

Chapter 1 -- Discussion Questions

Suggested Discussion and Solutions

Instructor Note: One of the authors of this text, Steven Mintz, writes ethics blogs under the name “Ethics Sage.” He writes three blogs: www.ethicssage.com, www.workplaceethicsadvice.com, and www.higheredethicswatch.com. These blogs are referenced occasionally to support possible solutions.

From time to time students at various universities submit rather elaborate comments and/or a new blog based on an original blog as part of their course assignment. You may want to ask students to find one of Steve’s blogs that is of interest, craft an *opposing view* or extended discussion of the blog issue, and then submit it to me. Steve will post it if it meets certain criteria. Here is a link to a student blog that deals with CSR and gender equality in response to one of my blogs (<https://www.workplaceethicsadvice.com/2020/09/my-entry.html>).

There is a file on the IRD to show you what one student wrote. Here is a link to a blog by a student in response to one of my blogs.

1. Is it ever appropriate to lie to someone? Give one example of when you believe lying might be justified

Lying involves two things: (1) An outright, purposeful false statement to another (lie by commission) and (2) The failure to disclose all the information a person has a right to know (lie by omission).

Recall the 2017 Las Vegas shooting that occurred on the night of Sunday, October 1 when a gunman opened fire on a crowd of concertgoers at the [Route 91 Harvest music festival](#) on the [Las Vegas Strip](#) in [Nevada](#), leaving 58 people dead and 851 injured. Between 10:05 and 10:15 p.m. PDT, 64-year-old Stephen Paddock of [Mesquite, Nevada](#), fired more than 1,100 rounds from his suite on the 32nd floor of the nearby [Mandalay Bay](#) hotel. About an hour after he fired his last shot into the crowd, he was found dead in his room from a self-inflicted gunshot wound. His motive remains unknown. Now, imagine you are a friend of Paddock and he confides in you about the pending shooting. You decide to inform the authorities. The authorities tell you they will have agents swarming over the hotel. In Paddock’s last act before the shooting, he tells you he’s quite certain the authorities have no idea what he is about to do. Should you be honest and tell him you went to the authorities and they will be prepared to cut off his action?

One could argue you are a dishonest person because you outright lied to Paddock about the police’s knowledge of your actions. You also failed to tell him the police would be ready to intercede. We could argue the issue of trustworthiness and loyalty as well. These pillars of character are at risk in your action. So, what justifies doing what you have done in informing the police? Simply put, an ethical person avoids harming others and you have the opportunity to live up to those values. Lying to Paddock (by omission) is justified here to save the lives of others. While Rights Theory holds that the ends do not

justify the means, sometimes the means should dictate what action should be taken to avoid harm. You considered the consequences of your actions, realized lying to Paddock was justified to save the lives of others, and calculated that the benefits of telling the police far outweighed any costs to your friendship.

While it could be argued that Paddock might decide not to go ahead with the shooting once you inform him of the police presence, Paddock still might do the deed in order to make the statement he wants to make. He might move up the time of the attack.

2. Is there a difference between cheating on a math test, pocketing an extra \$10 from the change given to you at a restaurant, and using someone else's ID to get a drink at a bar?

All are examples of lying and affect one's character through honesty and integrity. Many will use many rationalizations to justify their actions. Some may try to split hairs between what is wrong and what is more wrong – an ethical relativistic approach that should not be used. Just imagine a business that decides one improper financial reporting act is not as bad as another, so the former is allowed.

Notice in the first two instances the action harms others. For example, cheating on a math test affects the level playing field so that each student has an equal opportunity to excel on a test. Keeping the change means the waiter/waitress may have to cover the shortfall out of her pocket. Even using someone else's ID to get drunk puts the person whose ID you used at risk if, for example, you drive home in a drunken state and cause a serious accident that harms others.

3. Sir Walter Scott (1771–1832), the Scottish novelist and poet, wrote: “Oh what a tangled web we weave, when first we practice to deceive.” Comment on what you think Scott meant by this phrase.

Lies often require explanations that seem simple, but if examined, may call for further lies. In some cases, merely remembering a lie is more difficult than remembering the truth. Fiction is filled with stories of one lie leading to others. You might collect a list of those famous stories. This question provides an opportunity to remind students of the ethical slippery slope and once a lie is told, the person who tells it begins the slide and it is much more difficult to climb back up and regain the moral high ground. The concept of an 'ethical slippery slope' is one that defines behavior when a decision-maker first decides to deceive others by consciously covering up or lying about past behavior. This begins the slide down the proverbial ethical slippery slope where it becomes more difficult to reverse course because the decision maker is committed to the deceitful action; then since most people don't want others (i.e., superiors) to know about the initial, wrongful action over time cover up or lying slowly become untangled and the truth emerges.

Betty Vinson was a victim of the ethical slippery slope. Once she agreed to go along with financial wrongdoing and enter false data into WorldCom's accounting system, it became difficult for her to change direction as future requests were made for her to do the same.

Mark Twain is quoted as saying, “If you tell the truth you don’t have to remember anything,” meaning if you tell a lie you have to remember what lie you told to who.

An interesting angle to this discussion is what appears to be the failure of the media to spend the time to corroborate truthful information. In other words, what steps should journalists take to avoid “fake news.” The following link may be of interest if you choose to extend the boundaries of this question: <http://mediashift.org/2015/02/how-lies-spread-faster-than-truth-a-study-of-viral-content/>.

- 4. One explanation about rights is that “there is a difference between what we have the right to do and what is the right thing to do.” Explain what you think is meant by this statement. Do you believe that if someone attacks your credibility on social media that gives you the right to attack them?**

Having a right to do something allows one to be concerned with one’s self interest only (egoism). Doing the right thing often requires one to consider others besides and before one’s self (at a minimum enlightened egoism, but also utilitarianism, deontology, justice, and virtues). An example is shouting there is a fire in a crowded movie theater. We have the right to do so but it is not the right thing to do.

