kind of opportunity very often, so you decide to go to the game instead of the meeting. You've broken your promise, and you did it out of self-interest. You figured, who wouldn't want to see the Spurs play? What's worse, you call the group leader and say that you can't attend the meeting because you are sick. Now you've also lied. You've started the slide down the proverbial ethical slippery slope, and it will be difficult to climb back to the top.

Loyalty

We all should value loyalty in friendship. After all, you wouldn't want the friend who invited you to the basketball game to telephone the group leader later and say that you went to the game on the day of the group meeting.

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

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

While attending a Josephson Institute of Ethics training program for educators, one of the authors of this book heard Michael Josephson make an analogy about loyal behavior that sticks with him to this day. Josephson said: "Dogs are loyal to their master, while cats are loyal to the house." How true it is that dogs see their ultimate allegiance to their owner while cats get attached to the place they call home—their own personal space. Now, in a business context, this means that a manager should try to encourage "cat" behavior in the organization (sorry, dog lovers). In that way, if a cover-up of a financial wrongdoing exists, the "cat loyalty" mentality incorporated into the business environment dictates that the information be disclosed because it is not in the best interests of the organization to hide or ignore it. If we act with "dog loyalty," we will cover up for our supervisor, who has a say about what happens to us in the organization. Recall our discussion of cultural values, and that someone from a country or group with a low score on individualism (a collectivist society) is more likely to hide a damaging fact out of loyalty to the controller and her superiors, while someone from a more individualistic society is more likely to come forward with information about the wrongdoing. A cover-up may be an understandable position because of internal pressures that work against voicing one's concerns and acting on one's values, but it is unethical all the same. Moreover, once we go along with the cover-up, we have started the slide down the ethical slippery slope, and there may be no turning back. In fact, our supervisor may come to us during the next period and expect us to go along with the same cover-up in a similar situation. If we refuse at that point, the first instance may be brought up and used as a threat against us because we've already violated ethical standards once and don't want to get caught. It is important to emphasize that we should not act ethically out of fear of the consequences of hiding information. Instead, we should act ethically out of a positive sense that it is the right way to behave.

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. We have already discussed the Penn State scandal and forfeiture of trust by Joe Paterno for failing to take steps to stop child abuse. Another 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. Or consider former president Richard Nixon, who went along with the cover-up in the Watergate break-in only to be forced to resign the presidency once the cover-up became public knowledge.

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.[36]

By age 16, George Washington had copied by hand 110 *Rules of Civility & Decent Behavior in Company and Conversation.* They are based on a set of rules composed by French Jesuits in 1595. While many of the rules seem out of place in today's society, Washington's first rule is noteworthy: "Every Action done in Company, ought to be with Some Sign of Respect, to those that are Present."[37]

Washington's vernacular was consistent with the times as indicated by the last of his rules: "Labour to keep alive in your Breast that Little Spark of Celestial fire Called Conscience."[38] We have found many definitions of conscience, but the one we like best is the universal lexical English WordNet used for research and developed by the Cognitive Sciences Laboratory at Princeton University. The definition is: "Motivation deriving logically from ethical or moral principles that govern a person's thoughts and actions."[39]

As a member of the case discussion group in the previous example, it would be wrong to treat another member with discourtesy or prejudice because you have drawn conclusions about that person on the basis of national origin or some other factor rather than her abilities and conduct. You would not want to be disrespected or treated unfairly because of how you dress or walk or talk, so others should not be judged based on similar considerations. We should judge people based on their character.

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.[40]

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.”[41]

A responsible person carefully reflects on alternative courses of action using ethical principles. A responsible person acts diligently and perseveres in carrying out moral action. Imagine if you were given the task by your group to interview five CPAs in public practice about their most difficult ethical dilemma, and you decided to ask one person, who was a friend of the family, about five dilemmas that person faced in the practice of public accounting. Now, even if you made an “honest” mistake in interpreting the requirement, it is clear that you did not exercise the level of care that should be expected in this instance in carrying out the instructions to interview five different CPAs. The due care test is whether a “reasonable person” would conclude that you had acted with the level of care, or diligence, expected in the circumstance. The courts have used this test for many years to evaluate the actions of professionals.

