
An Honors Thesis (HONRS 499)

by

Neva A. Wilson

Thesis Advisor

Dr. Paul Parkison

Ball State University

Muncie, Indiana

Date: April, 1992

May, 1992
### Table of Contents:

<table>
<thead>
<tr>
<th>Page No.</th>
<th>Topic</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Synopsis to Research</td>
</tr>
<tr>
<td>1</td>
<td>Introduction</td>
</tr>
<tr>
<td>3</td>
<td>Ethical Decision-Making</td>
</tr>
<tr>
<td>12</td>
<td>AICPA's Code of Professional Conduct</td>
</tr>
<tr>
<td>29</td>
<td>Case Studies</td>
</tr>
<tr>
<td>32</td>
<td>Case Studies Not Addresses by the Code</td>
</tr>
<tr>
<td>36</td>
<td>Sources Cited</td>
</tr>
</tbody>
</table>
Synopsis to Research

This thesis is a discussion of ethics in the public accounting profession. It focuses upon how to make decisions in ethical dilemmas, the American Institute of Certified Public Accountant's (AICPA) Code of Professional Conduct, and other areas of ethical concern that may not be addressed by the AICPA's Code.

The research disclosed that the established ethic codes are important in the accounting profession, but they are only guidelines and are not all inclusive. In other words, the codes do not address every ethical situation that could be encountered during one's professional career as an accountant. The AICPA's Code is a minimum standard that must be followed by its members at all times. A professional must decide on an individual basis, for each ethical situation encountered, what is right and just. The public accountant has to look at the established ethical codes for guidance, specifically the Code of Professional Conduct by the AICPA, but the accountant must also be able to make ethical decisions based on his/her own personal code of ethics. While codes of ethics are important, the many different ethical situations one could encounter during one's career calls for applying the highest ethical standards to one's personal and professional life at all times in order to be successful at making the "right" decisions.

"Ethics and excellence usually go hand in hand. Though anyone can slip, ethical lapses are most common among the marginal performers who exist on the fringe of every business and profession". (Walters. 1990).
**Introduction**

There are many situations encountered in public accounting that requires ethical decision-making. Many of these situations are addressed by the AICPA's *Code of Professional Conduct*, but this code is only a minimum standard that must be followed by all members. A public accountant will encounter many situations that are not addressed by this code and he/she will have to draw upon other resources in making the "right" decisions in these circumstances.

Students going into public accounting, must consider how ethics are going to affect their career. They must look at their value systems and examine their own ethic codes. After becoming aware of their ethics and values, they are then able to examine and apply another code of ethics in making ethical decisions.

As public accountants, the first guide in making ethical decisions should be the AICPA's *Code of Professional Conduct*. Public accountants can also rely upon other codes that are used in the accounting profession. Some of these codes are "Guidance on Employee Ethics and Conduct" by the General Accounting Office (GAO), the National Accountant's Association's (NAA) "Standards of Ethical Conduct for Management Accountants", and the Institute of Internal Auditor's (IIA) Code of Ethics. Stephen E. Loeb, PhD., "concluded that accounting students need to be educated in ethics so that they develop an understanding and appreciation of the role of various codes of ethics that exist within accounting, the societal mechanisms to ensure that public accounting regulates itself, and develop an ability to effectively deal with the dynamic nature of the ethics environment and ethical dilemmas that arise in accounting". (Armstrong and Mintz. 1989).
The first goal in examining ethics should be to understand one's own personal values and ethics. In light of these, one should be able to set up a decision-making model to aid in understanding ethics and in making decisions of an ethical nature. After resolving how to go about making ethical decisions, the AICPA's Code must be incorporated into the decision-making model. To do this, the code must be understood thoroughly. Finally, ethical dilemmas must be examined that could arise in one's career so that ethical situation may be recognized and the consequences of any decisions that might be made will be understood.