In virtue ethics, the decision-maker would want to do the right thing and have it become a habit. Deontology would emphasize the duty of doing the right thing and telling the truth, not just when it is convenient or does not intervene with personal desires,

One example students can relate to with respect to having their credibility attacked is trolling. We all spend many hours each day on the Internet so our social media footprint says a lot about who we are. Disturbing behaviors such as hate-speech, cyberbullying, and trolling have made the online experience troubling for many of us.

Trolling defines a highly dysfunctional online user who targets others using cyberbullying, harassment, internet defamation, online deception, and the like. Trolls can hide behind their electronic devices, screen names and avatars when they go out trolling for trouble, and after their all done the target of their offensive behavior is left to pick up the pieces.

A troll might insert him/herself into a conversation on social media and post comments designed to upset or disrupt the conversation. Their sole purpose may be to offend others. It can be a losing battle to attack these folks back to get even or silence the troll. It’s likely to only inflame the rhetoric.

- 5. Do you think it is ethical for a prospective employer to investigate your social media footprint in making a hiring decision? What about monitoring social networking activities of employees while on the job?**

Social media is one of the most popular forms of communication, particularly with millennials. Anyone can connect with anyone else or find information about others that may not otherwise be available. Thus, it should not be surprising if firms use social media

to research potential job candidates. Firms may argue that social media is a public platform, unless the candidate makes it otherwise, and that it's their own choice to share the content that is available to anyone who searches for it. CareerBuilder found in a 2014 survey that 43% of hiring managers who research candidates said they had found information on social media that caused the firm not to hire the candidate.

A platform like LinkedIn allows a firm to fact-check a candidate's resume or CV. The firm may find out that a candidate lied on their application about qualifications, experiences, or other information. This information may cause the firm not to hire the candidate. However, other social media platforms may include pictures, statuses, and likes about illegal activity, bullying, a criminal past, or posts that include racism, sexism, homophobia, or an unpopular political position. Lying about qualifications and engaging in illegal activity are acceptable factors that might influence a firm's hiring decision. Personal opinions and free speech would be unethical to use in hiring decisions and may send the wrong message that a future employee should not feel free to speak out if she identifies wrongdoing.

On the other hand, if the employee is seeking a job with a government entity, the standards may be stricter because of the need to take care not to express one's opinion on controversial matters that may pertain to the work of the agency, albeit not directly related to a specific matter before the agency. In this case it is important for the employee's statements not to appear to reflect the agency's position on the matter.

The firm would be using rights and utilitarianism theories in using social media to research candidates. The firm may think that it has a right to know if a job candidate is lying or engaging in illegal activities. From a utilitarian point of view, the firm wants the result to be the hiring of an honest job candidate who is not engaging in illegal activities. The benefits of monitoring their social media footprint and, possibly, help to avoid harm to others, outweighs any costs to do so.

For example, what if the candidate was a child predator like Jared Fogle, the Subway spokesperson? [On November 19, 2015, Fogle was sentenced to more than 15 years in federal prison after pleading guilty to charges of child pornography and crossing state lines to pay for sex with minors.]

We believe candidates should know that in today world one's prospective employer may be searching the Internet for character-based information on candidates for positions. It is the candidate's personal responsibility to act appropriately and be cautious about what they say on the Internet. From a rights and virtue perspective, the firm should notify candidates that it will be researching their backgrounds on social media.

A firm may set policies for appropriate social media activities during the workday and on using company equipment for personal reasons. The firm wants a full day's work for its pay to an employee and may consider using company time for personal social networking and posting as a form of theft. Setting a company policy on proper use of company computers and email accounts may include usage of the Internet and appropriate surfing

of the net, online shopping, and other personal activities. A bigger challenge for firms is regulating employees' usage of a personal smart phone during the workday.

An individual using company time or equipment to access social media for personal activities is acting out of egoism, or self-interest only. You wouldn't want a personal assistant texting or updating her Facebook status while working for you, so why should you do it when working for others? A firm setting clear guidelines and expectations on personal activities on company time, if any, is employing utilitarian, deontological and virtues ethics reasoning. The policy might allow for exceptions such as monitoring the health of a sick child being watched by another.

- 6. According to the website *Indeed*, one question to ask the interviewer when you are interviewing for a job is: "What are the characteristics of someone who would succeed in this role?" Why might you ask such a question?**

You are looking to find out if the organization values ethical characteristics. The proper characteristics to talk about can be seen in the six pillars of character. You want to hear whether the company emphasizes values such as honesty, integrity, trustworthiness diligence, and responsibility. If all they talk about is loyalty then you should ask whether these values are important to the organization? If the interviewer does not address them to your satisfaction, you may want to move on and interview elsewhere. The reason is if they put you in a difficult situation, dealing with it may be difficult.

- 7. Some people believe that promise-keeping is the essence of ethical behavior. Do you agree?**

Promise-keeping is part of the six pillars of character. Promise-keeping is important in friendships. You expect your friends to keep your confidence and not disclose personal information unless you approve. A loyal friend will commit to this behavior.

Promise-keeping is important because it reflects honesty, integrity, due care, reliability, and responsibility. It all adds up to whether a person is trustworthy. The public interest in accounting is based on developing the characteristic trait of living up to commitments to serve the public good (i.e., investors and creditors). That makes for a trustworthy professional.

- 8. David Starr Jordan (1851–1931), an educator and writer, said, “Wisdom is knowing what to do next; virtue is doing it.” Explain the meaning of this phrase as you see it.**

This quote addresses the fact that it is not enough to know what is right or wrong; one must also act on that knowledge. Knowledge without action would be hollow. The well-known author Maya Angelou (1928 - 2014) has said that “Courage is the most important of all the virtues, because without courage you can't practice any other virtue consistently. You can practice any virtue erratically, but nothing consistently without courage.”

