C P

A New Approach to

UNDERSTANDING

ACCOUNTING ETHICS

Principles-based accounting

Professionalism

Pride

by

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2005

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THE (HONEST) TRUTH ABOUT DISHONESTY

How We Lie to Everyone—Especially Ourselves

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Ethical Obligations and Decision Making in Accounting

Text and Cases

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The Social Animal
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nda (with Anthony Pratkanis)
ı Timothy Wilson and Robin Akert)

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Mistakes Were Made (but not by *me*)

Why We Justify Foolish Beliefs, Bad Decisions, and Hurtful Acts

CAROL TAVRIS *and* ELLIOT ARONSON

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MANAGING BUSINESS ETHICS

Straight Talk about How To Do It Right

Sixth Edition

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DECISIVE

THE WRAP PROCESS

To make better choices, we must avoid the most common decision-making biases. Being aware of these biases isn't sufficient to avoid them, but a process can help. The WRAP process can help us make better, bolder decisions.

WIDEN YOUR OPTIONS

Narrow framing leads us to overlook options. *(Teenagers and executives often make "whether or not" decisions.)* We need to uncover new options and, when possible, consider them simultaneously through multitracking. *(Think AND not OR.)* Where can you find new options? Find someone who has solved your problem. Try laddering: First look for current bright spots *(local)*, then best practices *(regional)* and then analogies from related domains *(distant)*.

REALITY-TEST YOUR ASSUMPTIONS

In assessing our options, the confirmation bias leads us to collect skewed, self-serving information. To combat that bias, we can ask disconfirming questions *(What problems does the iPod have?)*. We can also zoom out *(looking for base rates)* and zoom in *(seeking more texture)*. And whenever possible we should ooch, conducting small experiments to teach us more. Why predict when you can know?

ATTAIN DISTANCE BEFORE DECIDING

Short-term emotion tempts us to make choices that are bad in the long term. To avoid that, we need to attain distance by shifting perspective: What would I tell my best friend to do? Or, what would my successor do? *(Or try 10/10/10.)* When decisions are agonizing, we need to clarify our core priorities—and go on the offensive for them. *(Remember the stainless steel bolts on the Navy ship.)*

PREPARE TO BE WRONG

We are overconfident, thinking we know how the future will unfold when we really don't. We should prepare for bad outcomes *(premortem)* as well as good ones *(preparade)*. And what would make us reconsider our decisions? We can set tripwires that snap us to attention at the right moments. *(David Lee Roth's brown M&M, Zappos' $1,000 offer)*

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you're facing an ethical dilemma to begin with. Pay attention to your gut, but don't let it make your decision for you. Once you recognize that you're facing an ethical dilemma, use the rational decision-making tools developed here to help guide your decision making.

Practical Preventive Medicine

DOING YOUR HOMEWORK There's no doubt that you'll encounter ethical dilemmas—every employee probably encounters hundreds of them during a career; the only thing in doubt is when. Your mission is to be as prepared as possible before you run into a problem. The more informed you are, the more effective you'll be in protecting yourself and your employer. The best ways to do that are to learn the rules of your organization and your profession, and to develop relationships that can help you if and when the need arises.

You can learn the rules in various ways. First, read your company's code of ethics (if it has one) and policy manual. Since most policy manuals are huge, you obviously can't memorize one. If you skim the contents, some of the rules will sink in—you may not remember the exact policy, but at least you'll probably remember that one exists and where to find it.

Second, ask questions. Managers, executives, and peers will admire your initiative when you ask what they think is "important around here." Since many organizational standards are unwritten, and they differ from company to company, the best way to find out about them is by asking. Query your coworkers (including management) about what kinds of ethical situations are most common in your organization and how your organization generally handles those issues. Ask your manager how to raise ethical issues within your organization. Since he or she will certainly tell you to raise an issue with him or her first, be sure to find out how you raise an issue in your manager's absence. This not only gives you a road map for raising issues, but it also sends a signal to your manager that ethics are important to you.

Finally, develop relationships with people outside of your chain of command. Get to know people in human resources, legal, audit, and other departments; they might be able to provide information, help you raise an issue or determine whether something is even an issue, or vouch for your credibility in a crisis. You might also want to join a professional group or association. Many professions have developed ethical standards apart from those that may exist in your company, and it can be helpful to know other people in your profession who can advise you if a crisis arises in your company. Some may say this is being political, but we think it's just plain smart to network with people outside of your immediate job and company. It's the difference between being a victim of circumstance and having the power, the knowledge, and the network to help manage circumstances.