This thesis is outlined in sections. The first section deals with how to make ethical decisions. It begins with a discussion on ethics, morals, and values and then discusses ethical decision-making models and other resources that one could use in making ethical decisions. The second section discusses the AICPA's Code of Professional Conduct. In this section, the Principles and the Rules are discussed along with interpretations and rulings to the Rules. The third section explores some case studies that deal with issues addressed in the Code of Professional Conduct. The final section explores situations that the Code does not directly respond to. In all of these situations ethical decision-making skills must be applied in order to find the best alternative.
Ethical Decision Making

In order to make ethical decisions, public accountants must first understand their own ethic code, values, and morals, and be able to incorporate those into a decision-making model. Ethics is basically defined as "consensually accepted standards of behavior for an occupation, trade, or profession". (Wheelen & Hunger. 1989:76). Codes of ethics usually are in the context of an all-inclusive theory about morality. Morals refers to precepts of personal behavior based on religion or culture, and it usually judges behavior as good or bad, thereby involving values. Values help create self-image and influences personal and professional goals and objectives. Values change as people change. Ethics is distinguished from values and morals because it involves reflective thinking and the use of rational thought to determine the best possible course of action in the face of conflicting choices. "Ethics is concerned with any situation where there is actual or potential harm to an individual or group". (Luoma. 1989).

Ethics raises several questions about situations that could cause harm to others. First, does the action unfairly single out an individual or group? Secondly, does the action violate moral or legal rights and does it conform to accepted moral standards? Finally, are there alternative courses of action that cause less harm? (Luoma. 1989).

There are two basic systems of ethics that are used by individuals. Utilitarianism ethics involves finding the balance between good and bad consequences. Deontology ethics emphasizes
rules and principles. Deontology is similar to cost/benefit analysis. It weighs the benefits of a decision against the costs and comes up with the "best" alternative. The problem with this approach is that "people consistently overestimate the cost of doing the right thing, and underestimate the cost of failing to do the right thing". (Walters. 1990).

Ethical absolutism is built on unchanging moral codes. It says a person ought to do something because of a rule which is already established. This is similar to following the AICPA's Code of Professional Conduct without questioning it. Ethical relativism assumes ethical values depend upon the situation. It examines the consequences of alternative actions. As a public accountant one should be able to apply ethical relativism to decisions when faced with an ethical dilemma. Public accountants should keep in mind that when the Code of Professional Conduct applies to a situation, the accountant should be able to analyze the possible alternatives and make decisions based on the Code and one's own personal ethics.

Ethical decision-making models helps to clarify alternatives in a given situation by examining the underlying values and consequences of each alternative. There are two methods of decision-making models that are helpful in making ethical decisions. The first one lists the steps one needs to go through in making an ethical decision, and the other method is a decision tree.

The first step in an ethical decision-making model is to determine the facts of the situation. Secondly, define the ethical
issues involved and list all the significant stakeholders that would be involved in any decision that could be made. The third step is to identify the major principles, rules, and values that are implicit in the situation. The next step is to specify the alternative courses of action that can be taken and specify the consequences, or pros and cons, of each alternative. According to Wheelen and Hunger, there are basically seven possible responses to an ethical decision and all of these should be considered carefully. They are:

1. Avoid thinking about the situation.
2. Obey any orders given by the authorities.
3. Leave the organization and the situation.
4. Conscientiously object to the situation.
5. Secretly tell the press or government.
6. Publicly tell the press or government.
7. Build consensus for change inside the organization.

The last response is considered the best response to most situations. However, this is not always feasible, so the other responses need to be explored also. Finally, it's time to make the decision. The consequences of each alternative should be balanced against primary principles and values, and the alternative that fits these principles and values the best should be selected. (Siers. 1991).

The second model is a decision tree for incorporating ethics into decision-making. This is a modified version of the decision tree from Wheelen and Hunger's "Decision Tree for Incorporating
Ethics into Decision Making in order to incorporate the AICPA's Code of Professional Conduct. This decision tree can be applied to the first decision-making model by using it in the final step of assessing the consequences of each alternative. This tree discusses an overwhelming factor. This is a situational factor that may justify overriding one of the ethical criteria.

"This is where individual judgement comes into play. There are no hard and fast rules in ethics, only principles and approaches. Choose that alternative that a person can clearly explain to a jury in a court of law". (Wheelen and Hunger, 1989:78).

**Decision Tree for Incorporating Ethics into Decision-Making**

Does the alternative chosen result in the optimization of satisfactions of interested parties inside and outside (the public) the organization? → NO

- Are there overwhelming factors that justify suboptimizing these goals and satisfactions?
  - NO
  - Reject the alternative.

