



# Ethics & Indigestion

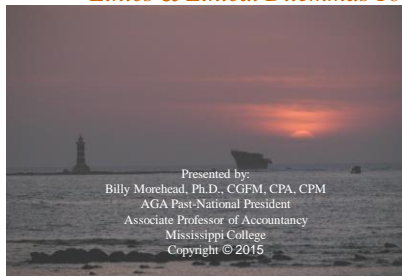
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## *Ethics & Indigestion: Ethics & Ethical Dilemmas Today!*



Presented by:  
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"The need for ethics in all professions has never been greater, nor have the actions of professionals ever been under more intense scrutiny... One of the most important lessons you'll take from this session is recognizing ethics as a constantly evolving pursuit. You don't study ethics; you *do* ethics" (CFE, Crossing the Line: Ethical Lessons for Financial Professionals, 1998).

1



## ETHICS UPDATE OVERVIEW

- I. General Ethics Discussion
- II. AICPA Independence, Integrity & Objectivity

2



## *General Ethics Discussion*



3



## General Ethics Discussion

"Never trust the people you cheat with.  
They will throw you under the bus."  
Marianne M. Jennings

"Three people can keep a secret if two  
are dead." Ben Franklin

4



"Ethical standards and practices in the workplace are the pillars of successful employment and ultimately the benchmark for a strong business"

-- Franklin Raines, former CEO of Fannie Mae (ousted in 2005); with a \$6 billion restatement of its financials, the board concluded that "[management was] manipulating earnings and creating an 'unethical and arrogant culture'"

5



## *What are "Ethics"?*

"Ethical standards are the generally accepted rules of conduct that govern society. Ethical rules are both standards and expectations for behavior, and we have developed them for nearly all aspects of life" (Jennings, 2008)

6



## What are "Ethics"?

- ✦ "The study of the general nature of morals and of the specific moral choices to be made by the individual in his relationship with others; the philosophy of morals"
- ✦ "The rules or standards governing the conduct of the members of a profession"  
The American Heritage Dictionary
- ✦ "Ethics consists of those unwritten rules we have developed for our interactions with each other" (Jennings, 2008)

7



## What are "Ethics"?

- ✦ Not the standards of the law
- ✦ In fact, a higher standard
  - ❑ Cutting in line
  - ❑ Married person committing adultery ("cheating", "unfaithful", "affair")
  - ❑ Cheating on a test
  - ❑ Plagiarism
  - ❑ Steroids use in sports
  - ❑ Weak product designs

8



## What is Your Personal Credo?

### Develop Two Lists:

- ✦ Who are YOU?
  - ❑ Not defined by "trappings of success"
  - ❑ Defined by "qualities" you would describe yourself regardless of what happened to you financially, professionally, or in your career
- ✦ Things I would never do to be successful (to get promoted; to make money, etc.)...

9



## Key Points:



- ✦ The "right choice" is sometimes obscured by considerations never before faced by our professional predecessors
- ✦ Often, there is no obvious line between "right and wrong"

10



## Key Points:

- ✦ We find ourselves on a "slippery slope" when it comes to finding the best course of action
- ✦ Rules can't always be relied upon to supply the answer
- ✦ New ethical issues emerge every day in this "information age"



11



## Key Points:

- ✦ Public trust in our financial systems and profession depends on keeping high standards of conduct among those who handle financial affairs.
- ✦ Without basic trust in our government, economy, currency, and business practices, the system would collapse.



12



### Key Points:

- ✦ Adherence to ethical standards secures the greater good of the industry and ensures that the ethical behavior of the individual member is above reproach.
- ✦ Psychologists tell us people naturally act in their own best interests. Therefore, it is in the best interest of the professional to be aware of the ethical codes that should guide his or her behavior.