Ethical dilemmas are situations where deciding what is best requires weighing ethical arguments between alternatives. Deciding what the best thing to do is almost always easier than doing it. Josephson Institute refers to moral temptations as a choice which is clear but still unattractive. The ratio of moral temptation to ethical dilemma might be four to one. Even those of us with the worst eating and exercise habits seem to know a lot about healthy alternatives. However, making yourself eat vegetables when you are hungry for chocolate is difficult and making yourself consistently prefer vegetables to cheeseburgers might require something beyond our abilities. Wisdom is mostly knowledge, but virtue is mostly desire, and habit.

9. Answer the following with regard to egoism. (a) Do you think it is the same to act in your own self-interest as it is to act in a selfish way? (b) Do you think “enlightened self-interest” is a contradiction in terms, or is it a valid basis for all actions?

(a) Acting selfishly and in your own self-interest are not the same thing. Normally, acting selfishly is only being concerned with self, not others, and being very short-sighted; it is being concerned with immediate gratification of some sort. Acting in one’s best interest may also mean acting in the best interest of all involved. For instance, I can turn up the television loud while I study because that is what I like, who cares if it is bothering my roommate or anyone else (egoism). Or, I have the television at a moderate volume so as not to disturb my roommate or anyone else (enlightened egoism). Or, I could use earphones so my roommate is not disturbed at all (more ethical form of enlightened egoism). In the former case I am acting selfishly and in the other two I am acting in my self-interest while considering others. In short, acting in my self-interest may be to act selfishly but only after I have considered how my actions affect others and weigh it in my decision. (b) “Enlightened self-interest” may seem like a contradiction in terms. Nevertheless, an individual must be “enlightened” to consider the long-term effects of a choice upon self, others, and the whole of humanity. For example, an individual may want the road near his house to be free of litter out of self-interest (resale value, dislike of clutter and untidiness, etc.), but can extend that desire to wanting all the roads of a neighborhood or city to be free of litter for the good of the community. In fact, long term self-interest requires that an individual consider others, since an individual does not live in a vacuum without interaction with others. A person who uses enlightened self-interest as a basis for ethical actions hopes others will consider her interests when making a decision that affects that person. A totally selfish person will probably face negative consequences from others.

10. What does the term "civility" mean to you? Do you think it is civil behavior to shout down a speaker with whom you do not agree? What about cancelling someone because you don't agree with their message?

Civility means to respect others’ points of view and listen attentively when they speak. Shouting down a speaker because you don’t like their message denies them of their Constitutional free speech rights. Imagine if everyone picked and chose who to listen to and shout down? It could stifle innovative thought and make it more difficult to have a

productive dialogue. An expression often use is we need to learn to disagree with each other but not be disagreeable about it.

What happens in the cancel culture is those offended by the comments of another party become denounced online by those who object to the behavior. It's a form of social and cultural boycott driven by 'groupthink' meaning the intolerance of others with a point of view that diverges from group norms. Taken to an extreme, it's like excommunicating someone from the community.

One way to examine the ethics of the cancel culture is to evaluate the pros and cons of the behavior. Why do some people say it's a good practice?

- Expressing oneself by taking others to task is part of the democratic process and free speech.
- Canceling others is a manifestation of holding others accountable for their behaviors.
- Calling-out is one way to challenge provocateurs, who deliberately hurt others, or powerful people beyond our reach.

Those who argue against it make the following points.

- Canceling someone is an attempt to stifle their free speech rights.
- Tweeting against others in anger begets more anger and can lead to a more serious practices such as bullying.
- Canceling is an ethical slippery slope; should we cancel everyone with whom we disagree? Where should the line be drawn or is it even possible to do so?

11. Distinguish between ethics, morals, and values.

You can use exhibits 1.2 and 1.3 to discuss this question.

Exhibit 1.2 Comparison of Morals and Ethics

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

BASIS FOR COMPARISON	MORALS	ETHICS
Expression	Morals are expressed in the form of general rules and statements.	Ethics are abstract.

Exhibit 1.3 Comparison of Morals and Values

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

Simply stated, values (i.e., moral values), are the foundation of our beliefs whether an action is right or wrong. Morals are the beliefs of an individual, group, or culture that enable a decision-maker by applying general principles in determining right and wrong. Here are a few of those principles.

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

Ethics pertain more to the principles followed in making ethical decisions. It provides context to the decision at hand. Here are some ethical principles.

- Truthfulness
- Honesty
- Integrity
- Fairness
- Respect
- Loyalty

12. MacIntyre, in his account of Aristotelian virtue, states that integrity is the one trait of character that encompasses all the others. How does this relate to the Principles in the AICPA Code of Professional Conduct?

Integers are whole numbers. This is the base word for integrity. Things with integrity are the same all the way through, or whole throughout. Thus, integrity equates with the consistency of one's actions. We must be consistently ethical to become an ethical person. If we can assume that everyone knows good treatment of their own interests and everyone knows good choices for their own short run, integrity might mean applying those same best choices to situations which affect others or affect the long run of all concerned.

A person of integrity acts with courage, sincerity, and honesty. Integrity encompasses all the other traits or values of character because it also implies action. Integrity requires a person to be honest, but to also act on that honesty. Integrity requires that a person have courage but also to act on that courage. Integrity requires that people not only have principles and values, they also have to stand by those principles and values and not bow to pressure thereby foregoing those principles.

Students often think that integrity is synonymous to honesty. Many dictionaries even state that honesty is the synonym for integrity and vice versus. Yet, just because a thief is being honest in one circumstance does not mean that he has integrity. A thief may admit to stealing only after being caught. We might say it is an honest act, but it lacks integrity because the thief failed to consider the consequences of his actions on those he stole from or their rights not to be robbed. Moreover, the thief failed to admit the mistake after being caught; promise not to do it again; and then act consistently with the integrity standard thereafter. A way to consider integrity is how consistently honest a person is, not just whether that person was honest in one circumstance.