After you've done your homework and learned about your company's standards and values, you may find that your values and your employer's values are in conflict. If the conflict is substantial, you may have no choice but to look for work in another organization. We'll be addressing issues of company values and codes more in Chapters 5 and 6.

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WHEN YOU'RE ASKED TO MAKE A SNAP DECISION Many businesspeople place value on the ability to make decisions quickly; and, as a result, many of us can feel pressure to make up our minds in a hurry. This can be a particular issue when people are inexperienced for whatever reason—this may be their first job or a new company or industry—and they may feel a need to prove their competence by making decisions quickly. Obviously, that can be dangerous. The ethical decision-making tools described earlier in the chapter assume that you'll have some time to devote to the decision—to consider multiple sides of the issue and the inherent conflicts with any one course of action. Do your best to get the time to assess, think through, and gather more information. Also consider the following guidelines when a quick decision seems called for:

1. Don't underestimate the importance of a hunch to alert you that you're facing an ethical dilemma. Your gut is your internal warning system. As one senior executive at a multinational computer company said, "The gut never lies." When your gut tells you something's wrong, consider it a warning siren.
2. Ask for time to think it over. Most snap decisions don't have to be that way. Say something like, "Let me think about it, and I'll get back to you soon." Bargaining for time is a smart way to give yourself a break—then you can really think about the decision and consult with others. It's better to take the time to make a good decision than it is to make a bad decision quickly and have lots of time to regret it. Would you rather be known as cautious or reckless?
3. Find out quickly if your organization has a policy that applies to your decision.
4. Ask your manager or your peers for advice. You should consider your manager the first line of defense when you encounter an ethical dilemma. Regardless of your level within the organization, never hesitate to ask for another opinion. This is where a trusted network comes in handy. If you have friends in human resources or the legal department, you can float the issue with them on a casual basis to see if there even is an issue.
5. Use the quick-check *New York Times* test (the disclosure rule). If you'd be embarrassed to have your decision disclosed in the media or to your family, don't do it.

SHOULD JORDAN ACCEPT THE PRINTER DISCOUNT?

Jordan is upgrading his department's data processing capabilities and has just placed an order for four personal computers and two laser printers with a computer company representative. When he mentions that he wishes he had a printer at home like the ones he just ordered, the representative tells him that because of his large order, she can give him a 50 percent discount on a printer for his home. Jordan feels that this is not quite right, but he's not sure why and would like some time to think about her offer.

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Behavioral ethics looks at how human beings actually behave in moral contexts and describes the actual behavior of people, how situational and social forces influence it, and ways in which decisions can be nudged in a more ethical direction through simple interventions. This approach to ethics requires understanding and explaining moral and immoral behavior in systematic ways. It requires understanding the antecedents and consequences of both ethical and unethical actions. Finally, it requires identifying levers at both the individual and the institutional level to change ethically questionable behaviors when individuals are acting in unethical ways that they would not endorse with greater reflection.[60]

Giving Voice to Values

LO 2-7
Describe the "Giving Voice to Values" technique and apply it to a case study.

"Giving Voice to Values (GVV)" is a behavioral ethics approach that shifts the focus away from traditional philosophical reasoning to an emphasis on developing the capacity to effectively express one's values in a way that positively influences others by finding the levers to effectively voice and enact one's values.[61] The methodology asks the protagonist to think about the arguments others might make that create barriers to expressing one's values in the workplace and how best to counteract these "reasons and rationalizations."[62]

GVV links to ethical intent and ethical action in Rest's Model. An ethical decision maker should start by committing to expressing her values in the workplace. The intent is there, but it may fall short of the mark of taking ethical action unless a pathway can be found to express one's values in the workplace. It is the pathway that GVV addresses.

GVV is used post–decision making; that is, you have already decided what to do and have chosen to voice your values. In the Ace Manufacturing case, elaborated on below, Davis knows he must act and we assume he has decided to give Paul a chance to explain about the "personal" expenditures. Other decisions might be made by students, but we use the alternative of giving Paul a chance to explain his actions as the basis for the following discussion.