13



### Types of Ethical Dilemmas:

*Developed and listed in Exchange, the magazine of BYU School of Business*

- ✦ Taking things that don't belong to you
- ✦ Saying things you know are not true
- ✦ Giving or allowing false impressions
- ✦ Buying influence or engaging in conflict of interest
- ✦ Hiding or divulging information
- ✦ Taking unfair advantage

14



### Types of Ethical Dilemmas:

*Developed and listed in Exchange, the magazine of BYU School of Business*

- ✦ Committing acts of personal decadence
- ✦ Perpetrating interpersonal abuse
- ✦ Permitting organizational abuse
- ✦ Violating rules
- ✦ Condoning unethical actions
- ✦ Balancing ethical dilemmas

15



### How We Avoid Ethical Dilemmas – We Call it Something Else:

- ✦ Downloading music – instead of “copyright infringement” we call it “peer-to-peer file sharing”
- ✦ Juggling numbers in financials – instead of “falsifying numbers” we call it “smoothing earnings”, “finance engineering”, “good finance strategy” or “cooking the books” (Jennings, 2008)

16



### Rationalizing Dilemmas Away:

- ✦ “Everybody else does it”
- ✦ “If we don't do it, someone else will”
- ✦ “That's the way it has always been done”
- ✦ “We'll wait until the lawyers tell us it is wrong” or “The law doesn't say we can't do it”

17



### Rationalizing Dilemmas Away:

- ✦ “It really doesn't hurt anyone”
- ✦ “The system is unfair”
- ✦ “It's a gray area”
- ✦ “I was just following orders”
- ✦ “We all don't share the same ethics”

18



*Twelve Questions For Evaluating Ethical Dilemmas:*  
*Laura Nash – Harvard Divinity School Meets Business*

1. Have you defined the problem accurately?
2. How would you define the problem if you stood on the other side of the fence?
3. How did this situation occur in the first place?
4. To whom and what do you give your loyalties as a person and as a member of the corporation?

19



*Twelve Questions For Evaluating Ethical Dilemmas:*  
*Laura Nash – Harvard Divinity School Meets Business*

5. What is your intention in making this decision?
6. How does this intention compare with the likely results?
7. Whom could your decision or action injure?
8. Can you engage the affected parties in a discussion of the problems before you make your decision?

20



*Twelve Questions For Evaluating Ethical Dilemmas:*  
*Laura Nash – Harvard Divinity School Meets Business*

9. Are you confident that your position will be as valid over a long period of time as it seems now?
10. Could you disclose, without qualms, your decision or action to your boss, your CEO, the board of directors, your family, or society as a whole?
11. What is the symbolic potential of your action if understood? If misunderstood?
12. Under what conditions would you allow exceptions to stand?

21



*Three Questions Managers Should Ponder in Resolving Ethical Dilemmas:*  
*Norman Vincent Peale & Ken Blanchard*

- ✦ Is it legal? If “no”, stop there!
- ✦ Is it balanced? Step back and view from other perspectives – other stakeholders
- ✦ How does it make me feel? Self-examination of your comfort level with decision

22



*The Wall Street Journal Model*

- ✦ Am I in compliance with the law?
- ✦ What contribution does this choice or action make to the company, the shareholders, the community, and others?
- ✦ What are the short- and long-term consequences of this decision?

23



*“Front Page” Test:*

“Contemplating any business act, an employee should ask himself whether he would be willing to see it immediately described by an informed and critical reporter on the front page of his local paper, there to be read by his spouse, children, and friends. At Salomon we simply want no part of any activities that pass legal tests but that we, as citizens, would find offensive”

Warren Buffett as Interim Chairman

24



### National Enquirer Test:

“Make up the worst possible headline you can think of and then re-evaluate your decision”

Marianne M. Jennings

25



### “FaceBook, Twitter, Instagram” Test?

What would happen if your story, image or video went viral?

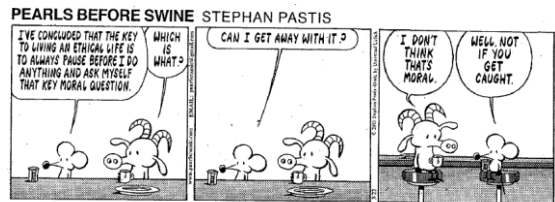
26



### Golden Rule of the Bible:

“Do unto others as you would have them do unto you” – Matthew 7:12 and Luke 6:31

27



28



### Codes of Ethics

- Ethical codes were designed to give professionals guidance in the decisions they make
- Remember – we must not only be ethical in action, but also, and VERY IMPORTANTLY, in appearance.
- The law, in this context, is the lowest common denominator and not the model by which our professional responsibilities should be judged.
- History suggests that an effective code of ethics, enforced diligently and with fairness, is the best way for financial professionals to avoid derision.



