A pathway to improve accounting ethics

C. Shane Warrick
Southern Arkansas University

Andrew D. Almand
Henderson State University

Kevin Pauli
Mississippi College

ABSTRACT

This paper addresses improving accounting ethics by usng theories and practices of fraud examination and moral intensity. Major themes relating to the characteristics of occupational fraud, red flags of occupational fraud, and the dimensions of moral intensity are presented to imply constructs for preventing and detecting accounting ethics violations. Proposals for reducing accounting ethics violations are given for exploration in future research.

Keywords: accounting ethics, ethics violations, moral intensity, fraud examination

INTRODUCTION

It is important that CPAs carry out their duties in an ethical manner because of the trust that is granted them from the public and the responsibility for proper performance within regulations (AICPA 2018a; Olson 1978). Additionally, it is in the best interest of the accounting profession to have efforts toward social responsibility and for limiting government intervention (Fogarty 1995; Parker 1994). Parker explains that as the accounting profession looks out for its own interests, the public is served.

The American Institute of Certified Public Accountants (AICPA) established the Code of Professional Conduct (CPC) to guide certified public accountants (CPAs) in how to accomplish their duties with integrity, competence, and objectivity. Accordingly, accounting ethics is generally viewed in terms of adherence to the CPC. The CPC has two sections: principles (a framework to guide establishment of rules) and rules (performance requirements) (AICPA 2018a). The principles provide guidance to the profession on: responsibilities; the public interest; integrity, objectivity and independence; due care; and scope and nature of services. The rules of the code are separated into topics that cover rules for members in public practice, business, and others. Topic rules include items such as independence, integrity, and objectivity; general standards; and acts discreditable. CPAs are deemed to have committed an accounting ethics violation when they do not follow these rules.

Gary Zeune (2012) describes these ethics violations occurring from reasons such as a lack of objectivity through CPAs believing their behaviors do not violate the CPC and even ignorance of knowing the Code. The AICPA reports ethics violations in the "Annual Report of AICPA Disciplinary Activity" (ARADA). This report documents the opening of an average of 607 new ethics violation cases each year for the years 2014 – 2017 (AICPA 2018b). For those same years, it reports that, on average, 125 cases end with the CPA being expelled or suspended. At the end of 2017, the AICPA was actively managing 591 suspension cases for continuing professional education completion and follow-up review. Research by Armitage and Moriarity (2016) indicates that AICPA disciplinary actions for the categories of criminal activity and substandard professional service account for 67 percent of disciplinary actions. Their research identifies criminal activity sanctions occurring at a somewhat even annual pace during an approximate 20-year span while substandard performance sanctions have an increasing rate of occurrence over that same time frame. Additionally, this research indicates that sanction severity is increasing as noted in the increased rate of suspension and termination from membership over the study time frame.

Providing new insight about accounting ethics is critical to keep the accounting profession revered as honorable. Although accountants have far less annual enforcements, on average, than physicians and attorneys, the profession should seek to decrease ethics violations and continuously promote the practice of accounting ethics (Krom 2016). The authors believe that exploring the area of fraud examination and the concept of moral intensity can advance accounting ethics by improving the prevention and detection of accounting ethics violations.

The remaining sections of the paper will address theoretical issues of using fraud examination and moral intensity to provide proposals for improving the prevention and detection of accounting ethics violations. Additionally, suggestions for future research and a conclusion are given.

FRAUD EXAMINATION

The accounting profession, as isolated to CPAs, is not the only environment in which ethical lapses occur. A rich body of study has occurred in criminology relating to "white collar" crime since the 1940s (Clevenger 2005). The study of white collar crime has led to the field of fraud examination and the creation of an organization dedicated to fighting fraud called the Association of Certified Fraud Examiners.

Fraud examination instruction provides an analysis of how to understand, investigate, and report information relating to fraud. Fraud examination, as addressed in this paper, will be limited to the category of occupational fraud, which can be described as the use of one's job to commit fraud (Albrecht et al. 2016). The review of theories and practices of occupational fraud can encourage an understanding of violations of the CPC and lead to strategies to reduce the occurrence of unethical behaviors in the accounting profession.

Sociologist Donald Cressey first studied occupational fraud in the 1940s. By interviewing individuals who had been convicted of embezzlement and sent to prison, he discovered that the individuals had similar characteristics in committing their crime (Cressey 1953). He noted that these individuals were generally first-time offenders and were individuals that would not be expected to commit crimes. These individuals had taken jobs with sincerity and became trusted employees (or owners) until they discovered that their job held the opportunity to solve a "non-shareable problem," a problem that one wishes no one to find out. Individuals who acted to solve the problem were termed, "financial trust violators." As a result of Cressey's work, further research found that perceived opportunity, perceived pressure, and rationalization are three common characteristics of fraudulent acts (Albrecht et al. 2016). These items makeup the fraud triangle, a widely-accepted framework for explaining occupational fraud.