Davis wants to do what he thinks is right, but he needs to be prepared for the eventuality that Paul will pressure him to stay silent. Davis needs to find a way to communicate his values powerfully and persuasively in the face of strong countervailing organizational or individuals norms, reasons, and rationalizations. In other words, how can Davis find a way to effectively articulate his point of view so that others can be convinced of its rightness?

According to Mary Gentile who developed the GVV methodology, "It shifts the focus away from awareness and analysis to action by addressing a series of questions for protagonists after identifying the right thing to do," including: How can you get it done effectively and efficiently? What do you need to say, to whom, and in what sequence? What will the objections or pushback be and, then, what will you say next? What data and examples do you need to support your point of view?[63]

Kohlberg argued that higher moral development requires role-taking ability. Role-taking ability involves understanding the cognitive and affective (i.e., relating to moods, emotions, and attitudes) aspects of another person's point of view. Davis needs to consider how Paul might react; what he might say; and how Davis might counter those statements when he meets with Paul.

The underlying theme of GVV is that we can effectively voice values in the workplace if we have the proper tools to do so. GVV relies on developing arguments and action plans, and rehearsing how to voice/enact not just any values, but moral values specifically. For our purposes, the pillars of character and virtues discussed in this and the previous chapter are our target behaviors.

Reasons and Rationalizations

An important part of the GVV methodology is to develop ways to confront barriers we may encounter when value conflicts exist in the workplace. These barriers often appear in the form of "reasons and rationalizations" that can confound our best attempts to fulfill our sense of organizational and personal purpose. These are the objections one might hear from colleagues when attempting to point out an ethical problem in the way things are being done, as Cynthia Cooper experienced in the WorldCom case. Or, sometimes you do not hear them because they are the unspoken assumptions of the organization.[64]

GVV provides a framework to deal with the opposing points of view based on the following series of questions.[65]

- What are the main arguments you are trying to counter? That is, what are the *reasons and rationalizations* you need to address?
- What is at *stake* for the key parties, including those who disagree with you?
- What *levers* can you use to influence those who disagree with you?
- What is your most *powerful and persuasive response* to the reasons and rationalizations you need to address? To whom should the argument be made? When and in what context?

Gentile identifies the most frequent categories of argument or rationalization that we face when we speak out against unethical practice. Some of the most common arguments include:

Expected or Standard Practice: "Everyone does this, so it's really standard practice. It's even expected."

Materiality: "The impact of this action is not material. It doesn't really hurt anyone."

Locus of Responsibility: "This is not my responsibility; I'm just following orders here."

Locus of Loyalty: "I know this isn't quite fair to the customer, but I don't want to hurt my reports/team /boss/company."

An additional argument we include is:

Isolated Incident: "This is a one-time request; you won't be asked to do it again."

Basic Exercise in GVV

GVV Brief Exercise: Doing Good by Being Good

Matt and Becca volunteered to head up the Accounting Club efforts to organize volunteers for a clean-up effort and raise donations to help the students, faculty, and staff at the college affected by Hurricane Debits. Over 1,200 had been displaced from their homes, apartments, and dorm rooms due to the severe weather. Over the next month the 25 students of the club helped clean up debris left by the storm and donated over 2,000 hours of time. Matt set up a GoFundMe Web page and posted pictures of the devastation on Instagram. Donations from the community totaled $20,367. The relief agencies in town suggested the club purchase $100 Visa and MasterCard gift cards to be distributed to the affected community members. Matt purchased 200 such cards and Becca delivered them.

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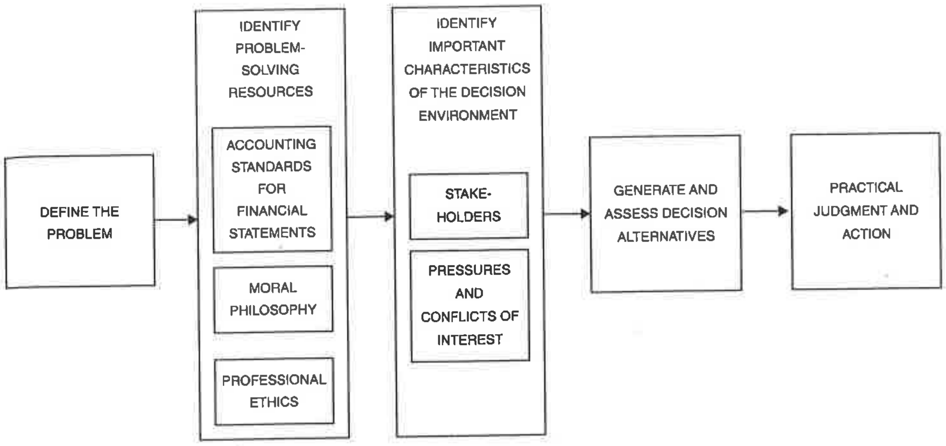

