Ethical Decision-Making in Accounting and Business

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RULES OF ENGAGEMENT

1. No Smart Phones or Other Noise Makers
2. Make Connections – Network
3. Ask Questions
4. Consider Takeaways
5. Have a Good Time
“It is our choices that show what we truly are, far more than our abilities.”

- *Harry Potter and the Chamber of Secrets*, by J. K. Rowling
AGENDA

Ethics and Decision-Making Objectives

Ethics Definitions and Theories

Description of CPA Ethics
  Overall
  Yellow Book
  Circular 230

AICPA Code of Professional Conduct
  Standards Summary
  Ethics Committee Procedures

Ethical Challenges Facing CPAs and Accountants
  Understanding Conflicts in Decision-Making
  Discussion of Ethical Dilemmas

Final Thoughts on Ethics and Decision-Making
Ethics and Decision-Making Objectives
ETHICS AND DECISION-MAKING

Ethics is not always making a decision between right and wrong

Ethics is also about making the key decisions between right and right

*Defining Moments: When Managers Must Choose Between Right and Right*
MAKING DECISIONS

1. People face trade-offs.

2. What people get is the cost of what they give-up.

3. Rational people make decisions on the margin.

4. People react to incentives.
Ethics Definitions and Theories
BACKGROUND OF ETHICS

Ethics – From the Greek “ethos,” meaning character; Ethics is the study of how we make decisions.

Ethics are the values by which human beings live in relation to other human beings, themselves, and/or nature.
RULE ETHICS

German Philosopher – Immanuel Kant (1724 – 1804) would say that consequences cannot make actions right or wrong.

The key question is: “What would happen if everyone acted this way?”

A good rule is one that:

- Becomes universal and can be applied consistently
- Is respectful of the autonomy and rationality of all human beings

Trade offs:

- Promotion of self interest versus Protection of rights

Does having rules make someone ethical?

An ethical person will want to know the rules so that he/she can make informed ethical choices.
STAGES OF MORAL DEVELOPMENT

American Psychologist – Lawrence Kohlberg (1927 – 1987)

1. Pre-conventional Level:
   • People act out of fear of punishment
     There is no morality.
     “I will not do it because I will be punished.”

2. Conventional Level:
   • People act to conform their behaviors to the
     expectations of the groups to which they belong.
     “I did nothing wrong.”
     “Everyone one else does it.”

3. Post-conventional Level
   • The individual understands the reasoning behind a
     moral principle.
     “I did the right thing.”
UTILITARIAN ETHICS

Englishmen → Philosopher – Jeremy Bentham (1748 – 1832) and Economist – John Stuart Mill (1806 – 1873)

Acting ethically means making decisions based on maximizing the most good and minimizing the most bad for the most people affected by the decisions.

_Dumbledorian Ethics_ – Article about the ethics of Harry Potter that explains Utilitarianism
Description Of CPA Ethics

CPA

(noun) A trusted expert who helps organizations and individuals envision and shape their financial future. Characterized by a COMMITMENT to competence, objectivity, and integrity; excellent PERFORMANCE on behalf of the public, clients, and employees; and ACCOUNTABILITY for the highest professional and business ethics.
CPA ETHICS

Maximize Revenue

→ Obtain loans from banks
→ Show healthy business performance

Minimize Revenue

→ Pay less taxes on less revenue
ACCOUNTING ETHICS

Accounting means financial information about a company

Reliable financial information helps educated investors and aids in decision-making

Accountants are the guardians of reliable financial information
1. Exaggerate revenue

2. Provide misleading information regarding business expenses

3. Misuse funds

UNETHICAL ACCOUNTING
1. Pressure/Incentive: Want to or have a need to commit fraud

2. Rationalization: Convinced that fraudulent behavior is worth the risks

3. Capability: I have the necessary traits and abilities to be the right person to pull it off. I have recognized this particular fraud opportunity and can turn it into reality. (Management override major problem)

4. Opportunity: There is a weakness in the system that the right person could exploit. Fraud is possible
Chapter 1: Accountability