Integrity is a principle in the AICPA Code that ties others together. Unless you are willing to exercise moral courage when the going gets tough in accounting, then difficulties will arise when pressured by a superior to overlook wrongdoing in financial reporting. Integrity is the essence of being a moral person – standing up for what is right regardless of the consequences.

13. Distinguish between ethical rights and obligations from the perspective of accountants and auditors.

Ethical rights describe how a person is entitled to be treated by another person. Ethical obligations are the duties to treat others in an ethical manner. Ask students what they think are their rights. Now which of those rights have an ethical basis? Have the students make a list of their ethical rights. If a student's ethical right conflicts with the student's ethical obligation, what should a student do?

From the perspective of accountants and auditors, obligations to the public are to act with integrity, be independent of clients both in fact and appearance, make objective decisions, and act in a responsible and trustworthy manner. The public has a right to receive accurate and reliable financial information to make informed decisions. Thus, the rights

of stakeholders and the obligations of accountants and auditors to those stakeholders are the flip sides of the same issue.

Assume that a CFO asks you, as the accountant for the company, to omit certain financial figures from the balance sheet that may paint the business in a bad light. Because the request does not involve a direct manipulation of numbers or records, would you agree to go along with the request? Would you ever consider blowing the whistle on the CFO? What ethical considerations exist for you in deciding on a course of action?

14. Do you think the "Resolution of Ethical Issues" section in The IMA Statement of Ethical Professional Practice is a helpful part of its ethical standards?

It's helpful because it details a process to follow when a conflict of interests between an accountant and the employer – supervisor – can't be resolved. It is a guideline. In an actual situation, the accountant should go to their supervisor; then the supervisor's boss, if necessary; and then to the board of directors to resolve the matter. Unlike the IMA standards, accountants may feel obligated to go outside the company to resolve matters in dispute. They will be protected if they go to the SEC, assuming the Commission takes up their cause.

15. One morning a student telephones her professor that she won't be able to take a scheduled exam because her car broke down on the way home from an out-of-town trip. She asks to take it at another time. What would you do if you were the professor and why?

The fact that the car broke down on the way home from an out-of-town trip raises questions why the student went out-of-town with an exam coming up. It's also possible that the student is lying. The professor can ask to see the repair bill for proof. After all, this is what a good auditor would do.

If the professor gives the student more time, then the student is being treated differently than all other students who were prepared and met their responsibilities to take the exam when scheduled. Justice says equals should be treated equally while unequals should be treated unequally. So, the question becomes whether the student's circumstances are such that she should be given more time. It is hard to argue that in this situation.

We can think of other situations where the extra time seems warranted, such as if there was a death in the student's family. Using the moral value of caring, it seems fair to treat this student differently because of the event. We could say that all students who have deaths in their family should be treated the same so we have consistency of behavior.

16. Assume that a CFO asks you, as the accountant for the company, to omit certain financial figures from the balance sheet that may paint the business in a bad light. Because the request does not involve a direct manipulation of numbers or records, would you agree to go along with the request? Would you ever consider blowing the

whistle on the CFO? What ethical considerations exist for you in deciding on a course of action?

What if a client asks you to leave out information about a multi-billion-dollar lawsuit for product tampering because it won't be resolved in the current period or next year? Would you omit it because its effects are not in the short-term – i.e., within one year? The omission of the information (in the accounts or notes as required) – is misleading to investors and creditors who have a right to know that the company may have a significant legal liability in two or more years. How will the company meet this obligation? Should it set aside the funds in a reserve account? These are all legitimate questions for users to ask, but they can't if the information is omitted. There are accounting rules about recognizing contingent events that should also be met. Without getting too specific, if it's reasonably possible that the lawsuit will be lost, then a disclosure is warranted.

There is a basic principle in financial reporting called “full disclosure.” It means to fully disclose all the information users of the financial statements need to make proper decisions. Omitting the information from the balance sheet violates the full disclosure principle.

Some students may conclude that since the effects are only on the balance sheet then it is permissible to omit the information. In other words, it doesn't affect the income statement. However, items that affect the balance sheet typically affect the income statement as well either in the current period or later on. A good example is unearned revenue.

Blowing the whistle has two dimensions: (1) blowing the whistle internally by going up the chain of command all the way to the audit committee/board of directors, as necessary and (2) going outside the company and inform the external accountants or the SEC. Internal whistleblowing is expected and is an element of integrity. However, going outside the company may create problems since accountants have an obligation to keep financial information confidential, both under the IMA and AICPA codes. It should never be done except in extreme situations.

The IMA has a process to provide advice for an accountant facing this kind of dilemma. It may be helpful to call the Institute to clarify one's professional obligations under the IMA Standards.

17. Do you think a CPA can justify allowing the unethical behavior of a supervisor by claiming, “It's not my job to police the behavior of others?”

Accountants and auditors are not policemen or policewomen yet they play an important role in ensuring behavior conforms to professional norms of behavior. Accounting professionals represent the public interest and as such they “police” the behavior of corporate officials. There are requirements to bring matters of concern all the way up to the highest levels of an organization, including the audit committee/board of directors.

The covenant between auditors and the public was established in 1933 when Congress required public companies to file financial statements that would be reviewed by independent auditors. This covenant places a special public obligation on auditors. In 1984, the Supreme Court, in *United States v. Arthur Young*, described the auditor's role as a "public watchdog function" that demands "total independence from the client at all times and requires complete fidelity to the public trust." Unfortunately, in the late 1990s and early 2000s auditors lost sight of their responsibilities to the public, which led Congress to act to police auditors' work by ending self-regulation when public company audits are involved and giving the oversight role to the PCAOB. The PCAOB was created to ensure that auditors of public companies are faithfully carrying out their duties on behalf of investors.

In October 2013, the SEC announced the launch of "Operation Broken Gate"—an initiative to identify auditors who neglect their duties and the required auditing standards. Operation Broken Gate is the SEC's effort to hold gatekeepers accountable.