- YES
  - Does the alternative respect the rights of all the affected parties? → NO
    - Reject the alternative.
  - YES
    - Does the alternative follow the AICPA's Code? → NO
      - Are there overwhelming factors that justify the abrogation of a right?
        - NO
        - Reject the alternative.
      - YES
        - Accept the alternative.
    - YES
      - Are there overwhelming factors that justify the violation of a canon of justice?
        - NO
        - Reject the alternative.
      - YES
        - Accept the alternative.
While the AICPA's Code of Professional Conduct is the primary ethic code that public accountants use as guidelines for ethical conduct, there are several other codes of ethics that one can use as resources in solving ethical dilemmas. The General Accounting Office has the code, "Guidance on Employee Ethics and Conduct", the National Accountants Association has the "Standards of Ethical Conduct for Management Accountants", and the Institute of Internal Auditors has its own code of ethics also.

The GAO approach to ethics centers on setting a tone at the top, on following policy guidance, and on filing and reviewing of required forms. (Grosshans. 1989). The tone at the top is set by the comptroller general. The message, according to Grosshans, is that "GAO stands for quality in the way it does its work and how it acts. He (comptroller) expects this high standard on every assignment." "GAO reserves the right to scope and design the job to allow it to get all the facts (pro and con) and call the shots the way it sees them." (1989).

The GAO's ethic code serves as a guideline for the GAO's employees. It specifies that all employees should avoid even the appearance of being less than objective. The ethics code also has guidelines on accepting or giving gifts where it could look as if the employee's were being influenced in performing their duties. The question that each employee is supposed to ask his/herself is if he/she would mind if the exchange of the gift or favor was discussed in the press.
The credibility of the GAO's ethical system is built on the "cultural values of independence, objectivity, accuracy, and ethical conduct". (Grosshans. 1989). Each time a report is issues, the GAO goes to great strides to ensure that all of these values are protected in order to protect its credibility.

In 1988 the GAO revised its auditing standards by enforcing quality and high ethical standards. These standards now applies to any organization that audits any governmental program. Also, any organization that conducts an audit for the GAO must have an internal quality control system and participate in an external quality control review. (Grosshans. 1989).

The NAA has an ethic code called "Standards of Ethical Conduct of Management Accountants". These standards stress competence, confidentiality, integrity, and objectivity. To maintain competence, management accountants are encouraged to develop their knowledge and skills, and to perform their duties according to the laws, regulations, and technical standards. They are also required to prepare "complete and clear reports and recommendations after obtaining relevant and reliable information". (NAA. 1982).

The standard on confidentiality is similar to the AICPA's Code. The management accountants must refrain from disclosing information unless the legal system requires it. The NAA does require its members to inform their subordinates when information is confidential and to monitor the subordinates to ensure they keep this code of confidentiality.
The standard of integrity states that the NAA's members have a responsibility to avoid conflicts of interest. The members must refrain from activities that could prejudice them in performing their duties and refuse gifts that might appear to influence their judgement. Members must also communicate their own professional limitations, and refrain from any activity that would discredit the profession.

In using objectivity, the NAA's standards concentrates on the objectivity of communications. The NAA's members are required to be fair and objective in their communications, and to disclose all information that could "reasonably be expected to influence an intended user". (NAA. 1982).

The major problem with the NAA's code of ethics is that it is difficult to enforce. The individual members have had problems in identifying unethical behaviors or situations. When an ethical situation occurs, the member should follow the policies of the organization in which he/she works. If following these policies does not solve the problem, then the accountant may have no recourse but to resign from his/her position. Communication of ethical situations outside of the organization in which he/she works is not appropriate, except for discussing the situation with the NAA Ethics Counseling Service which any member can call to discuss his/her ethical problem and to obtain assistance in resolving the issue. (Walters. 1990).

The IIA also has a code of ethics and is similar to NAA's and AICPA's codes. This Code has an introduction, an interpretation of
principles, and eight articles that address members responsibility to their employers. The eight articles require members to exercise honesty, objectivity, and diligence. The articles also require members to exhibit loyalty to their employers and to refrain from activities that could conflict with their duties. The other articles discuss the rule of accepting gifts and maintaining confidentiality. Finally, IIA's members are required to obtain sufficient factual evidence when expressing opinions.