Tone from the top → Decision-Making, Hiring, Day-to-Day

Making decisions consistent with public interest → Integrity

Auditors place priority on responsibility to public

Proper use and prudent management of resources

Transparency → What, How, Why
THE IRS

Circular 230

Covered Opinion or Other Written Advice
→ In order to be ethical, CPAs must base decision-making on reasonable factual or legal assumptions

Audit Lottery

Skepticism

Client information to others
QUOTE BREAK

“Ethics is knowing the difference between what you have a right to do and what is right to do.”
- Potter Stewart

“The time is always right to do what is right.”
- Martin Luther King Jr.
AICPA Code of Professional Conduct
THE AICPA CODE OF PROFESSIONAL CONDUCT

1. Principles are ideal standards and are not enforceable. (Based in Philosophy)

2. Rules of Conduct are minimal standards of ethical conduct stated as specific rules. They are enforceable. (Ex. Rule 101 – Independence)

3. Interpretations of rules of conduct. Not enforceable, but you must justify departure.

4. Ethical rulings. Published explanations of questions asked to the AICPA. Not enforceable, but you must justify departure.
THE AICPA CODE OF PROFESSIONAL CONDUCT

• Article I – Responsibilities ... to clients, users, and other CPAs
• Article II – The Public Interest (trust)
• Article III – Integrity ("can accommodate the inadvertent error and honest difference of opinion; it cannot accommodate deceit or subordination of principle")
• Article IV – Objectivity and Independence
  • "Objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest."
• Article V – Due Care
  • "The quest for excellence is the essence of due care."
  • Competence in all engagements
RULE 101 – INDEPENDENCE

• Conceptual Framework
  ▶ Independence of Fact
  ▶ Independence of Appearance

• The most detailed section of our Code of Conduct

• 37 pages of very specific examples, contrasts with 1 page for Rule 201, General Standards
RULE 101 – INDEPENDENCE

Two questions for thought:

1. Can an accountant give and/or accept gifts?

2. Given that everyone is honest, would petty cash be over, even, or short in the long-run?
RULE 102 – INTEGRITY AND OBJECTIVITY

• Preparing tax returns for both husband and wife during divorce proceedings

• Recommending a client to a service bureau in which the member or its firm hold material financial interests
RULE 201 – GENERAL STANDARDS

• All things “technical!”

• When we think of ethics, rarely do we think technical standards.
  - Professional Competence
  - Due Professional Care
  - Planning and Supervision
  - Sufficient Relevant Data
RULE 301 – CONFIDENTIAL CLIENT INFORMATION

- A member in public practice shall not disclose any confidential client information without the specific consent of the client.

- IRS letter also has requirement
SECTION 400 – RESPONSIBILITIES TO COLLEAGUES

• Section of the code not completed yet

• What do you think should be in this section?
RULE 501 – ACTS DISCREDITABLE

• All things behavioral!

• *Catch-all Category*, but it is just over 3 pages of text

→ What does it mean?

• A member shall not commit an act discreditable to the profession.

• Beauty may be in the eye of the beholder, but your potentially discreditable act will lay in the hands of your peers.
RULE 501 – ACTS DISCREDITABLE

- Client Records - Can they be held for ransom?
  
  – Sometimes
CLIENT PROVIDED RECORDS

• Bank Statements
• Invoices
• Ledgers

– Must return
CLIENT RECORDS PREPARED BY THE MEMBER

- Depreciation Schedules
- General Ledger
- Tax Returns
- Financial Statements

- May be withheld if incomplete or fees specific to the preparation of those records are unpaid
RULE 502 – ADVERTISING AND SOLICITATION

• Rule 502 includes both general advertising and specific prospects (written and verbal)
  – Create false or unjustified expectations of favorable results
  – Imply the ability to influence any court or agency
  – Mislead on fees when you know they’ll be higher
  – Contain any misrepresentations that would deceive a reasonable person
RULE 503 – COMMISSIONS AND REFERRAL FEES

• Audits and Review – Never
• Compilation – Must disclose lack of independence
  – Must tell client you paid or received a fee
ILLINOIS CPA SOCIETY
ETHICS COMMITTEE

Parliamentary procedures (i.e. motions, etc)

Types of Cases

How You Can Avoid the Ethics Committee...
1. Know the AICPA professional standards

2. Ensure that others you work with know the standards

3. Always think about the long-term implications of your technical and behavioral decisions
How do we know we are acting ethically?