18. Why do bad things sometimes happen to good people? Does this mean they are a bad person?

Good people strive to do the right thing. They recognize that their actions have consequences. They are aware of the rights of others and act in ways that are consistent with the way they would like to be treated. This is the essence of *The Golden Rule*.

Good people think with their head and act in concert with their heart, and they apply the knowledge and wisdom gained through a lifetime of experiences. Good people are honest, trustworthy, fair-minded, and empathetic towards others. Good people accept responsibility for the consequences of their actions and strive to improve their behavior throughout their lifetime.

Good people sometimes do bad things in the workplace. That does not mean they are bad people. Instead, circumstances may arise where they feel pressured by superiors to deviate from ethical standards. So, they may do wrong things in one instance but might also learn their lesson and not do so again. However, if bad things occur more often, it would be reasonable to question their character.

The culture of a workplace creates the boundaries for acceptable and unacceptable conduct. Managers should set high standards and hold employees to them. Consistency breeds acceptance and personal responsibility establishes ethical obligations in the workplace.

The ethical challenges come not from one's own ethics but from the ethics of people around us and the organization of which we are a part. At work, a person may be called upon to do things that turn out to be unethical or even illegal.

19. Consider the ethical principle of praising the good and ignoring the bad. Is this a good way to foster ethical behavior?

The point of this question is that we do not pay enough attention to the good people; those who do the right thing. It seems the news outlets and social media concentrate on bad news and bad people, not those who have lived up to a high ethical standard. We need role models in society and what better place to look than for “heroes.”

Ignoring the bad is different. We want to examine bad behavior to learn from it. It helps us to put into perspective how bad behavior can create negative consequences for others. So, we should do both: point out good behavior and criticize bad behavior.

A good example of bad behavior that has opened our eyes to the over-priced pharmaceuticals in the U.S. and taking advantage of those in the need is the story of Martin Shkreli, former CEO of Turing Pharmaceuticals, who in 2015 increased the price to consumers for the drug Daraprim by 5,000 percent, from \$13.50 per pill to \$750 per pill. Daraprim is used to treat toxoplasmosis, which can affect pregnant women, people with HIV and others with weakened immune systems. Shkreli rationalized the decision by arguing that by raising the price of the drug, Turing would be able to put money into developing better treatments for toxoplasmosis. The public did not agree with his logic, instead believing that greed was behind the decision. Shkreli became the poster child for capitalism run amok. It earned him the reputation for being ‘Most Hated Man in America.’

The story of Martin Shkreli illustrates the core elements of human morality (the principles of good and bad behavior; right and wrong) are universal. Ethics remains relevant to everyday life today because the fundamental issues involved in human interactions in society are the same no matter where or when people interact.

20 Mark Twain once said, “If you tell the truth, you don’t have to remember anything.” Explain what you think Twain meant by this statement and how it addresses one’s character.

Mark Twain is said to have said, “If you tell the truth you don’t have to remember anything,” meaning if you tell a lie you have to remember what lie you told and to whom. This truism can also be expressed as, “it takes more effort to lie than it does to tell the truth.”

The quote implies that it takes less energy to be honest than it does to construct lies and keep your story straight. Of course, this is only true as a rule of thumb, and not as an absolute. Still, the problem with lying is getting your story straight when pressed on the details. This is a tactic police use in trying to get the truth out of a witness or suspect. When it is unclear whether that person is telling the truth, police ask probing questions to see if they can catch them in a lie.

Truthfulness is a pillar of character that underlies ethical behavior. Truthfulness and trustworthiness go hand in hand. To be a truthful person means to be open and honest with the facts, which enhances reliability.

We've discussed the ethical slippery slope many times in this chapter. Students should know that taking the first step down the slope can be disastrous to one's reputation and ultimately lead to violations of the AICPA Code, SEC regulations, and other laws.

Colonial Bank

Case Overview

On January 2, 2018, U.S. District Court Judge Barbara Rothstein ruled that PricewaterhouseCoopers (PwC) negligently failed to uncover a \$2.3 billion fraud scheme between PwC audit client Colonial Bank and Taylor, Bean & Whitaker. Colonial Bank is now in receivership under Federal Deposit Insurance Corporation (FDIC) rules. Taylor Bean is a bankrupt mortgage lender. PwC already paid an undisclosed amount in 2016 to settle related claims by Taylor Bean's trustee.¹ The decision in the case means it now moves into a damages phase, where the FDIC is seeking as much as \$2.1 billion.

The collapse of Colonial Bank, which had \$25 billion in assets and \$20 billion in deposits, was the biggest bank failure of 2009. The FDIC estimates Colonial's failure will ultimately cost its insurance fund \$5 billion, making it one of the most expensive bank failures in U.S. history. The lawsuit against PwC was the first of its kind filed against an accounting firm in the aftermath of the financial recession. On August 12, 2012, some former Colonial Bank directors and officers agreed to settle the securities class action lawsuit against them for the bank's collapse. The settlement did not include PwC.

While Judge Rothstein held PwC liable for negligence, it rejected similar claims by the bankruptcy trustee for Colonial BancGroup because the bank itself was responsible for the fraud. That professional negligence claim was barred by the *in pari delicto* doctrine and the audit interference rule. Latin for "in equal fault," *in pari delicto* means, if the fault of the fraud is more or less equal between two or more parties (i.e., Colonial Bank and PwC), neither party can claim breach of the contract by the other. The audit interference rule holds that an auditor may assert a comparative-fault defense where it can establish that the client's negligence "interfered with" the auditor's performance of its duties, as in the Colonial Bank case.

In her opinion, Judge Rothstein emphasized that PwC had relied on the chief architect of the fraud, Taylor Bean chair Lee Farkas, to verify key information about the collateral underlying a Colonial credit facility for Taylor Bean. PwC signed off on Colonial's audit without ever understanding the underlying accounting event, which was based on phantom mortgage securitizations. PwC allowed Colonial to account for certain types of mortgages from Taylor Bean as sales rather than as loans from Colonial to Taylor Bean that were secured by mortgages.