29



### Codes of Ethics



- AICPA
- AGA
- CFE
- CMA
- IIA

30

"Diligence, objectivity, independence, due care, and conflicts of interest are not just boiler plate provisions inserted into codes of professional responsibility. Financial professionals such as accountants [and] auditors ... are required to follow these codes to protect both themselves and their clients. Such standards require professionals not just to be reactive (give advice when asked), but to be proactive as well (looking for possible conflicts or problems)." (CFE, Crossing the Line, 1998).

31

## The History of Ethical Codes

- ✦ Date back to the "guilds" in medieval times
- ✦ Industrial Revolution made guilds obsolete, but maintained codes
- ✦ From the beginning, codes of ethics have been what we might call "civic-minded".
- ✦ Practical, "market function", and kind of a currency
- ✦ Public relations "tool" and "prescription" for conduct
- ✦ In early 20<sup>th</sup> Century, ethical codes of conduct helped the professions and the professionals establish themselves in the public eye

32

## Ethics – A Constraint on Behavior?

- ✦ Do we want to "win at any cost?"
- ✦ Ethical principles – "the things we're *not* supposed to do."
- ✦ Ethics are generally viewed as a behavior motivation, not as a constraint.
- ✦ Ethics has to become an **initiative** or an **incentive**, not a regulation or binding judgement.



33

## Making Decisions

- ✦ If something is written about the issue, consult it.
- ✦ Compare the situation with the general rule of law or the profession
- ✦ If it's covered, be sure the specifics of your position apply.
- ✦ If it's not covered, or the rule doesn't really apply, then think some more.
- ✦ Decide, based upon what you know about past situations – which action among the several you can take carries the most positive ethical consequences?
- ✦ Ethics in an "information age" demand their own answers.
- ✦ The "rules" may have to be changed to fit the situations.



34

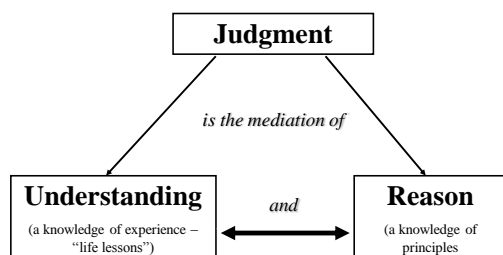
## To Lie or Not to Lie? – That is the Question.

- ✦ Truth-telling is one of the highest standards of financial professionals. Accuracy and truth in reporting are bedrock values of the financial world. No one can conscientiously assert that lying should become a universal law, so it's not an acceptable action.

35

- ✦ Formally speaking, a lie is always a lie and a lie is evil (Immanuel Kant).
- ✦ Practically speaking, it may happen that a lie becomes necessary and productive (Immanuel Kant).
- ✦ A lie is justified in self-defense? (undercover work, a "sting", wire tapping, etc.) (Immanuel Kant).

36



Samuel Kern

37



### Four-Point Test for Financial Professionals

- ❖ Is the action I am considering legal and consistent with ethical standards for all citizens?
- ❖ Is the action I am considering consistent with the Codes of Professional Ethics by which I am bound?
- ❖ Is the action I am considering consistent with my own personal standards?
- ❖ How would this action look on the evening news or the front page of the local paper? How would this publicity reflect on my colleagues, on my profession, and on my own professional and personal reputation?

