

Executive Summary

UNDERSTANDING ACCOUNTING ETHICS IS A STUDY OF ETHICS for the accounting profession, with attention both to law and personal choice. Using the notion of a ‘virtue’, it explains how the code of ethics for accountants follows from the distinctive role that accountants play in society. It illustrates these ideas through case studies, especially of Enron and WorldCom. It offers definite proposals for teaching ethics to accounting professionals.

What follows here is an executive summary of each chapter, including representative quotations from each chapter. Readers are encouraged to read at first those chapters that most interest them and then later attend to the argument of the book as a whole.

Chapter 1: Introduction

Recent accounting scandals have precipitated reforms in the accounting profession, some involving oversight agencies and laws that operate ‘from the outside’, others that involve attention to principles and ideals ‘from the inside.’ The latter must include a return to principles-based accounting; a renewed sense of professionalism; and an appropriate pride in the profession. All of these in turn require attention to the ethical foundations of accounting.

~ “Professionalism is fundamentally an ethical orientation, implying integrity and adherence to high ideals. Thus, any reform that attempts 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.” (pp. 16-17)

~ “An accountant’s ‘philosophy’ is important for achieving unity of life. One needs to consider: Is accountancy a profession that can serve as the organizing principle of a worthwhile human life?” (p. 22)

Chapter 2: From Rules to Principles

It’s not enough that a practitioner simply ‘follow the rules’, no matter how detailed or subtle those rules may be. Rules are necessary for correct action, but not sufficient. The key question to consider is: Are rules in the service of principles, or do rules trump principles? Clearly, rules have to be in the service of principles. But it follows from this a practitioner must continually rely on the sort of good judgment that involves an appropriate ethical commitment.

~ “It is clear, then, that it would not be possible for someone to act with intelligence and integrity, by simply trying to follow rules, no matter how well crafted or carefully qualified those rules may be. Someone who is attempting to follow rules must, at nearly every point, rely on good judgment, draw upon deeper principles, and view his action in relation to various idealizations. The ability to do this well is an ethical capacity. Thus, simply to follow rules well requires an appropriate ethical orientation.” (p. 32)

~ “The interpretation of any rule requires an appeal to how a reasonable person would judge or view things.” (p. 36)

~ “A fairly clear example of the importance of good character generally for a practitioner has to do with greed. We may define greed as the desire or wish to have ‘as much wealth

as possible'. Greed therefore is of its nature unlimited; it is never truly satisfied. Greed is not, for instance, a desire for the exact capital needed for some specific enterprise; neither is it a desire for a sufficiency of wealth to raise a family with moderate advantages and ease. Both of these desires are limited, and when one reaches the stipulated amount, the desire vanishes. But greed, as is well recognized, is never satisfied. It sets goals for itself, but once these are met, it immediately is dissatisfied and looks for more." (p. 44)

Chapter 3: Elements of Ethics

Accounting ethics is a branch of ethics in general, so some fundamentals of ethics must first be considered. A 'virtue based' approach to ethics is best suited to the study of accounting ethics, rather than the chief alternatives, utilitarianism or Kantianism. A virtue may be defined as a trait which enables something (or someone) to carry out its distinctive task well. Something that has the requisite virtues is a good thing of that kind. But the virtue of a thing needs to be considered in relation to the 'common good' and to the law which governs the associations of which it is a part.

~ "Typically, we acquire a virtue of character by doing the relevant sorts of actions in some restricted or less significant field of action. A child, for instance, develops honesty by being truthful about relatively small and insignificant matters. A recruit grows in courage by field exercises which are successively closer in character to actual battle conditions. Because typically we acquire traits of character in relatively minor situations, indirectly related to those circumstances in which it is most important to exercise those traits, it happens that scrupulously good behavior in minor details ends up being very important for the development and maintenance of virtues of character." (p. 73)

~ "People form an association in order to procure some good, or enjoy a service, or achieve a result, that each could not attain at all, or attain easily, on his own." (p. 75)

~ "Every association involves reciprocity. Each member gives up trying to achieve some good on his own; he consents to receive it through the association; and therefore he directs his efforts at some coordinated plan of action required by the association." (p. 75)

Chapter 4: Basics of Accounting Ethics

The virtues of an accountant, then, are those traits that enable a practitioner to carry out well the distinctive task of accountancy. But what is that task? It is the fostering of trust that is necessary for the sound operation of commerce and the marketplace. This trust is an 'honorable' good, not an instrumental good. As a result, accounting is a profession and not a business. That an accountant needs to be objective, independent, and have integrity, follows from these considerations. The virtues of an accountant include both 'intellectual' traits, and traits of character.