One way in which the AICPA and GAO have ensured that the ethics codes are practiced by members have been to require that member firms implement a quality control system. Quality control systems help to assure that professional services are in compliance with professional standards. The quality control system's structure, policies, and procedures should be appropriate in relation to the firm's size, nature of practice, and the degree of operating autonomy within the firm. When implementing the system, the costs must be weighed against the benefits derived.

Quality control standards apply to audits and reviews. Quality control systems are set up in order to assign personnel to engagements, to assure that members will seek assistance from appropriate expert sources, and to assure that independence is maintained. A quality control system aids in making sure that proper supervision and hiring takes place and that adequate professional development and advancement occurs. Quality control systems also helps answer a question whether to accept a client or to continue serving a specific client.
A public accountant needs to be able to examine his/her own ethics, values, and morals, and be able to make ethical decisions based on his/her own ethics or those ethic codes developed by other professionals. The primary code of ethics that a public accountant needs to know and understand is the AICPA's Code of Professional Conduct. This code establishes the minimum standards that a public accountant must follow in order to continue being a member of the AICPA. The courts have also used the AICPA's Code in settling law disputes against/for public accountants, so it is necessary to know and understand the Code in order to be successful in public accounting. This Code is discussed in the next section.
AICPA's Code of Professional Conduct

The AICPA's Code of Professional Conduct is applicable to all AICPA members. Compliance with the Code is voluntary. Secondary measures used to ensure compliance are reinforcement by peers, public opinion, and disciplinary proceedings. The disciplinary measures that are used, when violations of the Code occur, are admonishment, suspension, or expulsion from the AICPA. The state CPA boards monitor ethical matters and issue the appropriate disciplinary measures.

The AICPA's Code of Professional Conduct has two sections: the Principles and the Rules. The first section of the Code is the Principles. The Principles provide the framework for the Rules and "express the profession's recognition of its responsibilities to the public, to clients, and to colleagues". (AICPA. 1988).

The first article of the Principles deals with the responsibilities of members. This articles states, "In carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgements in all their activities". (AICPA. 1988). Members have a responsibility to all who use their services. They also have the responsibility "to improve the art of accounting, maintain the public's confidence, and carry out the profession's special responsibilities for self-governance". In carrying out the professional responsibilities, members are to "exercise sensitive professional and moral judgement". (AICPA. 1988).
The second article deals with serving the public interest. The public interest is best served when the public accountant performs his/her duties with integrity, objectivity, independence, and due care. In the case, US v. Arthur Young and Company, et.al. The court stated that,

"the independent auditor assumes a public responsibility transcending any employment relationship with the client. The independent public accountant...owes ultimate allegiance to the corporation's creditors and stakeholders 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". (Weiss. 1987).

The next three articles address the Principles of integrity, objectivity, independence and due care. Integrity is defined as honesty and candor and deals with what is right and just. Objectivity requires impartiality; it is a frame of mind and involves one's professional judgement. To be objective, one must be intellectually honest and free of conflicts of interest. Independence "precludes relationships that may appear to impair objectivity". (AICPA. 1988). Independence is also discussed in the Rules. Finally, exercising due care requires one to follow both technical and ethical standards in performing services. It requires members to strive for excellence and to do all duties to the best of their abilities. Due care is derived from education and experience. Each member is responsible for assessing his/her own competence when undertaking any professional responsibility.

The sixth and final article deals with the scope and nature of services that can be performed by a member of the AICPA. A public accountant must determine the scope and nature of the services that
he/she can provide by observing the other Principles of the Code, especially the Principles of serving the public interest and having integrity, objectivity and independence. This can be accomplished by practicing in firms with adequate internal quality-control procedures. Also, the individual member must consider whether the scope and nature of the services he/she performs will conflict with auditing procedures, and if the services to be rendered will be consistent with his/her professional role. (AICPA. 1988).

The Rules are the second section of the Code. Members of the AICPA must adhere to these Rules. The Rules discuss the topics of independence, integrity and objectivity, and the general standards and compliance with those standards. Other rules are about the use of accounting principles, confidential client information, contingent fees, and acts that are discreditable to the profession. The final Rules deal with advertising, commissions, and the form and name of the practice.