Responsibility for accounting professionals means to meet one’s ethical and professional obligations when performing services for an employer or client. Professional accountants in business often find themselves at the front line of protecting the integrity of the financial reporting process. Public accountants should approach audit services with an inquiring mind and be skeptical of what the client says and the information provided. As discussed later on, in the final analysis, the ultimate obligation of accounting professionals is to meet their public interest responsibilities. The public (i.e., investors and creditors) relies on the ethics of accountants and auditors and trusts they will act in the name of the public good.

Fairness

A person of fairness treats others equally, impartially, and openly. In business, we might say that the fair allocation of scarce resources requires that those who have earned the right to a greater share of corporate resources as judged objectively by performance measures should receive a larger share than those whose performance has not met the standard.

Let’s assume that your instructor told the case study groups at the beginning of the course that the group with the highest overall numerical average would receive an A, the group with second highest a B, and so on. At the end of the term, the teacher gave the group with the second-highest average—90.5—an A and the group with the highest average—91.2—a B. Perhaps the instructor took subjective factors into account in deciding on the final grading. You might view the instructor’s action as unfair to the group with the highest average. It certainly contradicts his original stated policy and is capricious and unfair, especially if the instructor does not explain his reason for doing this. As Josephson points out, “Fairness implies adherence to a balanced standard of justice without relevance to one’s own feelings or inclinations.”[42]

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

Caring

The late Edmund L. Pincoffs, a philosopher who formerly taught at the University of Texas at Austin, believed that virtues such as caring, kindness, sensitivity, altruism, and benevolence enable a person who possesses these qualities to consider the interests of others.[43] Josephson believes that caring is the “heart of ethics and ethical decision making.”[44]

The essence of caring is empathy. *Empathy* is the ability to understand, be sensitive to, and care about the feelings of others. Caring and empathy support each other and enable a person to put herself in the position of another. This is essential to ethical decision making.

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

Putting yourself in the place of another is sometimes difficult to do because the circumstances are unique to the situation. For example, what would you do if a member of your team walked into a meeting all bleary-eyed? You might ignore it, or you might ask that person if everything is all right. If you do and are informed that the person was up all night with a crying baby, then you might say something like, "If there's anything I can do to lighten the load for you today, just say the word."

A person who can empathize seems to know just what to say to make the other person feel better about circumstances. On the other hand, if you have never been married and have not had children, you might not be able to understand the feelings of a mother who has just spent the night trying to comfort a screaming child.

Citizenship

Josephson points out that "citizenship includes civic virtues and duties that prescribe how we ought to behave as part of a community."[45] An important part of good citizenship is to obey the laws, be informed about the issues, volunteer in your community, and vote in elections. During his presidency, Barack Obama called for citizens to engage in some kind of public service to benefit society as a whole.

Accounting professionals are part of a community with specific ideals and ethical standards that govern behavior. These include responsibilities to one another to advance the profession and not bring discredit on oneself or others. As citizens of a community, accountants and auditors should strive to enhance the reputation of the accounting profession.

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

Expectations of Millennials

Universum, the global employer branding and research company, annually surveys college undergraduate and MBA students. In 2014, it surveyed about 60,000 U.S. college students from 311 institutions to find out what they were looking for as they enter the world of work, as well as their views on the attractiveness of specific employers. The results of the survey reflect a desire to join an organization that respects its people, provides a supportive environment, recognizes performance, provides development and leadership opportunities, challenges one intellectually, fosters a work/life balance, and serves the public good.[46]

Students were asked to identify up to three career goals. The top five goals (with percentages of students who selected them) were:

1. Work/life balance (79 percent)
2. Job security (50 percent)
3. Be a leader or manager of people (43 percent)
4. Be competitively or intellectually challenged (43 percent)
5. Dedicated to a cause or feel I am serving a greater good (36 percent)

It also asked students to identify the most important "attractors" an employer could offer. The responses provided by at least 40 percent of students were:

1. Leaders who will support my development (49 percent)
2. Respect for its people (46 percent)
3. Creative and dynamic work environment (43 percent)
4. Recognizing performance (meritocracy) (43 percent)
5. Friendly work environment (42 percent)

These results are interesting in that Millennials clearly recognize motivating factors other than money in selecting a career. Their values appear in many ways to be consistent with the Six Pillars of Character including respect, responsibility, fairness, and civic virtue. Moreover, they were concerned about a prospective employer's reputation and image, and 39 percent found ethical standards to be an attractive attribute in a prospective employer, second only to financial strength (40 percent). Other civic virtue issues of importance included corporate social responsibility (21 percent) and environmental sustainability (13 percent).

How did the accounting profession fare with respect to the most desirable businesses to work for? Perhaps not surprisingly, Google was the most desirable employer to work for (21 percent), followed by Walt Disney Company (14 percent) and then Apple (13 percent). Of the Big-4 international professional accounting firms, Ernst & Young (EY) was the highest rated (13 percent), followed by Deloitte (11 percent), PricewaterhouseCoopers (PwC) (10 percent), and KPMG (7 percent). We caution students not to make too much of the rank ordering of CPA firms because more prestigious surveys such as the 2015 survey conducted by Fortune Magazine of the top 500 companies to work for has KPMG at the top while another survey conducted by Vault in 2015 ranks PwC the highest. Consulting Magazine's 2014 survey lists Deloitte Consulting as the best firm to work for followed by EY. These surveys generally are based on quality of life issues and development opportunities.

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

All too often in politics and government, a well-respected leader becomes involved in behavior that, once disclosed, tears down a reputation earned over many years of service. The example of former senator and presidential candidate John Edwards shows how quickly one's reputation can be destroyed—in this case because of the disclosure of an extramarital affair that Edwards had with a 42-year-old campaign employee, Rielle Hunter, that Edwards covered up.

In 2006, Edwards's political action committee (PAC) paid Hunter's video production firm $100,000 for work. Then the committee paid another $14,086 on April 1, 2007. The Edwards camp said the latter payment from the PAC was in exchange for 100 hours of unused videotape Hunter shot. The same day, the Edwards presidential campaign had injected $14,034.61 into the PAC for a "furniture purchase," according to federal election records.

Edwards, a U.S. senator representing North Carolina from 1998 until his vice presidential bid in 2004, acknowledged in May 2009 that federal investigators were looking into how he used campaign funds. Edwards was accused of soliciting nearly $1 million from wealthy backers to finance a cover-up of his illicit affair during his 2008 bid for the White House.

Edwards admitted to ABC News[47] in an interview with Bob Woodruff in August 2009 that he repeatedly lied about having an affair with Hunter. Edwards strenuously denied being involved in paying the woman hush money or fathering her newborn child, admitted the affair was a mistake in the interview, and said: "Two years ago, I made a very serious mistake, a mistake that I am responsible for and no one else. In 2006, I told Elizabeth [his wife] about the mistake, asked her for her forgiveness, asked God for His forgiveness. And we have kept this within our family since that time." Edwards said he told his entire family about the affair after it ended in 2006, and that his wife Elizabeth was "furious" but that their marriage would survive. On January 21, 2010, he also finally admitted to fathering Hunter's child, Quinn (and since the girl was born in 2008, that indicates pretty clearly that Edwards's statement that the affair ended in 2006 was less than truthful).

On May 31, 2012, a jury found him not guilty on one of six counts in the campaign-finance trial and deadlocked on the remaining charges; the Department of Justice decided not to retry him on those charges. On the courthouse steps, Edwards acknowledged his moral shortcomings.