Figure 6.1 A Decision Model for Accounting Ethics

understand the rules related to the preparation of financial statements. In Chapter Four and Chapter Five, we shed light on how accounting standards and moral philosophy can serve as resources for addressing the technical and the ethical dimensions of the problems accountants face. In this chapter, we see how professional ethics bridges those two dimensions by complying with the standards for preparing high-quality financial reports.

ACCOUNTING AS A PROFESSION

In ordinary language, we often refer to someone as a professional just to indicate that the person is highly qualified for a specific task or does a job well. A more precise meaning of the concept "professional" is tied to being part of a distinct type of organization that provides an important public service, a "profession". This term denotes particular kinds of vocations that have special features and are practiced under distinctive conditions. Among the common professions are medicine, law, nursing, psychological counseling, and accounting and auditing.

A profession is a social community that administers a distinctive occupation organized to serve a society. Typically, the profession has a monopoly on administering that occupation, to oversee its practice and those who perform its tasks. A profession should be seen as a *community* comprised of those who are qualified (and certified) to work within that community. The members of a profession have an educational background – knowledge and skills – that allows them to practice the occupation. The fact that the occupation is *administered* by the profession through its agencies and institutions means that its members and their activities are to be guided by particular standards, rules and codes. These professional bodies grant rewards for following these standards and mete out penalties (or sanctions) when serious violations of these standards occur. The penalties, for example, mean that the professional body can prohibit individual members from performing their distinctive tasks, practicing their unique occupation, if these members violate professional standards and fail to serve the public interest. The profession is *organized for a society*; this means that the

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profession administers the benefits associated with its members' ability to offer specific services to the general society (for instance, give legal advice, perform surgery or practice dentistry). This management of the profession is achieved by mandating and enforcing a knowledge-oriented and skillful self-discipline within the profession. In other words, the general society delegates the task of carrying out specific functions (for instance, auditing) to the profession, and this professional body ensures that the special practice of performing these functions (preparing a financial statement or auditing it) is carried out in a manner that serves the needs and desires of the society that allows the profession to exist. To say that professions typically are *monopolies* means that the professional occupation (with its special functions and distinctive tasks) cannot be practiced by just anybody. These tasks, the duties of the special occupation, are to be performed only by members of the profession, those who are qualified and certified by the professional body itself. Given this limitation, professions are self-protective against possible competitors. Most importantly, the members of the profession have the great responsibility to carry out their practice in a manner that justifies the monopoly status of the profession. They are obligated to fulfill the roles assigned to them within the profession, so that the general society can be served.

Professions consist of numerous individuals who have volunteered their services to an occupation or practice. These individuals have professional rights and duties because of their membership in the profession. Professionals are granted privileges and have restraints and limitations. A professional member is allowed to do things that others, non-professionals, cannot do. For instance, surgeons may cut into other people's bodies, and auditors may inspect the confidential information of company-clients. At the same time, however, being a professional means acceptance of constraints and limitations – there are things prohibited to professionals that others may do. For instance, a surgeon may not freely engage in a romantic relationship with a patient; an auditor may not talk openly about the interesting things he or she has found within the financial records of a client. In addition, there are actions taken by a professional – even mandated – that are contrary to the norms and values of common morality that are honored by those who are outside a given profession. For instance, we accept that defense attorneys do everything in their power to defend a violent criminal, even when their efforts may seem repugnant to an ordinary citizen. Yet it is socially unacceptable for a private person to do such a thing. In a word: there are standards of behavior for professionals, and professionals are held accountable to those standards by the administrative functions and management roles of the profession itself. Professionals are bound to the specific discipline of their occupation, and they will be held accountable if they violate the standards of their own profession. Yet given these constraints and obligations, the day-to-day practice of professionals permits a great deal of autonomous behavior, a wide scope of judgment and personal decision making. In this context, it is not common that professional bodies need to sanction or penalize their individual members, and the supervisory functions of professional bodies over their members are seldom used.