Judge Rothstein ruled PwC was guilty of professional negligence. She rapped the firm for failing to follow "illogical dates" and to check whether an entire class of loans—nearly 20% of its mortgage lending warehouse—existed. She also cited testimony from a PwC partner in an earlier, related case that "our audit procedures were not designed to detect fraud."

PwC gave the bank's parent, Colonial BancGroup, a clean audit opinion for years before it was disclosed that substantial portions of Colonial's loans to Taylor Bean were secured

against assets that did not exist. In the malpractice case, Judge Rothstein agreed with the FDIC that PwC failed to meet professional accounting standards in its audits of Colonial. “PwC did not design its audits to detect fraud and PwC’s failure to do so constitutes a violation of the auditing standards,” Rothstein ruled.²

PwC Defense of Audit

PwC, in its defense, said it was duped by Farkas, who skimmed millions of dollars from Colonial to buy a private jet, vintage cars, and a vacation home. Rothstein had ruled that Colonial executives lied to PwC’s auditors, circumvented internal controls by “recycling” mortgage data, and even created wire transfers to trick PwC into believing Taylor Bean’s collateral mortgages had been paid off.

PwC put its own spin on the verdict by stating that the court’s ruling recognized that in addition to those Colonial Bank employees who perpetrated the fraud, numerous other employees at Colonial BancGroup actively and substantially interfered with their audit. But Rothstein faulted PwC for failing to inspect or even request to inspect the underlying documents for some Taylor Bean mortgages. “PwC argues that even if it had attempted to inspect the underlying loan documents, it would not have uncovered the fraud because the fraudsters would simply have created fake documents. This, of course, is something that we will never know.”³

Elizabeth Tanis, PwC’s lead trial counsel said, “As the professional audit standards make clear, even a properly-designed and executed audit may not detect fraud, especially in instances when there is collusion, fabrication of documents, and the override of controls, as there was at Colonial Bank.”

PwC has maintained in court documents that its responsibility is to follow accounting principles—which might not necessarily detect fraud.

A rather unusual aspect to the claim that PwC did not follow appropriate professional standards is the allegation that PwC did not understand the nature and scope of the transactions. After a PwC auditor who was supposed to make sense of the transactions gave up, saying they were “above his pay grade,” PwC assigned a college-graduate intern to evaluate the nearly \$600 million asset. Rothstein was distinctly harsh about PwC’s failings. Basing Colonial’s certification on Farkas’ account of Taylor Bean’s collateral was “quintessentially the same as asking the fox to report on the condition of the hen house.” She added that expecting an intern to decipher a loan facility beyond the expertise of a senior auditor was a “truly astonishing” departure from PwC’s mandate.⁴

Internal Audit and ICFR

Colonial Bank had outsourced internal audit to another accounting firm, Crowe Horwath. PwC was required to review Crowe’s work product, and it did so. Crowe, however, never identified or performed any evaluation of internal controls specifically relating to the credit facility, and there was no documentation suggesting otherwise. Nonetheless, PwC

concluded that internal controls for Colonial's Treasury operation (including the credit facility) were effective and could be relied upon by PwC to reduce its substantive audit procedures. PwC reached this conclusion in the absence of any evidence that Crowe (or anyone else) had tested any internal controls for the credit facility.⁵

Digging deeper, PwC knew that Colonial's Treasury and Securities Purchased Under Agreements to Resell (which included \$51.5 billion in credit facility financing for Taylor Bean on December 31, 2007) was a "Significant Process" for which it would test controls. During the actual audit however, PwC excluded the credit facility entirely from the key controls that it tested despite the credit facility's significant account balance and distinct class of transactions that called for transaction-specific controls.

PwC did not perform any walkthrough, skipping this crucial step because key controls were not identified by Crowe, and/or PwC did not properly assess the inherent risks regarding the existence and validity of credit facility assets. PwC instead decided that it would rely on Crowe to perform all walkthroughs.

The FDIC's claims against Crowe Horwath, that it acted under a consulting contract as Colonial's internal audit department, were unusual. PwC's workpapers gave the FDIC a glimpse into PwC's opinion of the quality of Crowe's work. Regardless of what PwC thought, the FDIC believed that PwC did not do enough to compensate for any failings or verify the assertions about internal controls Crowe made on behalf of Colonial management.⁶

The FDIC asserted gross negligence by Crowe. Allegedly, there was concealment and collusion to perpetrate a fraud within the bank and from outside sources. Crowe was held to the AICPA's standards for consulting work which, while stringent as the AICPA Code of Professional Conduct standards, do not carry the force of law that the Sarbanes-Oxley Act and the PCAOB auditing standards do. The FDIC also maintained that Crowe should have followed the professional standards promulgated by the Institute of Internal Auditors. Would an internal audit function staffed by Colonial employees instead of an outside consultant have been sued under the same circumstances? On April 4, 2018, the FDIC settled its claims of professional malpractice and breach of contract against Crowe, disclosing that Crowe will make a \$60 million payment to the FDIC.

On March 15, 2019, the FDIC announced that it had reached a \$335 million settlement of the negligence action the agency had brought against PwC in connection with the accounting firm's audit work for Colonial Bank. The curious thing about this settlement is that it represents only a little more half of the amount that a federal district court judge awarded the FDIC as damages in a July 2018 order in the case.