Edwards violated virtually every tenet of ethical behavior and destroyed his reputation. He lied about the affair and attempted to cover it up, including allegations that he fathered Hunter's baby. He violated the trust of the public and lied after telling his family about the affair in 2006. He even had the audacity to run for the Democratic nomination for president in 2008. One has to wonder what it says about Edwards's ethics that he was willing to run for president of the United States while hiding the knowledge of his affair, without considering what might happen if he had won the Democratic nomination in 2008, and then the affair became public knowledge during the general election campaign. His behavior is the ultimate example of ethical blindness and the pursuit of one's own self-interests to the detriment of all others. Perhaps the noted Canadian-American chemist and author Orlando Aloysius Battista (1917–1995), said it best: "An error doesn't become a mistake until you refuse to correct it." In other words, when you do something wrong, admit it, take responsibility for your actions, accept the consequences, promise never to do it again, and move on. Unfortunately, most adulterers like Edwards go to great lengths to cover up their moral failings and don't admit to them until they have been caught.

Civility, Ethics, and Workplace Behavior

Can there be any doubt that incivility in society is on the rise? Not according to one of your authors. Mintz opines in his blog about incivility that daily we witness instances of inconsiderate, "in your face" behavior in communications and other forms of rudeness. There are many causes of incivility, many of which are social media–driven. The sometimes anonymous feel of posts on Twitter and other social media sites makes it relatively easy to use impersonal forms of communication to vent one's feelings without the immediate consequences of face-to-face discussions. One inappropriate Twitter rant begets another and eventually we see a further erosion of ethics in society.

Civility is not peripheral to ethics, dealing merely with manners, proper etiquette, and politeness. It runs much deeper and requires restraint, respect, and responsible action both in one's personal behavior and professional activities. Remember, ethics deals in broad terms with how we treat others.

Two pertinent questions are: Can you be civil and not entirely ethical? Can you be ethical and not terribly civil? The answer to the first is a qualified "yes." You can be well behaved and gracious to others but still be motivated by non-ethical values such as greed. The problem is you may wind up using others to advance your self-interests. The answer to the second is "no." Treating others badly and with disrespect means you have not committed to act in accordance with the pillars of character.

Taken to its extreme, uncivil behavior could manifest itself in meanness toward others, bullying, and cyberbullying. Such behaviors fly in the face of caring and empathy for others. Fair treatment is replaced by biased behaviors against others who somehow are seen as different, inferior, or just not worthy of respect. Civility should be taught in our schools at the earliest possible age. Benjamin Franklin said that "the purpose of the high school shall be to teach civility, because without civility democracy will fail."

Just as one's social networking practices in personal matters can influence workplace behavior including critical postings about fellow employees or the company, uncivil behavior in personal affairs might translate into incivility in the workplace. This may be company driven if employees feel mistreated or under extreme pressure to produce results. The result could be a lack of organizational commitment and loyalty issues that lead one to vent frustrations on social media. Of course, one's propensity to act disrespectfully toward others can translate into workplace incivility including bullying behavior.

Incivility in the workplace can lead to tangible costs for a business. In a survey of 800 managers and employees in 17 industries published in *Harvard Business Review*, Porath and Pearson report that workers who had experienced incivility indicated that they lost work time worrying about the incident (80 percent), their commitment to the organization declined (78 percent), performance declined (66 percent), lost work time avoiding the offender (63 percent), and intentionally decreased their work effort (48 percent).[48]

Civility in accounting manifests itself in the way accounting professionals market and promote their services and in their interactions with clients. The AICPA Code of Professional Conduct prohibits acts that might bring the profession into disrepute or do harm to current or prospective clients. For example, advertising of professional services and solicitation of new clients should not be made in a false, fraudulent, misleading, or deceptive manner. CPAs should not make promises in their communications that may not be kept such as to create unjustified expectations of favorable results.

Professionalism and work ethic are important qualities of accounting professionals. Professionalism is generally defined as the strict adherence to courtesy, honesty, and responsibility when dealing with individuals or other companies in business and clients in public accounting. For CPAs, this means to act in accordance with personal and professional values such as trustworthiness, integrity, transparency, and the pursuit of excellence. A strong work ethic includes completing assignments in a timely manner, diligently, and with the highest quality possible. Ethics and professionalism in accounting also means to always place the public interest ahead of one's self-interests, the interests of an employer, and the client's interests. The public expects accounting and auditing professionals to be selfless in the pursuit of the public good.

Modern Moral Philosophies

LO 1-4
Differentiate between moral philosophies and their effect on ethical reasoning in accounting.