Because professions have monopoly status in their society, the administration of their members' activities is best understood as a type of management for the sake of a social responsibility. Professionals perform important social functions; they play an invaluable role in the general society. Because of this, professions are held to be

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responsible primarily to the general society itself; professions serve the public interest. By extension, individual members of the profession are liable to that society for the manner in which they carry out their professional duties and play their distinctive roles. For this social responsibility professional bodies develop systems for self-regulation with the aim of legitimizing their own functions in the eyes of the public. Professions support their own members as they serve the needs and expectations of society.

This system of self-regulation includes standards-setting organizations which develop professional standards and codes of ethics. There are also institutions that permit the profession to discipline its members whenever professional standards are violated or codes of conduct ignored. By means of these agencies, standards and enforcement procedures, the profession disciplines its members and holds them accountable to the constraints and limitations of the profession. Professional bodies hold their members to public service. To the extent that many professionals act in ways that violate such standards, it may threaten the legitimacy of the profession, violating the public's trust, and this may undermine the profession's very existence. In the wake of the big accounting scandals of the 2000s and the demise of the auditing firm Arthur Andersen, the auditing profession in the United States of America found itself in such a situation. The scandals undermined public trust and called into question the monopoly status of the accounting profession, with its privileges and responsibilities to serve public needs. Given the threat of accounting scandals that may erode public trust, professions are very concerned about maintaining the respect and goodwill of their stakeholders and the general society. To counter potential threats to their privileged status and to act in responsible fashion, professions continually develop and update their standards and codes and strive to meet social expectations and retain public trust.

PROFESSIONS

A profession is a community within a broader society that administers an occupation organized for that society. Typically, the profession has a monopoly for administering that occupation, for managing its members. Professional bodies govern the professional practice of its members. They do this by developing professional standards and codes of ethics, monitoring the roles and behavior of its members as they perform their duties, and by sanctioning those professionals who violate the standards.

Accounting (and auditing) is a profession that shares the characteristics outlined in the definition above. The degree of professionalization – and thereby of regulation – differs among countries, but generally, accountants are regulated by accounting regulatory bodies. This chapter focuses on professional ethics, and we limit our presentation of professional ethics to the standards and codes developed by the International Ethics Standards Board for Accountants (IESBA), which is part of the International Federation of Accountants (IFAC).[1] In the following, we will outline the code of ethics developed by IESBA and discuss its use for accountant decision making.

> Judgment is inseparable from integrity and good professionalism, since no one who lacks integrity or professionalism can reliably exercise good judgment.

A profession, not a business

Accounting is a profession, not a business. Later, in chapter four, we'll explain more carefully what makes a profession different from a business. Intuitively, a business provides a service to please a customer and ultimately at the bidding of a customer; a profession serves the public interest by adhering to an ideal.

Accounting is a profession which adheres to ideals of truthfulness and accuracy in order to support the trust that is necessary for flourishing business and healthy financial markets. This is well-captured in a speech by John Bogle, Founder of the Vanguard Group, when he served on the Independence Standards Board (since disbanded with the formation of the PCAOB). He first describes the societal need to which the profession of accounting answers:

> Sound securities markets require sound financial information. It is as simple as that. Investors require—and have a right to require—complete information about each and every security, information that fairly and honestly represents every significant fact and figure that might be needed to evaluate the worth of a corporation. Not only is accuracy required but, more than that, a broad sweep of information that provides every appropriate figure that a prudent, probing, sophisticated professional investor might require in the effort to decide whether a security should be purchased, held, or sold. Full disclosure. Fair disclosure. Complete disclosure. Those are the watchwords of the financial system that has contributed so much to our nation's growth, progress, and prosperity.[7]

Bogle then draws attention to what he calls "the pervasiveness of the societal trend of professions to become businesses", affecting law,

[7] The Seymour Jones Distinguished Lecture at the Vincent C. Ross Institute of Accounting Research Stern School of Business, New York University, New York, New York, October 16, 2000.