The Colonial ruling marks the first time an auditor has been held liable for fraud in many years. Lawyers who defended auditors were outraged by the ruling, calling it "an aggressive interpretation," "extremely disturbing," and a "one-off decision that will be reversed upon appeal." They are particularly upset that the case ever went to trial. In most auditing failure cases, companies are barred from suing their auditors for failing to detect

fraud if—as happened at Colonial—their employees actively participated in the malfeasance. But in this case, the bank went bankrupt, and the FDIC sued to recover money for taxpayers. Courts around the country are split on whether the government can do that, and Judge Rothstein opted to let the FDIC sue. Attorney Michael Dell argued that the Colonial decision would fundamentally change the nature of auditing: “Audit firms would effectively be insurers for the wrongdoing of their clients.” If the ruling stands, some lawyers believe investors will find it easier to hold auditors accountable in future corporate fraud cases.⁷

Questions

1. Which rules of conduct in the AICPA Code of Professional Conduct were violated by PwC? Explain.

PwC did not follow GAAS nor conduct its audit with the degree of competence required and acting with due care or adequate levels of professional skepticism. It did not staff its audit with qualified personnel. As stated in the case, an intern was left to make the judgment on a very complex portfolio that their senior auditor on the job could not figure out. It issued an unqualified audit opinion without obtaining sufficient evidence to formulate its opinion. PwC’s actions are also acts discreditable to the profession and have brought great embarrassment to the profession and may in fact result in a much different legal landscape for the whole profession to operate in moving forward.

PwC also failed to maintain their integrity in accepting client explanations rather than doing the work to enable it to make independent assessments about the credit facility, excluding it from the review of client internal controls despite its significance to the overall reliability of Colonial’s financial statements.

2. Which PCAOB auditing standards were violated by PwC? Explain why those violations occurred and whether PwC should be held responsible.

As stated above, PwC failed to follow GAAS. Specifically, it starts with their ICFR review. The firm relied on the work of an outside audit firm that played the role of internal auditor for Colonial. PwC should have done an independent review of the ICFR for Colonial, or at least looked at the work done by Crowe Horwath in detail. As presented in the case, Crowe did not even do work in internal controls surrounding the loan portfolio in question. Auditors are required to conduct an integrated audit (or a separate one of both the company and the ICFR). The evaluation of the ICFR and the risk associated with it provides the auditor with the information they need to plan for and conduct an audit. It directly impacts the extent of the testing required to be conducted during an audit.

PwC did not perform a walkthrough, deciding to skip this step because key controls were not identified by Crowe and/or it did not properly assess the inherent risks regarding the existence and validity of credit facility assets. PwC

instead decided to rely on Crowe to perform all walkthroughs, a step that may have caused PwC to fail to review the ICFR sufficiently to warrant an opinion on these matters.

PwC did not staff the audit with qualified personnel and therefore could not do the quality work that is demanded in an audit. The firm did not obtain the required evidence to support the opinion that they made. One will never know if they would have uncovered the fraud had they done the work they should have done. However, their flagrant disregard for conducting the audit in accordance with GAAS is gross negligence and in the eyes of the law constructive fraud. However, neither the PCAOB nor the SEC has sanctioned PwC over its work in the Colonial Bank audit.

- 3. Attorney Michael Dell argued that the Colonial Bank ruling would effectively hold audit firms liable for the wrongdoing of their clients. Is that the way you read the facts of the case and Judge Rothstein's ruling? Is there anything wrong with holding auditors responsible for the wrongdoing of their clients when client employees actively participate in the malfeasance? Explain.**

The disturbing part of the ruling appears to be the judge's apparent criticism of PwC stating that they did not conduct their audit to uncover fraud. That is problematic in that audits are not designed to uncover fraud and this leads to the question as to whether this ruling will open up the flood gates on parties holding audit firms liable when fraud is uncovered and the auditors missed it.

The key issue from an audit point of view is whether PwC sufficiently looked for red flags that might indicate fraud was present. It appears PwC did not meet its professional, and legal, responsibilities in that regard. PwC had said that Colonial and its employees "actively and substantially interfered with their audit." If so, that was the ultimate red flag and PwC should have doubled their efforts to uncover the fraud.

However, the ruling did make a distinction in regard to the fact that Colonial is equally responsible as they were the ones who actually committed the fraud. So, the ruling could have been worse. However, in this case the fact that PwC's work was so poor that they should never have issued an opinion would appear to justify the lawsuit. It seems appropriate an audit firm should not be able to avoid a judgment when they breach professional standards and do not follow GAAS as we see in this case.

- 4. When should auditors disclose critical audit matters (CAMs)? Assume the Colonial Bank case occurred subsequent to the effective dates of the new auditing standard on disclosing CAMs. Which disclosures should PwC have included in the audit report of Colonial Bank?**

By definition, a critical audit matter is defined as a matter that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment. Assuming that PwC actually performed the work they should have, they would have reported on the loan portfolio, loss reserve, and underlying collateral as that was a material aspect of the financials. The fact that they could not understand the information provided surrounding the loans and the difficulty they were having should have been disclosed. These facts should have been disclosed to the audit committee and then the audit committee in turn should have ensured that PwC got the information they needed.

Based on the work PwC did and the information they were given, PwC should have issued a qualified opinion if in the end they could not obtain the support they needed to test this area (or resigned from the engagement). In addition, they should have put staff on the engagement who knew what they were doing and who would not compromise their ethics for the sake of completing the job. However, they chose just not to do the work.

PwC also would have reported on the ICFR and should have reported on material weaknesses surrounding the internal controls. This is all predicated on them actually doing the job they were hired to do in compliance with professional standards and in accordance with GAAS.

Chapter 1 Cases

Case 1-1 Operation Varsity Blues

What motivates a parent to bribe key people to get their kid admitted to a prestigious university? That is the ethical question of “Operation Varsity Blues.”

In March 2019, the story broke of an alarming fraudulent scheme by parents to pay off middleman, William “Rick” Singer, and athletic coaches to give favored treatment to the children of rich and well-connected people.

Singer, CEO of a college admissions prep company, The Key, took in large amounts of money and laundered them as contributions to a foundation he controlled, Key Worldwide Foundation, which only pretended to help underprivileged students. Using Singer’s connections, the parents bribed coaches and administrators at some of the most prestigious institutions in the U.S.

Singer helped parents craft fake documentation to allow students to be admitted as recruited athletes even though they never participated in a sport, and he developed an elaborate system to help students cheat on their college entrance exams. He then paid coaches and administrators to look the other way.