The ancient Greeks believed that reason and thought precede the choice of action and that we deliberate about things we can influence with our decisions. In making decisions, most people want to follow laws and rules. However, rules are not always clear, and laws may not cover every situation. Therefore, it is the ethical foundation that we develop and nurture that will determine how we react to unstructured situations that challenge our sense of right and wrong. In the end, we need to rely on moral principles to guide our decision making. However, the ability to reason out ethical conflicts may not be enough to assure ethical decision making occurs in accounting. This is because while we believe that we should behave in accordance with core values, we may wind up deviating from these values that trigger ethical reasoning in accounting because of internal pressures from supervisors and others in top management. In the end, a self-interest motive may prevail over making a decision from an ethical perspective, and unethical behavior may result. This is the moral of the story of Betty Vinson's role in the WorldCom fraud. Moreover, even if we know what the right thing to do is, we still may be unable to act on our beliefs because others in the organization provide reasons and rationalizations to deviate from those beliefs and may establish barriers to ethical action. This occurred in the WorldCom fraud when Scott Sullivan, the CFO, attempted to divert Cynthia Cooper from her goal to reveal the accounting fraud.

The noted philosopher James Rest points out that moral philosophies present guidelines for "determining how conflicts in human interests are to be settled for optimizing mutual benefit of people living together in groups." However, there is no single moral philosophy everyone accepts. Notably, moral philosophies have been used to defend a particular type of economic system and individuals' behavior within these systems.[49]

Adam Smith's seminal work, *An Inquiry Into the Nature and Causes of the Wealth of Nations (1776),* outlined the basis for free-market capitalism. Capitalism *laissez-faire* philosophies, such as minimizing the role of government intervention and taxation in the free markets, and the idea that an "invisible hand" guides supply and demand are key elements of his political philosophy. These ideas reflect the concept that each person, by looking out for his or her self-interest, inadvertently helps to create the best outcome for all. "It is not from the benevolence of the butcher, the brewer, or the baker, that we can expect our dinner, but from their regard to their own interest," Smith wrote.[50]

Even before Smith wrote *The Wealth of Nations* he produced a treatise on moral philosophy. *The Theory of Moral Sentiments* (1759) makes the case that business should be guided by the morals of good people. Smith sets forth a theory of how we come to be moral, of how morality functions on both individual and societal levels, and of what forces are likely to corrupt our sense of morality, which is derived from our capacity to sympathize directly and indirectly with other people. This occurs by feeling what others actually feel in their circumstances. We are able to achieve this moral perspective because of our consciences, which allow us to envision our own actions just as a disinterested observer might.[51]

Moral norms therefore express the feelings of an impartial spectator. A feeling, whether on the part of a person motivated to take action or on the part of a person who has been acted upon by others, is worthy of moral approval if and only if an impartial observer would sympathize with that feeling. When achieving a morally right feeling is difficult, we call that achievement "virtuous"; otherwise, we describe people as acting or failing to act within the bounds of "propriety." In the end, moral norms and ideals, and the judgments by which we guide ourselves towards those norms and ideals, arise out of the process by which we try to achieve mutual sympathy.

Smith distinguishes two kinds of normative guides to action: rules and virtues. Moral rules bar certain types of egregious behavior, such as murder, theft, and rape. They provide a basis for shared expectations of society and are essential to justice, without which societies could not survive. Virtue, on the other hand, requires more than simply following moral rules. Our emotional tendencies not only affect the sentiments of the impartial observer but we adopt those sentiments so that we identify with and become the impartial spectator to the extent possible. If we are truly virtuous, a submission to certain rules will constrain everything we do, but within that framework we can operate without rules by adopting dispositions such as kindness, empathy, patience, endurance, and courage.[52]