The first rule deals with independence. Independence "may be defined in a professional context as a state in which one is self-reliant and not easily influenced by others". (Cottell and Perlin. 1990. p.29). Independence can be considered on three different levels. The first level deals with the auditor's character and whether he/she is responsible and has the virtues of honesty and objectivity. This is the highest form of independence. The second level deals with the auditor's relationship with the client. Independence is achieved on this level if the auditor avoids any relationship that would impair his/her ability to take an unbiased
viewpoint. This means avoiding any personal or business relationship with clients that would compromise an auditor's professional judgement. Finally, the third level deals with the appearance of independence. An auditor needs to "avoid any relationship that might suggest to a reasonable observer that a conflict of interest exists". (Cottell and Perlin. 1990:31).

There are basically two types of independence that the AICPA's Code discusses. This is independence in fact and in appearance. Some examples of independence in fact being violated are lacking objectivity and skepticism, such as in the second level of independence, and when an auditor accepts management's word for things that should be independently verified by him/her. Some other examples of independence in fact being violated are when a public accountant agrees to a client-imposed restriction on an audit or when the auditor neglects to do a critical evaluation of a significant client transaction. (Cottell and Perlin. 1990:32).

Level three dealt with independence in appearance. An example of when this could be violated is when a public accounting firm audits a client and performs the role of management consultant for the same client. In the mind of the public, the accounting firm could appear to lack independence.

Another example of the lack of independence in appearance could occur is when a client has been served by the same accounting firm for an extended period of time. The accounting firm and the client become associated together and this may be perceived as lacking independence.
Finally, the competition that has occurred in the accounting practices recently has caused some people to feel that accounting firms would "sacrifice independence in order to gain business advantages in an unrestrained competitive environment". (Cottell and Perlin. 1990:34).

The AICPA has published six interpretations of independence. The first interpretation, 101-1, discusses direct and indirect material interests in a client. A public accountant who has a direct or indirect material interest in a client, or an accountant that has a loan with a client which is not listed as one of the exceptions, is considered to lack independence. Also this interpretation states that if an accountant is like an employee of the client then he/she lacks independence.

The interpretation, 101-2, states that a former partner who possibly becomes associated with a client doesn't impair independence if that partner has fixed retirement benefits and doesn't participate or appear to participate in the accountant's business.

The interpretation, 101-3, discusses write-up services. First of all, an accounting firm cannot do write-up services for an SEC client if the firm also does audit services for that client. If an accounting firm wishes to do write-up services for a non-SEC client, these services cannot impair integrity and objectivity of the firm. Also, the firm cannot assume the role of an employee of that client, and the client has to take responsibility for the
statements. Accounting firms can rent computer time to non-SEC clients without impairing independence.

Interpretation, 101-6, discusses how the threat of litigation can affect independence. Whether the litigation is actual or threatened, it can cause impairment of independence if it was commenced by the present management alleging audit deficiencies. Litigation can also impair independence when it is commenced by the auditor for fraud or deceit by the present management. If the litigation is immaterial and not related to an audit then it doesn't impair independence.

Interpretation, 101-8, states that a financial interest in a non-client impairs independence when the non-client has a financial interest in the CPA's clients.

The last interpretation, 101-9, discusses the effect of family members on a CPA's independence. The spouse and the dependents of the CPA are considered to impair independence in the same way as the CPA, except that the spouse or dependents can be employed by a client if they do not exert significant influence on the client. A CPA must consider what a reasonable person would question in relationship to independence in appearance. (AICPA. 1988).

There have been a great many rulings applied to the independence rule. Independence is considered lacking when:

1. A CPA accepts more than a token gift from a client.
2. A CPA co-signs client's checks.
3. A CPA supervises client's office personnel on a monthly basis.
4. A CPA serves as a legislator of a local government unit and his/her firm performs services for that same unit.

5. A CPA is a trustee of a foundation whom the CPA's firm performs services for.

6. A CPA's spouse is a trustee of a trust that own stock in a client of the CPA.

7. A CPA leases something to a client.

These are just a few of examples on the rulings for the independence rule. A CPA must be very diligent in applying the independence rule and interpretations to his/her professional and personal life.

The next rule discusses integrity and objectivity, and states that these qualities must be maintained in any professional service that a member performs. This can be accomplished by avoiding conflicts of interest and by not knowingly misrepresenting facts or subordinating one's judgement. According to the AICPA's Code, resolving doubt in favor of a client does not impair a CPA's integrity and objectivity.