Singer pled guilty to four felony counts, admitting he accepting some \$25 million in bribes to rig the admissions process in what he described as a "side door" into college.

The Department of Justice charged 55 parents, coaches, and administrators with fraud that enabled children of wealthy parents to gain admission to colleges they were not qualified to attend. These included Georgetown, Stanford, UCLA, USC, and the University of Texas at Austin.

When the story first broke all attention was on two Hollywood actresses Lori Loughlin and Felicity Huffman. At her sentencing, Huffman was very contrite saying “I am in full acceptance of my guilt – deep regret and shame.” She also said her daughter had no idea of the scheme. She was sentenced to two weeks in prison.

Loughlin was convicted of conspiracy to commit wire and mail fraud. She was sentenced to two months in prison, a \$150,000 fine, two years of supervised released, and 100 hours of community service.

Loughlin’s husband, Giannulli, was convicted of paying \$500,000 in bribes to facilitate his children’s acceptance to USC. He earlier had pleaded guilty to conspiracy to commit wire and mail fraud.

In another case, California investor Todd Blake and his wife, Diane, pled guilty admitting they paid \$250,000 to get their daughter into the University of Southern California as a purported volleyball recruit even though she didn’t play volleyball in any organized way.

At USC, athletic director Donna Heinel and men's and women's water polo coach Jovan Vavic were fired after allegedly receiving bribes totaling more than \$1.3 million and \$250,000, respectively, to help parents take advantage of relaxed admissions standards for athletes at USC even though their kids were not being recruited as athletes.

In one audacious scheme, Singer bribed test administrators in Houston and Los Angeles to allow Mark Riddell, a very bright individual, to secretly take the ACT and SAT tests in place of the children of the parents that Singer represented. He scored 35 out of 36 on the ACT, which put him in about the 99th percentile of ACT takers.

Some of the students were expelled. Others had their admissions revoked. Some of the coaches have been fired. They faced charges – athletic coaches who were involved in misrepresenting people as being recruits.

Of the 55 people charged only a handful are still fighting the charges. The first trial was scheduled to begin in October 2020 but has been delayed due to COVID-19. It was expected to begin in January 2021 at the earliest.

Questions

- 1. Examine the behavior of the parents from the perspective of moral relativism. Is it fair to say the parents believed the rules should not apply to them? Explain.**

It is fair to say the parents believed the rules did not apply to them. They acted in a way that is consistent with moral 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. The parents seemed to feel entitled to give Singer money to pay off officials to gain entrance to college for their kids.

The motivation for the payments was to get their kids into the best schools. However, they went about it in a fraudulent way. Perhaps they didn't view it that way but that was the outcome. The fact that they didn't see it as wrong raises questions about whether they were oblivious to the ethical issues, sometimes referred to as ethical blindness.

When people play by different rules in the same situation it becomes difficult to treat them equally unless factors exist to do otherwise. The kids who gained admission through their parents' actions had an upper hand on those who played by the rules. This violates the basic principle of fairness.

- 2. Evaluate the actions of the parents using teleology, deontology, and justice.**

Teleology uses harms and benefits to evaluate whether an action is ethical. The benefits, of course, were to get their kids into a good, prestigious college. The costs were whatever they had to pay to do so. Additional costs that may not have been foreseen at the outset include the financial penalties, jail time, and, perhaps, a loss of reputation for the parents involved. As in most act utilitarian decisions, it is difficult to weigh the consequences of one's actions.

Given the problems with act utilitarianism, a rule utilitarianism makes more sense. We could say that the basic moral rule is: Never bribe another party for favored treatment. Clearly, this is what went on in Operation Varsity Blues. Regardless of the costs and benefits, this rule would lead us to the conclusion that paying Singer to do something he should not have violated the rule.

The categorical imperative holds that we should never do an act that we would not want others to do. From a deontology perspective, we would look at the issue from the point of view whether we would want other parents to bribe Singer or other officials to gain admission for their kids, making it a universally-accepted action. If that were so then the amount of the bribe would go up because there would be no way of knowing how much the others are paying to gain favored treatment for their kids.

Clearly, the offending parents did not have a right to pay off Singer to gain favored treatment for their kids and the universities did not have a moral duty to accept the kids.

Justice is the strongest method of ethical reasoning in this case. It holds that equals should be treated equally and unequals differently based on the circumstances involved. The kids of all parents who apply to a particular college should have the same right to be admitted – an equal chance – although factors such as grade-point average, scores on the SAT and ACT, and outside activities can provide a basis for treating the kids differently. However, this is not true about being able to pay more money to someone like Singer and to be treated differently than other kids because their parents couldn't come up with the same amount.

A basic element of justice is fairness. Is it fair that by admitting the kids of well-to-do parents, the kids of those parents that play by the rules may not be admitted? In other words, the kids of the wealthy who get admitted under such circumstances, as in The Varsity Blues, may take an admission spot away from other kids equally or more qualified for admission.

Point out to students that at her sentencing, Laughlin said “I made an awful decision. I went along with a plan to give my daughters an unfair advantage in the college admissions process. I now understand that my decision helped exacerbate existing inequalities in society generally and the higher education system more specifically.”

3. What is your takeaway from Operation Varsity Blues?

Students might say that it doesn't pay to do something illegal to get a desired result. Ask students whether they would have wanted their parents to make such payments to get them into a different college. What about to get a scholarship that reduces the cost of college? Would they care that friends and others may not be admitted because of their actions? Where do they draw the line? The problem is it becomes an ethical slippery slope.

One test of ethical behavior is to ask yourself whether you would make such payments if it became known on social media. Would they be proud to defend the payments? Probably not because the payments were hidden.

Videos:

Comprehensive overview of the case and charges (30 minutes) -
https://www.youtube.com/watch?v=tC_g4lgYN7Y

Excellent, brief review of charges (1 ½ minutes) --
<https://www.youtube.com/watch?v=JirTNC9zcPk>