Perceived opportunity describes how the individual imagined being able to carry out the fraud without being caught or punished. This opportunity generally presents itself through weak internal controls. Perceived pressure is the situation or accumulation of events that the person feels to be non-shareable but could be alleviated through committing the act. The pressure could take the form of drug or alcohol addiction, financial struggles, or an extra-marital affair. Finally, rationalization represents how the individual arrives to a belief that the act is not against his moral standard and is, therefore, an appropriate action to pursue. Rationalization is depicted in thoughts such as, "I am only borrowing," "I deserve this," or "no one will notice." In the occurrence of an occupational fraud, each component of the triangle is expected to exist; therefore, they provide a useful way of understanding "why" and "how" the individual committed the fraud. Additionally, they provide a useful way to begin to develop a plan of action to prevent a similar infraction (Cressey 1953; Albrecht et al. 2016).

As Donald Cressey studied embezzlers, accounting ethics researchers can study individuals who have been sanctioned by the AICPA for substandard professional performance and criminal acts to gain an understanding of the "why" and "how" of an accounting ethics violation. These sanctioned individuals would be identifiable in the AICPA website listing "Disciplinary Actions" (AICPA 2018d). This type of research leads to Proposition 1.

Proposition 1:

Defining the characteristics of an accounting ethics violation will improve efforts for preventing and detecting violations.

Once there is consensus on the characteristics of an ethics violation, more efficient research can proceed on how to eliminate violations. As we understand the nature of unethical accounting acts, CPAs and reviewing bodies need a way to determine if they are occurring. However, this search for unethical acts is often hindered by concealment. To overcome concealment and identify the need to look deeper into an issue, the accounting profession can use a process of responding to "red flags."

With regard to occupational fraud, the Treadway Commission described how important it is to combat corporate fraud (NCFFR 1987). Their findings highlighted how fraud prevention measures were reasonable, attainable, and needed. Since fraud by its nature is concealed, measures needed to be taken to help individuals looking for fraud know when to investigate more intensely. Suspicions of fraud are labeled as "red flags." Since the Treadway Commission report, countless other publications have endorsed the use of red flags to help identify fraud (AICPA 2018c; Pincus 1989). These red flags have been categorized into six broad categories: accounting anomalies, internal control weaknesses, analytical anomalies, extravagant lifestyle, unusual behavior, and tips and complaints (Albrecht et al. 2016).

Of these six categories, prior accounting ethics research is most closely related to tips and complaints. As discovered in fraud examination, it is most beneficial to make reporting as easy as possible then demonstrate due care and restraint in evaluating the merits of the tip or complaint (Albrecht et al. 2016). It is encouraged to allow employees, vendors, and customers the opportunity to obtain information on how to report suspected fraudulent activity. In relating this to the accounting profession, the AICPA website does display an "Ethics Hotline," however it is several "clicks" into the site and listed under the Professional Ethics Division (AICPA 2018g). While the following studies were not conducted as red flag studies in accounting ethics, they point to the potential of identifying red flags and lead to an emphasis for moral intensity discussed later in the paper. Beets and Killough (1990) found that CPAs would consider reporting identified ethics violations about 50 percent of the time. The same study showed clients would report violations in only 41 percent of the cases. The Higgs-Kleyn and Kapelianis (1991) study complements the Beets and Killough study in finding that accountants perceive a low risk of being detected if they do break the code. A review of the accounting literature yielded no results for studies examining the remaining five red flag groups in accounting ethics research.

Just as the occupational fraud red flags help identify potential issues, accounting ethics red flags can help detect potential violations. Identification of red flag categories as they relate to accounting ethics violations should be researched in an effort toward violation detection. This leads to our next proposition.

Proposition 2:

Identification of red flags for accounting ethics violations will improve efforts for detecting violations.

MORAL INTENSITY

Ethical decisions have been described by Rest (1986) to occur in four stages: recognizing a moral issue, making a moral judgment, establishing moral intent, and engaging in a moral behavior. To address this ethical decision process, moral intensity is a construct that focuses on raising the awareness of a current issue toward each of the four decision steps in the process (Jones 1991). Moral intensity considers items such as the magnitude of consequences, probability of effect, and proximity to determine how an individual will behave in regard to an ethical issue (Jones 1991). Jones proposed that ethical decisions can be achieved when the dimensions of an issue are more salient (meaningful) to a decision maker.

Studies with moral intensity have proven beneficial to understanding ethical behavior. These studies have applied Jones' construct and conclude that as the moral intensity of an issue increased, more ethical behavior was demonstrated by the viewer of the ethical issue. May and Pauli (2002) documented that moral intensity is related to the ethical decision making process in Rest's model areas of moral recognition, moral evaluation, and moral intention. Flannery and May (2000) found that the moral intensity dimension, magnitude of consequence significantly impacted manager actions in making ethical environmental decisions.