38



**Codes of Ethics** – “Who we are and what we stand for”

**Codes of Practice** – “How we do things around here”

**Codes of Conduct** – “How we expect you to behave”

39



### AICPA – Code of Professional Conduct

#### ❖ Principles:

- ❖ **Article I – Responsibilities** – *In carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgments in all their activities*
- ❖ **Article II – The Public Interest** – *Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism*
- ❖ **Article III – Integrity** – *To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity*

40



### AICPA – Code of Professional Conduct

#### ❖ Principles, continued:

- ❖ **Article IV – Objectivity and Independence** – *A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and in appearance when providing auditing and other attestation services.*
- ❖ **Article V – Due Care** – *A member should observe the profession’s technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member’s ability.*
- ❖ **Article VI – Scope and Nature of Services** – *A member in public practice should observe the Principles of the “Code of Professional Conduct” in determining the scope and nature of services to be provided.*

41



### Association of Government Accountants – Code of Ethics

#### ❖ Objectives:

- ❖ Credibility
- ❖ Professionalism
- ❖ Quality of Services
- ❖ Confidence



42

## AGA – Code of Ethics

### ✦ Principles

- ✦ Objectivity
- ✦ Professional Competence and Due Care
- ✦ Confidentiality
- ✦ Professional Behavior
- ✦ Technical Standards

43

## AGA – Code of Ethics

### ✦ Professional Conduct

#### ✦ Personal Behavior

- Actively promote and encourage the highest level of ethics within the government financial management community.
- Conduct yourself with integrity, dignity, and respect for others.
- Transmit or use confidential information obtained in your professional work only for the purpose intended and not for personal gain or other advantage or the disadvantage of others.
- Adhere to the standards of conduct of your employer and any professional associations or organizations of which you are a member.

44

## AGA – Code of Ethics

### ✦ Professional Conduct

#### ✦ Professional Competence and Performance

- Strive to perform the duties of your position and supervise the work of your subordinates with the highest degree of professional care
- Continually seek to increase your professional knowledge and skills to improve your services to employers, associates and fellow members.
- Render opinions, observations, or conclusions for official purposes only after appropriate consideration of the pertinent facts and after assuring yourself that you have the appropriate expertise and are free from real or perceived conflicts of interest.

45

## AGA – Code of Ethics

### ✦ Professional Conduct

#### ✦ Professional Competence and Performance

- Exercise diligence, objectivity, and honesty in your professional activities and be aware of your responsibility to disclose improprieties that come to your attention to the appropriate parties.
- Be aware of and strive to apply work-related requirements and standards prescribed by authorized government agencies and employers

46

## AGA – Code of Ethics

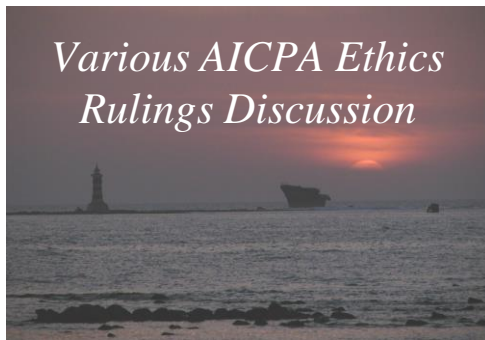
### ✦ Professional Conduct

#### ✦ Responsibilities to Others

- Consider the public interest to be paramount in carrying out your duties
- Avoid any activity that creates or gives the appearance of a conflict with your employer-related responsibilities

47

## Various AICPA Ethics Rulings Discussion



48

## AICPA INDEPENDENCE

- Conceptual Framework For AICPA Independence
  - Other Independence Considerations
    - Rule 101 – Independence
      - Impairment
      - Threats
      - Safeguards
    - Performance of Nonattest Services – General, Tax Compliance Services, Forensic Services
  - Rule 102 – Integrity and Objectivity
    - Conflicts
    - Obligations

49

## AICPA INDEPENDENCE

### Independence is Defined as:

#### Independence of mind

- State of mind
- Permits performance of attest service...without the compromise of professional judgment;
- Allows CPA to act with **integrity** and exercise **objectivity** and **professional skepticism**

#### Independence in appearance

- Avoidance of circumstances that would cause a reasonable and informed third party to conclude integrity, objectivity, or professional skepticism compromised

50

## AICPA INDEPENDENCE Conceptual Framework

### Key Definitions

**Impair**—To effectively extinguish independence (if impaired, CPA is NOT independent).

**Threats**—Circumstances that could impair independence; could compromise judgment.

**Safeguards**— Controls that mitigate or eliminate threats to independence. To be effective, safeguards should eliminate the threat or reduce to an acceptable level the threat's potential toward impairment.