“Judge a man by the questions he asks – not by the answers he gives.”

Voltaire

Ask yourself:

Who will the decision help?
Who will the decision harm?
Why is the decision appropriate for the situation/time?

Sometimes the choice is between right and right!
Ethical Challenges Facing CPAs and Accountants
ETHICAL CHALLENGES AT CPA FIRMS

• Charge Hour Budgets
• Fixed Fee Engagements
• Realization Percentages
• Up or Out Mentality
• Partner Billing Numbers
• Client Entertainment / Befriending Clients
• Aggressive Tax Positions (I am Dr. Refund and my Practice is thriving)
• Audit Programs that we do not always understand
• Practical vs. Technically correct
• Consulting Projects
• Feeling that Client’s expect us to have all the answers
• Client Acceptance
Discussion

Your boss says to you…

“I am not telling you to do anything illegal. I am just telling you what I want done.”
Betty Vinson

WorldCom Accountant instructed by the CEO and CFO to book accounting adjustments to boost income

Was her decision okay because she was instructed to by those charged with decision-making?
Final Thoughts on Ethics and Decision-Making
CPAS TO BE VALUE-ADDED

Do not participate in acts discreditable

Only accept clients and engagements for which you have the expertise

Remember you are a CPA at all times → 24/7 mindset!
ACCOUNTING STANDARDS

• Our standards and our ethics are what set us apart from others.

• Adhering to tough (but fair) professional standards is the trademark of our profession.

• When standards are violated, it tarnishes the entire profession.
FRAMEWORK FOR ETHICAL DECISION-MAKING PART 1

• Step 1) Determine the facts of the situation. This process involves determining the who, what, where, when, and how.

• Step 2) Identify the ethical issue and the stakeholders. Stakeholders may include shareholders, creditors, management, employees, and the community.

• Step 3) Identify the values related to the situation. For example, in some situations confidentiality may be an important value that may conflict with the right to know.

• Step 4) Specify the alternative courses of action.
FRAMEWORK FOR ETHICAL DECISION-MAKING PART 2

• Step 5) Evaluate the courses of action specified in step 4 in terms of their consistency with the values identified in step 3. This step may or may not lead to a suggested course of action.

• Step 6) Identify the consequences of each possible course of action. If step 5 does not provide a course of action, assess the consequences of each possible course of action for all of the stakeholders involved.

• Step 7) Make your decision and take any indicated action.
ETHICAL PEOPLE

Can an ethical person have unethical behaviors?

Can guidelines keep people ethical?
Being ethical is doing the right thing…
Even when no one else knows.
ETHICS OF DRIVING

1. Don’t hit anything
2. Don’t get hit by anything
3. Stay out of other peoples’ way
4. Know what others expect you to do
5. Let others know what you are doing- Be Transparent!
6. For backseat driving...
Do the Right Thing!
Additional Resources

1. AICPA celebrates 125 years video = 6 minutes
   https://www.aicpa.org/News/AICPATV/Pages/Home.aspx

2. What motivates us = 11 minutes
   http://www.youtube.com/watch?v=dgKKPQiRRag

3. TED TALK Morality Molecule = 17 minutes
   http://www.ted.com/talks/paul_zak_trust_morality_and_oxytocin.html

4. TED TALK Our Buggy Moral Code = 17 minutes
   http://www.ted.com/talks/dan_ariely_on_our_buggy_moral_code.html

5. TED TALK A lesser-known global consequence of the
   global financial collapse = 3 minutes