Moral philosophies provide specific principles and rules that we can use to decide what is right or wrong in specific instances. They can help a business decision maker formulate strategies to deal with ethical dilemmas and resolve them in a morally appropriate way. There are many such philosophies, but we limit the discussion to those that are most applicable to the study of accounting ethics, including teleology, deontology, justice, and virtue ethics. Our approach focuses on the most basic concepts needed to help you understand the ethical decision-making process in business and accounting that we outline in Chapter 2. We do not favor any one of these philosophies because there is no one correct way to resolve ethical issues in business. Instead, we present them to aid in resolving ethical dilemmas in accounting. Exhibit 1.3 summarizes the basis for making ethical judgments for each of the major moral philosophies. The discussion that follows elaborates on these principles and applies them to a common situation in accounting. One word of caution. Even though you may know what the right thing to do is, that does not mean you will act in the same way as your thoughts and feelings. Distractions occur and reasons and rationalizations are provided, making it more difficult to "give voice to your values," as will be discussed in Chapter 2.

Teleology

Recall that *telos* is the Greek word for "end" or "purpose." 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.* Two important teleological philosophies that typically guide decision making in individual business decisions are egoism and utilitarianism.

Egoism and Enlightened Egoism

Egoism defines right or acceptable behavior in terms of its consequences for the individual. *Egoists* believe that they should make decisions that maximize their own self-interest, which is defined differently by each individual. In other words, the individual should "[d]o the act that promotes the greatest good for oneself."[53] Many believe that egoistic people and companies are inherently unethical, are short-term-oriented, and will take advantage of others to achieve their goals. Our *laissez-faire* economic system enables the selfish pursuit of individual profit, so a regulated marketplace is essential to protect the interests of those affected by individual (and corporate) decision making.

There 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.[54]

Let's examine the following example from the perspectives of egoism and enlightened egoism. The date is Friday, January 17, 2016, and the time is 5:00 p.m. It is the last day of fieldwork on an audit, and you

EXHIBIT 1.3 Ethical Reasoning Method Bases for Making Ethical Judgments

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

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, 2015, and that were not confirmed by the customer as being outstanding, have now been collected. If these receivables have been collected and in amounts equal to the year-end outstanding balances, then you will be confident that the December 31 balance is correct and this aspect of the receivables audit can be relied on. One account receivable for $1 million has not been collected, even though it is 90 days past due. You go to your supervisor and discuss whether to establish an allowance for uncollectibles for part of or the entire amount. Your supervisor contacts the manager in charge of the audit, who goes to the CFO to discuss the matter. The CFO says in no uncertain terms that you should not record an allowance of any amount. The CFO does not want to reduce earnings below the current level because that will cause the company to fail to meet financial analysts' estimates of earnings for the year. Your supervisor informs you that the firm will go along with the client on this matter, even though the $1 million amount is material. In fact, it is 10 percent of the overall accounts receivable balance on December 31, 2015.

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.

If you are an egoist, you might conclude that it is in your best interests to go along with the firm's position, to support the client's presumed interests. After all, you do not want to lose your job. An enlightened egoist would consider the interests of others, including the investors and creditors, but still might reason that it is in her long-run interests to go along with the firm's position to support the client because she may not advance within the firm unless she is perceived to be a "team player."

Utilitarianism

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.[55] Given its emphasis on evaluating the benefits and harms of alternatives on stakeholders, utilitarianism requires that people look beyond self-interest to consider impartially the interest of all persons affected by their actions.

The utilitarian theory was first formulated in the eighteenth century by the English writer Jeremy Bentham (1748–1832) and later refined by John Stuart Mill (1806–1873). Bentham sought an objective basis that would provide a publicly acceptable norm for determining what kinds of laws England should enact. He believed that the most promising way to reach an agreement was to choose the policy that would bring about the greatest net benefits to society once the harms had been taken into account. His motto became "the greatest good for the greatest number." Over the years, the principle of utilitarianism has been expanded and refined so that today there are many different variations of the principle. Modern utilitarians often describe benefits and harms in terms of satisfaction of personal preferences or in purely economic terms of monetary benefits over monetary costs.[56]

Utilitarians differ in their views about the kind of question we ought to ask ourselves when making an ethical decision. Some believe the proper question is: What effect will my doing this action in this situation have on the general balance of good over evil? If lying would produce the best consequences in a particular situation, we ought to lie.[57] 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