There are two interpretations to this rule. The first interpretation, 102-1, states that an accountant who knowingly make or permits false or misleading entries in financial statements is not practicing integrity or objectivity. The second interpretation, 102-2, states that conflicts of interest occur if a CPA has a significant relationship that could be viewed as impairing his/her objectivity. In order for this relationship to be acceptable according to the Rules, the CPA must gain consent
from the client so that the CPA can disclose the relationship to any interested parties. (AICPA. 1988).

The third rule discusses the general standards that all members in public practice must follow in performing services. For all professional engagements the CPA should only undertake to perform professional services that he/she can complete with competence. All members must exercise due professional care in all professional engagements. All engagements undertaken must be adequately planned and supervised, and members must "obtain sufficient relevant date to afford a reasonable basis for conclusions and recommendations". (AICPA. 1988). Additionally, all members must comply with the standards promulgated by FASB, GASB, and AICPA designated bodies whenever these standards apply to professional services that are performed.

There are two interpretations to the general standards rule. The first one, 201-1, states that in completing an engagement, competence includes technical qualification, ability to supervise, knowledge of subject matter, and an ability to research the subject and consult with others. The second interpretation, 201-4, discussed the type of engagements and the standards that the engagement must follow. For example, attestation services must follow the "Attestation Standards", audits must follow the standards issued by GAAS and SAS's, and prospective financial services must follow the standards issued by "Statements on Standards for Accountant's Services on Prospective Financial Statements". (AICPA. 1988).
There have been many rulings on the general standard rule. For example, a CPA, who prepares unaudited financial statements for a company in which he/she owns stock, is required to issue a disclaimer due to lack of independence. Also, a CPA should have the technical knowledge necessary to be able to supervise and evaluate the work of any specialist in his/her employ. Another ruling stated that unaudited interim reports issued by a client are associated with the CPA if his/her name is on them.

The next rule is about accounting principles. The AICPA Code states that members cannot provide positive or negative assurance that financial statements are in conformity with GAAP if the statements contain departures from General Accepted Accounting Principles (GAAP). An exception occurs when following GAAP would result in misleading statements. These departures must be disclosed in the report, and also, the reasons and effects of the departure must be discussed along with why compliance would result in a misleading statement. (AICPA. 1988).

Public accountants also need to be aware of situations where GAAP is used yet the financial statements are still misleading. "Companies search for accounting methods that best suit the game plan". (Davis. 1989). Here are some examples of accounting practices that match GAAP but distort the bottom line. The GAF corporation had a trick for fattening the bottom line. It changed the fiscal year in order to include a one time net gain of $3.9 million. Other corporations have used the "half-a-hit-gambit" scheme of asset write-downs. These corporations are partially
writing down some assets that are not being used even if the assets will be brought back on-line in the future. This practice reduces depreciation and results in higher earnings. Also, by reducing the book value of the asset, return on investment increases. This practice can "smooth income and cover a multitude of management discretions". (Davis. 1989).

Another example of where corporations distort the financial statements and still use GAAP is when the company writes off everything possible during bad years. This is called "taking a bath". The last quarter of 1985 a lot of companies "took a bath" on poor investments that had occurred in prior years. Davis describes this as "Rumpelstiltskin accounting" when managers decide when to face the music for bad managerial decisions. When this practice occurs, pretax earnings of prior years were probably overstated or unreliable. "Baths make wrongdoings appear virtuous and bad judgement appear praiseworthy by glossing over managerial errors". (Davis. 1989).

The AICPA mentions some "red flags" that might represent that the financial statements are misleading. Auditors need to look for:

1. Large and unusual transactions at the end of the year.
2. Large discrepancies between physical and book inventory.
3. Investments in high-risk companies.
4. Industry norms or the past record of the company doesn't fit the numbers on the financial statements.
5. Discrepancies between customers' accounts payable and company's accounts receivables. (Davis. 1989).

There have been two interpretations to the rule of accounting principles. Interpretation, 203-1, states that departures from SFAS is allowed only when results will be misleading. This requires use of professional judgement. Some examples of when departures are allowed is when there is new legislation and conflicting industry practices. Interpretation, 203-3, just states that "SFAS's which stipulate that certain information should be disclosed are not covered by Rule 203". (AICPA. 1988).