51

## AICPA INDEPENDENCE Conceptual Framework

### IMPORTANCE OF FRAMEWORK

- Assistance in understanding AICPA independence interpretations and rulings
- Guidance where guidance is absent
- This Framework may not be used to overcome prohibitions or requirement contained in AICPA ethics interpretations and rulings

52

## AICPA INDEPENDENCE Conceptual Framework

### Professional Ethics Executive Committee's (PEEC's) recommends a RISK-BASED APPROACH involving two steps:

- Identifying and evaluating threats to independence (individually and in the aggregate; cumulative effect)
- Determining whether safeguards reduce to an acceptable level, eliminate or sufficiently mitigate threats or can do so (perception by responsible third party)
- If no safeguards are available, independence is impaired

53

## AICPA INDEPENDENCE Conceptual Framework

### Details On "Identifying And Evaluating Threats"

- An individual and aggregate approach must be used
- Some threats may be deemed acceptable
- Safeguards not required when threats deemed acceptable

54



## AICPA INDEPENDENCE Conceptual Framework

### Details—do Safeguards Eliminate Or Sufficiently Mitigate Threats?

- Different safeguards used for different types of threats
- One safeguard may be sufficient for multiple threats
- Safeguards must eliminate a threat or reduce it to an acceptable level

55



## AICPA INDEPENDENCE Conceptual Framework

### Seven Broad Threats (not all inclusive):

- **Self-review** – Reviewing evidence from one's own work or firm's nonattest work
- **Advocacy** –Actions promoting an attest client's interests or position
- **Adverse interest** –Actions or interests between the CPA and client that are in opposition

56



## AICPA INDEPENDENCE Conceptual Framework

### (Threats Continued)

- **Familiarity** –Close or longstanding relationship with the client (or those who perform NAS)
- **Undue influence** –Attempt to coerce or exercise excessive influence over CPA by client's management or other interested party
- **Financial self-interest** –Potential benefit to the CPA from a financial interest in or relationship with an attest client
- **Management participation**–Taking on role of management or performing management functions

57



## AICPA INDEPENDENCE Conceptual Framework

### SPECIFICS ON USE OF SAFEGUARDS:

Should eliminate or reduce threats to independence

- Effectiveness depends on numerous factors including:
  - Specific facts & circumstances of situations
  - Proper identification of threats
  - Proper design of safeguards
  - Party(ies) subject to safeguards
  - How safeguards are applied
  - Consistency of application
  - Who applies the safeguards

58



## AICPA INDEPENDENCE Conceptual Framework

Three broad categories with 36 specific **safeguards** identified:

- **Created by the Profession, Legislation or Regulation** (6)
- **Implemented by the Attest Client** (5)
- **Implemented by the Firm** (25)

59



## AICPA INDEPENDENCE Conceptual Framework

### Created by the Profession, Legislation or Regulation

- Required education and training on independence and ethics rules for new professionals
- CPE requirements on independence and ethics rules
- Professional standards, monitoring & disciplinary processes
- External review of a firm's quality control system
- Legislation governing independence requirements of the firm
- Competency & experience requirements for professional licensure

60



## AICPA INDEPENDENCE Conceptual Framework

### Implemented by the Attest Client

- Skilled, knowledgeable, and experienced personnel making management decisions relative to nonattest services by the CPA to the attest client
- A tone at the top that emphasizes client's commitment to fair financial reporting
- P&P's designed to achieve fair financial reporting
- Appropriate governance structure (such as active audit committee) designed to ensure appropriate oversight, decision making, and communication
- P&P's relative to services available without impairing independence with attest firm

61



## AICPA INDEPENDENCE Conceptual Framework

### Implemented by the Firm

- Firm leadership that stresses independence and the firm's actions toward public interest
- P&P's designed to implement & monitor QC in attest engagement
- Documented independence P&P's regarding of identification and evaluation of threats of independence; and, application of safeguards
- Internal P&P's designed to monitor compliance
- Use of different partners and engagement teams for attest versus nonattest services