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medicine, and financial services, and he claims that accounting finds itself under similar pressures. He speculates that the "high standards of the attestation profession" have served as something of a check on these pressures, but he warns that accounting nonetheless finds itself in danger of losing in part its integrity and independence:

> [O]ver the years, attestation has come to account for only about one-third of the $26 billion of revenues of today's "Big Five" accounting firms, with tax services accounting for one-quarter. The remainder, not far from one-half of revenues, is derived from consulting, management, and advisory services. The potential problem that arises from this trend, obviously, is that the desire to garner or retain a highly-lucrative consulting contract from an audit client could jeopardize the auditor's independence....
>
> It must also be clear that, whether or not the auditor has the backbone to maintain its independence under these circumstances, many management and consulting arrangements could easily be perceived as representing a new element in the relationship between auditor and corporation—a business relationship with a customer rather than a professional relationship with a client. Surely this issue goes to the very core of the central issue of philosophy that I expressed earlier: The movement of auditing from profession to business, with all the potential conflicts of interest that entails.

We'll see later in our case studies that Andersen adopted a business-partner role that apparently clouded its judgment and hindered it from performing its attest role correctly. Bogle's concerns were unfortunately amply vindicated.

Sarbanes-Oxley prohibits the relationships and conflicts of interest that Bogle highlights. Nonetheless, the law is not sufficient for fully correcting the problem, for two reasons. First, there is the problem of how in the first place the accounting profession might have allowed its nature as a profession to erode; such an internal change could not possibly be reversed simply by the passage and enforcement of a law. For instance, in the book, *Inside Arthur Andersen*, the authors describe what they call the 'partner purge' of 1992. A criterion was imposed on

Andersen partners of handling 20,000 billable hours per year. Those unable or unwilling to do so were asked to leave:

> The purge cut deeply, removing about 10 percent of the most conservative partners with traditional values, and increasing the value put on revenue generation through sales. Many of those removed were the most experienced individuals with a deep commitment to quality or were auditors with exceptional technical skills. They were good at conducting audits but not selling them. When Andersen lost these partners, the firm lost expertise through which quality was taught and learned....The purge also contributed to the destabilization of the delicate balance between youth and experience within the firm...With the partner purge, the role of the partners shifted to one aligned with management and sales.[8]

Clearly, a cultural shift of this kind within a firm could not be reversed simply through legislation. What would be needed, in addition, would be a change in the outlook of practitioners, toward a better understanding of and commitment to professionalism and all that it implies. The same thing of course applies as well to firms which did not have such a radical 'purge', but which still to some extent capitulated from within to the sorts of pressures that Bogle describes.

Second, there is the problem of 'the general fighting the last war'. Successful old generals often fail because they are fighting the last war, not the present war. Similarly, legislation often fails because it was designed to remedy bad practices from the past, not anticipating some new form of malfeasance. How can the accounting profession prevent a scandal from arising in the first place? How can it prevent the 'next' war from breaking out? Surely a firmer grasp of the nature of accounting as a profession is absolutely necessary for accountants today, precisely to guard against other, unforeseen ways in which the practitioners might go off track.

Professionalism is fundamentally an ethical orientation, implying integrity and adherence to high ideals. Thus, any reform that attempts

[8] Susan E. Squires, Cynthia J. Smith, Lorna McDougall, and William R. Yeack, *Inside Arthur Andersen: Shifting Values, Unexpected Consequences*, New York: Prentice Hall, 2003, p. 99.

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to articulate, once again, the highest ideals of professionalism for an accountant, must necessarily pay careful attention to ethics. *There can be no true professionalism without attention to ethics.*

> Professionalism is an ethical orientation, implying integrity and adherence to high ideals. Any reform that attempts to articulate the highest ideals of professionalism for an accountant, must necessarily pay careful attention to ethics.

Pride in accounting

In his speech immediately following the passage of Sarbanes-Oxley, AICPA President Barry Melancon remarked:

> We are committed to rebuilding confidence in the financial markets and their institutions. We're committed to dramatically reducing the risk that future investors will fall prey to the kind of financial malfeasance that characterized Enron and WorldCom. And we are committed to something else as well: restoring pride in our profession. For us, it's personal.[9]

But how does one go about doing this? Melancon first acknowledges, as we have said, that there needs to be a reform from within the profession, and that externally mandated changes are insufficient:

> But let's recognize the challenge ahead: Reestablishing the perception of the audited financial statement as a clear picture window into a publicly traded company will not be achieved purely by legislation or regulation. No, the lead role must be played by all members of the profession. We must reach back to our core roots which earned us enormous respect as trusted advisers. We must reassert the heritage that made the accountant the professional in whom Americans confide their most confidential financial information and to whom they turn for honest advice.