~ "Obviously no one can claim to be a member of a profession, or expect to succeed in one, unless he is prepared, when necessary, to subordinate his own interest to that of his client.... The high-minded accountant who undertakes to practice in this field assumes high ethical obligations, and it is the assumption of such obligations that makes what might otherwise be a business, a profession. Of all the group of professions which are closely allied with business, there is none in which the practitioner is under a greater ethical obligation to persons who are not his immediate clients; and it is for this reason I believe accounting ought, and can be made, to take an outstanding position in this group.'—George Oliver May (in 'The Accountant and the Investor', 1932)" (p. 87)

~ “But there are some goods that have a value that cannot be measured in terms of instrumental goods. Health is obviously of that sort: good health is not on the same level as instrumental goods, because good health is a precondition for enjoying any instrumental good at all. Other goods that are incommensurable with instrumental goods are such things as knowledge; human rights; freedom; justice; religious worship. Call these ‘honorable’ goods (from the Latin, *bonum honestum*). It is a mark of a profession that it aims at a good of that sort, which is incommensurably higher than instrumental goods.” (p. 89)

~ “Accounting is a profession because it aims at knowledge, insofar as it verifies that some presentation of the position of a company is accurate and representative; and because the trust which accounting makes possible is a precondition of the good operation of the marketplace (call this the ‘public trust’). Knowledge and trust are not instrumental goods; therefore, accounting is a profession.” (p. 89)

~ “The payment that a professional receives for services has more of the character of an honorarium or stipend than a strict equivalent. Strictly, the work of a professional cannot be compensated for by money, because money is only an instrumental good, but a professional provides an incommensurably higher good.” (p. 90)

~ “By certifying the public reports that collectively depict a corporation’s financial status, the independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation’s creditors and stockholders, as well as to the investing public. This ‘public watchdog’ function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust.” (*U.S. v. Arthur Young*) (p. 104)

Chapter 5: Enron, a Failure of Objectivity and Independence

A practitioner must be concerned not simply with independence in fact, but also with the appearance of independence. The reason is that when a practitioner’s independence seems to be compromised, then that practitioner is precisely not well positioned to judge whether it really is so. Enron’s rapid collapse, and the corresponding demise of Andersen, teach these truths all too well.

~ “Watkins is an employee of Enron, but as a professional CPA, she has a responsibility to the Public Interest that transcends her employment there. It is not clear, however, that her concerns for her own standing ever rise to the level of professional integrity; they seem to be phrased more in terms of her career: ‘My 8 years of Enron work history will be worth nothing on my resume,’ she writes to Lay, ‘the business world will consider the past successes as nothing but an elaborate accounting hoax.’” (p. 122)

~ “The relevant accounting rule at the time stipulated that SPEs, to be truly independent, had to have at least 3% outside equity. But this is a necessary condition, not a sufficient condition of independence. *If an entity cannot be regarded as independent if it fails to have 3% equity, it does not follow that it will always be independent if it does have 3% equity.* The rule must be treated as a good starting point, which guides but does not substitute for professional judgment.” (p. 123)

~ “[T]he argument that an accountant’s liability in law should be more restricted than the extent of public reliance upon an accountant’s work, can ultimately make sense only if there exist strong and demonstrably effective safeguards already in place, internal to

the profession of accounting itself, so that legal protection of the investor's reasonable expectation becomes unnecessary." (p. 128)

Chapter 6: WorldCom, a Failure of Professionalism and Integrity

Professionalism and integrity imply a commitment to the public interest that transcends the demands of one's employer or client. The WorldCom fraud involved none of the accounting pyrotechnics which marked Enron SPEs, but it did require a dramatic lapse from professionalism on the part of many CPAs within WorldCom, and a lack of due diligence on the part of its external auditor.

~ "[T]he WorldCom scandal was made possible because some accountants failed to live the virtues of accountancy, and failed to adhere to the principles and ideals of their profession. Worse than this: Ebbers, Sullivan, and Myers presumed that it would be so. Even in a post-Enron environment, they acted on the presumption that the accountants whose cooperation they needed to perpetrate their fraud would not oppose them (at the price of losing their jobs), or would turn a blind eye, or would even assist them—and, sad to say, they were proved right in this." (p. 148)

Chapter 7: Can Accounting Ethics Be Taught?

If ethics in accounting involves acquiring both 'intellectual' virtues and the virtues of character, then ethics can be taught if these things can be taught. But they can indeed be taught. Intellectual virtues can be taught through good instruction, attention to case studies, and apprenticeship to senior practitioners who display good judgment. Virtues of character can be acquired by scrupulous attention to upright choices in small matters and in 'first steps'. Ethics can in this way be integrated into the complete education and professional development of a practitioner.

~ "But the question of whether accounting ethics in particular can be taught hinges on what we mean by accounting ethics. As Plato pointed out similarly in the *Meno*, the question of whether virtue can be taught depends upon our answer to the question, 'What is virtue?'" (p. 166)

~ "[E]thical accounting involves understanding; idealism; character; and culture. So the question of whether accounting ethics can be taught resolves into the question of whether any or all of these components can be 'taught' and, if so, how they can be 'taught'. But it is clear that they can be taught." (p. 167)

~ "Character ... is formed by and tested in small things and first things. This component of ethical accounting can be 'taught', then, by any efforts to insure that a practitioner's work in these respects is exemplary. For instance, in small things: there should be a complete intolerance of dishonesty, misrepresentation, or action under conflict of interest in a firm as regards what a practitioner does even outside of an engagement—in such 'small matters' as the use of expense accounts; claiming of tax exemptions and deductions; and practices of billing." (p. 169)

~ "Culture in a firm is determined above all by the 'tone at the top'—the example set by management of moderation and integrity, but it is fostered of course by practices which draw attention to and reward action in which practitioners apparently sacrifice personal advantage for the sake of principle and probity." (p. 169)