Prior accounting research can validate the potential of moral intensity for helping in accounting ethics. In the accounting ethics study by Beets and Killough (1990), the concept of moral intensity was not directly discussed, but the concept can be seen in the finding that both CPAs and clients were more likely to report what they considered would result in a severe violation sanction. Taxation research by Carnes and Englebrecht (1995) described how the magnitude of an imposed penalty and the perception of detection risk were significant to tax compliance. Gul et al. (2003) find that Chinese auditor's with lower levels of ethical reasoning act more ethically when the perception of detection is high. These issues are directly related to the dimensions of magnitude of consequence, probability of effect, and proximity conveyed in moral intensity.

The profession can address the use of moral intensity in multiple ways. One way is to continue to increase the saliency of the CPC to individual accountants and third party observers (clients and review bodies) through stressing the critical importance of the issue for preventing further government intervention most importantly and even avoidance of negative personal consequences from violation. The increased saliency of the CPC will strengthen the awareness that not observing the Code is an ethics violation and that the act should not be pursued or that identified violations should be confronted. A more prominent display of the Ethics Hotline, prominently displaying the consequences to violations of individual members such as Frank Marano and Rita Hill, and highlighting the potential for being caught in a violation are in alignment with the concept of moral intensity for preventing and detecting unethical acts (AICPA 2018e; AICPA 2018f)[1].

Another way to address moral intensity is to establish the severity of the issue with future CPAs currently in higher education. Shawver (2006) found that using case analysis and testing were significant factors in helping students understand accounting ethics. Additionally, the profession can encourage the asking of more questions of CPAs on following the CPC, as fraud examination has found this useful. Joseph Wells notes, that "People don't want to be caught telling big lies; instead of taking that risk, they will try to avoid answering you" (Wells 2001). Questioning sensitive issues allows individuals who suspect problems the freedom to speak up and has the potential to encourage violators to confess or show red flags of an underlying issue (Wells 2001). This could be implemented in areas such as the peer review process or in-house quality reviews.

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[1] AICPA disciplinary actions: Marano – two year suspension of membership, 43 hours CPE, must have pre-issuance reviews of reports for one year; Hill – terminated from membership.

Developing awareness of the moral intensity relating to accounting ethics violations should aid in both the prevention and detection of the acts. Increasing moral intensity to issues CPAs face should decrease the probability that a CPA would commit a violation; this increase in moral intensity should also increase the probability that a CPA would report a known violation when s/he becomes aware the violation has occurred. This proposition is stated formally below:

Proposition 3:

Increasing the moral intensity of accounting ethics issues will improve efforts for preventing and detecting violations.

PROPOSITION MODEL

Figure 1 (Appendix) depicts the propositions offered in the paper. Propositions are identified as the oval shapes with their expected impact for prevention and detection shown through the drawn arrows. From proposition 1, identification of the characteristics involved with an accounting ethics violation will aid in prevention through (1) allowing an individual CPA experiencing these characteristics to self-assess and modify actions and (2) allow for the opportunity to create safeguards which limit the possibility for a violation occurrence. Identification of the characteristics aids in detection of violations by (1) providing information capable of leading to the establishment of red flags for violations and (2) possible starting points for proactively searching for violations as when in a peer review or in a complaint investigation.

From proposition 2, identification of red flags for a violation will aid in the detection of an ethics violation by offering signs of where an underlying or concealed issue may reside. Recognition of an established flag can then point to an area for continued evaluation for a possible concealed violation to be detected. Proposition 3 identifies moral intensity aiding in prevention, enhancing recognition of red flags, and detection. Moral intensity aids in the prevention of unethical acts by heightening awareness of the ethical issue thus improving the ethical decision making process. Moral intensity aids the recognition of red flags by heightening awareness of the red flags to identifying a violation. Finally, moral intensity can improve efforts for detecting unethical acts by highlighting an ethical issue for its significance to be identified and reported.

FUTURE RESEARCH

The time and effort required for future research on the propositions outlined in this paper will likely be very beneficial to the profession. Additionally, future research should address the CPA's willingness to provide documentation on the code of ethics, such as: How often do you as the CPA review the CPC?, Would the CPA be willing to document an understanding of the code when submitting annual CPE credit to a state board?, and Would a CPA provide code of ethics information to clients in places such as the engagement letter?

Both Armitage and Moriarity (2016) and Badawi (2002) empirically investigate AICPA ethics violations. Using the results from these studies would provide a starting place for identifying red flags and determining the specific ways the profession can increase moral intensity.

CONCLUSION

The field of fraud examination and concept of moral intensity provide relevant issues to consider for improving our understanding of accounting ethics. While articles on accounting ethics are not in short supply, many of those articles question how the self-regulation system is benefiting the profession and others tell about legislating accounting ethics (Parker 1994; Robertson & Hawkins 1999; Neill & Jinkerson 2005; Rockness & Rockness 2005). This paper focuses on initiating discussions about the characteristics of ethics violations to bring guidance on the how and why an individual chose to violate the code. This paper also offers how providing red flags to be considered as individuals review work products, or even associate with fellow CPAs, will be advantageous through helping identify potential violations. Increasing the moral intensity associated with ethical accounting decisions will also increase the prevention and detection of violations. Implementing these efforts can lead to a more ethical accounting profession.

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APPENDIX

Figure 1
Model Diagram of Proposals