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[9] Barry C. Melancon, "A New Accounting Culture."

But this sort of reform involves articulating once again the ideals of the profession, and reasserting the true ethic, outlook, and culture of accountancy:

> What is needed is not just reform of the accounting laws, it is a rejuvenated accounting culture, both internally in corporate finance offices and externally in audit firms. The culture must build upon the profession's traditional values, such as rigorous commitment to integrity, a passion for getting it right, a commitment to rules—not just to their letter, but their spirit, and zero tolerance for those who break them. These values are the commitment of all of the 350,000 CPAs who are members of the AICPA across this country. We are determined to restore the image of the accounting profession and rebuild the legacy we will pass on to the next generation of accountants.

Clearly what Melancon talks about here—integrity; a passion for getting it right; the profession's 'traditional values'—are all a matter of accounting ethics. Therefore, *there can be no new accounting culture without a turn to accounting ethics.*

Virtue-based ethics

In this book, we provide a virtue-based approach to accounting ethics. "There is a need for virtue in accounting, because the virtues enable accountants to resist client and commercial pressures that may result between an accountant's obligation to a client or employer and public interest considerations."[10] In a virtue-based approach to the profession, one first identifies the distinctive 'function' or purpose of accounting. We maintain that the function of accounting is to enable the trust that is required for thriving business and sound financial markets. Next one considers what traits an accountant should have, in order to carry out this distinctive function well. We therefore go on to explain what the traits of objectivity, integrity, and independence are, and how these are the 'virtues' of an accountant.

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[10] S. Mintz, "Virtue Ethics and Accounting Education", *Issues in Accounting Education* 10 (Fall): 247-267, p. 247.

How an Ethical Culture Can Become an Unethical Culture

The story of Arthur Andersen, the now defunct auditing company, provides a sad example. It demonstrates how a solidly ethical culture can be transformed into an unethical culture rather quickly and lead to the demise of an 88-year-old firm.

Founder Arthur Andersen created the company when he was in his twenties. As chief executive, the messages he conveyed about ethical conduct were strong, consistent, and clear. Andersen's mantra, "Think straight—talk straight," guided employee behavior in an organization where "integrity mattered more than fees." Stories about the founder's ethics quickly became part of the firm's mythology and lore. For example, at the age of 28, Andersen confronted a railway executive who insisted that the accounting firm approve his company's books. Andersen said, "There's not enough money in the city of Chicago to induce me to change that report."[87] Andersen lost the railway company's business, but when that company later went bankrupt, Arthur Andersen became known as an organization people could trust to be honest and to stand up for what was right.

In the 1930s, Arthur Andersen emphasized accountants' special responsibility to the public. The founder died in 1974, but because his values were internalized by so many others, he was followed by leaders with similar beliefs, and the strong ethical culture continued for decades. The management style Andersen initiated was a centralized, top-down approach that produced employees who were systematically trained in the "Andersen Way." Customers around the world knew they could expect quality work and integrity from Andersen employees, who were all carefully socialized to speak the same language and to share "Android" values. Through the 1980s, people were proud to say they worked for Arthur Andersen, which would provide a good career with a respected company.

In the mid-1990s, Arthur Andersen still provided formal ethical standards and ethics training. In 1995 it even established a consulting group, led by Barbara Toffler, to help other businesses manage their ethics. But Toffler quickly became concerned about the ethics of her own employer, which she chronicled in her book *Final Accounting: Ambition, Greed, and the Fall of Arthur Andersen*.[88] Toffler attributed much of the change from ethical culture to unethical culture to the fact that the firm's profits increasingly came from management consulting rather than auditing. Auditing and consulting are very different undertakings, and the cultural standards that worked so well in auditing were inconsistent with the needs of the consulting business. Under the new business realities, rather than standing for principles of honesty and integrity, consultants were encouraged to keep clients happy and to concentrate on getting return business because only revenues mattered. They were even expected to pad prices or create work to increase profits.

Even the training that had always been so important to Andersen's culture wasn't immune from change. Traditionally, new employees (recent college graduates) had been required to attend a three-day enculturation session, but now new consultants (often hired with experience outside the firm) were told not to forgo lucrative client work to attend the training. So Toffler and lots of other consultants never received the cultural training.