62



## AICPA INDEPENDENCE Conceptual Framework

### Implemented by the Firm

- P&P's that monitor and address excessive reliance on revenues from a single client
- Designated member of senior management responsible for ensuring firm's QC standards met & maintained
- P&P's designed to identify interests or relationships between firm, partners, professional staff and clients
- Training & timely communication of firm's P&P's and changes
- Disciplinary mechanism designed to promote compliance

63



## AICPA INDEPENDENCE Conceptual Framework

### Implemented by the Firm

- P&P's designed to empower staff to communicate without fear of retribution
- P&P's relating to independence communication with audit committees & those charged with governance
- Disclosures regarding nature of services and fees
- Involvement of other professionals
- Consultation with interested third party(ies)
- Rotation of senior personnel who are part of the attest team
- P&P's ensuring attest team members do not make management decisions

64



## AICPA INDEPENDENCE Conceptual Framework

### *Other Considerations-- Impossible For Code To Address All Independence Circumstances*

- Evaluate specific circumstances
  - Would circumstances lead a reasonable person to conclude that there is an unacceptable threat?
- Consider risk-based approach in doing evaluation
- Safeguard(s) must be applied if threats not at an acceptable level
- Safeguards must reduce or eliminate threats to acceptable level
- Must document safeguards were applied
  - Failure to prepare the documentation is Rule 202, *Compliance With Standards*, violation

65



## Various AICPA Ethics Rulings & Interpretations

**Rule 102 – Integrity and Objectivity.** In the performance of any professional services a member should maintain objectivity and Integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

66

**AICPA INDEPENDENCE  
Conceptual Framework****Interpretations Rule 102 – Integrity & Objectivity**

- Violations when CPA knowingly:
  - Makes or permits or directs another to make, materially false and misleading entries in an entity's financial statements or records; or
  - Fails to correct an entity's financial statements or records that are materially false and misleading when he or she has the authority to record an entry; or
  - Signs, or permits or directs another to sign, a document containing materially false and misleading information

67

**AICPA INDEPENDENCE  
Conceptual Framework****Interpretations Rule 102 – Integrity & Objectivity**

- Conflicts of Interest (not all inclusive):
  - Performing litigation services in connection with lawsuit filed against a client of firm
  - CPA has provide tax or personal financial planning for a couple who are now divorcing; CPA has been asked to provide the service during divorce proceedings
  - CPA suggests client invest in a business he/she has financial interest
  - CPA provides tax or PFP services for several members of the same family who have opposing interests

68

**AICPA INDEPENDENCE  
Conceptual Framework****Interpretations Rule 102 – Integrity & Objectivity**

- Conflicts of Interest (not all inclusive):
  - CPA has significant financial interest, is a member of management, or in a position of influence in a company which is a competitor of client
  - CPA is on City's Board of Tax Appeals with matters against a tax client
  - CPA has been asked to provide service in connection with the purchase of real estate from a client

69

**AICPA INDEPENDENCE  
Conceptual Framework****Interpretations Rule 102 – Integrity & Objectivity**

- Conflicts of Interest (not all inclusive):
  - CPA refers client to an insurance broker or other provider which refers client back to CPA under exclusive arrangement
  - CPA recommends or refers client to service bureau in which CPA (or partners) hold material financial interest

70

**AICPA INDEPENDENCE  
Conceptual Framework****Interpretations Rule 102 – Integrity & Objectivity**

- Obligations: In dealing with his/her external accountant, member must be candid and not knowingly misrepresent facts or knowingly fail to disclose material facts...including in response to written representation.

71

**AICPA INDEPENDENCE  
Conceptual Framework****Interpretations Rule 102 – Integrity & Objectivity**

- Subordination of judgment by member: If a member and his/her supervisor have a disagreement or dispute relating to services provided the following steps must be taken:
  - Consider whether entry, failure to record entry, financial statement, or omission represents acceptable GAAP and does not materially misrepresent the facts. If no continued disagreement, do nothing further (all is well)
  - If yes, CPA should take concerns to next appropriate higher level of management within entity. Document discussion and decision.
  - If CPA concludes appropriate action was not taken, consider separation from entity; consider any responsibility for communication to third parties; consider consultation with legal counsel

72



*Questions?*

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