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By the time Toffler arrived at Andersen, no one referred to the ethical standards, although they still existed in a big maroon binder. Toffler says, "When I brought up the subject of internal ethics, I was looked at as if I had teleported in from another world." So Andersen still had ethics policies, and they still talked about ethics in formal documents, but the business had changed dramatically and the approach to ethics management had not kept pace.[89]

Andersen was convicted of obstruction of justice for shredding documents associated with its role as Enron's auditing firm and quickly went out of business. The Supreme Court reversed the decision in 2005, ruling that the jury had not been advised that conviction in a white-collar crime case requires evidence of criminal intent. However, the Supreme Court reversal did not clear Andersen of wrongdoing. In fact, prosecutors provided evidence of criminal intent.[90] In the end, even if someone had wanted to, there was no firm left to resurrect.

Was Andersen's transformation from ethical culture to unethical culture a conscious process? Did anyone ever say, "Now we're going to create an unethical culture at Arthur Andersen"? That's doubtful. But leaders' lack of attention to the ethical culture as the organization was undergoing a significant business transformation practically guaranteed that the messages sent by the informal culture (revenues, revenues, revenues) would begin to overpower those sent by the formal culture (ethics standards) and lead to a culture that was seriously out of alignment as well as one that increasingly sent messages suggesting that only the bottom line mattered.

Becoming a More Ethical Culture

What should an organization do if it wants to transform itself into a more ethical culture? Given our multisystem perspective on ethical culture, changing organizational ethics in a positive direction involves simultaneously developing or changing multiple aspects of the organization's ethical culture. If the effort is to be successful, this ethical culture development or change should involve the alignment of all relevant formal and informal organizational systems to focus on ethics. Obviously, this requires a major commitment from the most senior levels in the organization. Culture change attempted at lower levels is likely to be ineffective unless it is fully supported and modeled by senior management. Unfortunately, some companies (e.g., Arthur Andersen) go out of business before they have this opportunity.

Changing organizational culture is more difficult than developing it. In a new organization, workers are quite open to learning and accepting the culture of their new organizational home, especially if it fits with their own values. However, anthropologists and organizational scientists agree that changing an existing culture is an extremely difficult process.[91] This view is consistent with an idea basic to all organizational change and development efforts—that changing individual and group behavior is both difficult and time-consuming. The human tendency to want to conserve the existing culture is referred to as cultural persistence, or inertia. Culture has an addictive quality, perhaps because culture members are aware that culture components cannot be altered without affecting other cherished values and

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Accountants should respect the *confidentiality* of information[3] acquired as a result of professional and business relationships and not disclose any such information to third parties without proper and specific authority (unless there is a legal or professional right or duty to disclose). Nor should the accountant use the information for personal advantage for himself or for third parties. The duty to maintain confidentiality is very strict, but there are exceptions in cases where the client releases the accountant from confidentiality or in cases where regulatory bodies subpoena the accountant in order to disclose confidential information.

Professional behavior is expected of accountants. This means complying with relevant laws and regulations and avoiding any action that discredits the profession. This principle directly relates to the conduct of the accountant, and has a compliance dimension as well as a reputational dimension. First, it deals with the responsibility for acting in accordance with the laws and regulations that govern accountancy. Second, it deals with acting in a manner that is compatible with maintaining the reputation and legitimacy of the accountancy profession in the eyes of the general public. This principle can be seen as an overarching principle that overlaps with the other principles, in the sense that it relates to the overall conduct of the accountant and the degree to which he or she complies with the relevant expectations of the profession.

Threats and Safeguards

The IESBA code of ethics also outlines threats to the fundamental principles and lists safeguards that can be applied in order to eliminate or reduce such threats. The code of ethics distinguishes between five different types of threats which are common in that professional practice of accountants:

1. Self-interest threats
2. Self-review threats
3. Advocacy threats
4. Familiarity threats
5. Intimidation threats.

Self-interest threats refer to threats that a financial or other interest will inappropriately influence the professional accountant's judgment or behavior. If the accountant's professional judgments advance his or her own interests, it will, in effect, become more difficult to be unbiased and objective. This refers not only to conscious but also to spontaneous decision making, for biases also have a strong influence on the unconscious assessments and the more spontaneous decisions of individuals. For this reason, professionals are discouraged from having private interests related to their professional assignments. For instance, auditors may not own stock in the companies they audit. (More discussion will be given to the distinction between conscious (deliberative) decisions and more spontaneous (heuristic) decisions in Chapter Nine.)