The rule that discusses confidentiality states that confidential information cannot be disclosed unless the client consents. The exceptions to this rule are when a member must comply with general standards and accounting principles obligations, when there is a subpoena or summons issued, when the AICPA conducts a review of professional services, and when initiating a complaint or when responding to an inquiry of a recognized investigative or disciplinary body. (AICPA. 1988). The communications between a CPA and a client are not considered privileged information under common law. This means that under certain proceedings a CPA can be forced to disclose the required information.

There have been two interpretations to the confidentiality rule. Interpretation, 301-2, states that the rule cannot prohibit or interfere with compliance with laws and government regulations. Interpretation, 301-3, states that a member may allow confidential
client information to be shown to prospective buyers, but he/she must make appropriate precautions such as a written agreement that binds the prospective buyer to keeping the information confidential. (AICPA. 1988).

There are quite a few rulings on the confidentiality rule. For example, a CPA can utilize outside computer services as long as there is no release of confidential information. Also, the CPA can use a records retention agency. Another example is that when a CPA withdraws from an engagement because of irregularities, he/she should urge the successor to have the client grant permission to reveal the reasons for the predecessor's withdrawal. (AICPA. 1988).

Members are precluded from performing services on a contingent fee basis under Rule 302. Fees cannot be contingent upon findings or results of the member's services. Fees can vary with the complexity of the services and can be fixed by the courts. Only in tax services can the fees be based on the results of judicial proceedings. (AICPA. 1988).

The interpretation to contingent fees, 302-1, states that "The findings of government agencies does not refer to preparation of original tax returns, amended returns, claims for refunds, and requests for private letter rulings". (AICPA. 1988).

In the rulings for contingent fees, it states that fees should not be based on a percentage of a bond issue or on the acquisition price of an investment for the work done on either project. Also, an expert witness fee cannot be based on the amount awarded to the
client. Finally, another ruling states that a member cannot base his/her fees on how much taxes he/she saves for the client. (AICPA. 1988).

The AICPA Code states that a member "cannot commit an act discreditable to the profession". There are five interpretations to this rule. Interpretation, 501-1, states that it is discreditable to keep client records after the client requests them. The CPA may keep records prepared specifically for him/her and any workpapers with information not reflected in clients books until the client pays the CPA's fee. A ruling states that the CPA is only required to return those records that were originally provided to him/her when an engagement is terminated.

Interpretation, 501-2, states that discriminating is a discreditable act. 501-3 states that not following governmental standards when doing audits on governmental units is considered discreditable. Interpretation, 501-4, states that by "negligently making or permitting others to make false or misleading journal entries" a CPA is committing a discreditable act. 501-5 states that members must follow requirements beyond GAAS when required. If the member does not follow required standards, then he/she must disclose in a report why the standards were not followed. (AICPA. 1988).

The rulings state that a CPA who is employed by a non-CPA firm must still comply with the Rules of Conduct, and if the CPA is a partner in that firm, then he/she is responsible for making sure
that all persons who are associated with the CPA's firm complies with the Rules also.

Another ruling states that if a CPA serves as a bank director, then he/she should consider if the confidentiality rule is broken, or if there is a conflict of interest between the bank and the CPA's clients. Other considerations should be if the CPA is using the directorship to obtain clients and if the independence rule has been violated. For example, has the bank made a material loan to one of the CPA's clients?

The rule on advertising has changed over the years. Until 1978, any form of advertising was strictly forbidden. Because of possible violations of antitrust laws, the rule was changed. Now advertising is allowed, but only certain forms are considered acceptable.

The advertising rule has been used conservatively. Some national and local firms have run advertising campaigns. There have been advertisements in business journals such as Wall Street Journal and Business Week. These advertisements have been "soft sell" which basically have been used to polish the firm's public image and identity. (Gray, 1989). The advertising rule states that a CPA should not use false, misleading, or deceptive advertising. (AICPA, 1988).

Interpretation, 502-2, lists the prohibited forms of advertising. These include advertising that creates a "false or unjustified expectation", that implies an ability of the CPA to influence others in the judicial system, and that would "lead a
reasonable person to misunderstand or be deceived". (AICPA. 1988).
Another prohibited form of advertisement would be one that created an unrealistic estimate of future fees.

In 1977, the U.S. Supreme Court ruled in Bates v. State Bar of Arizona, that a restriction against advertising in the legal profession violated the constitutional guarantee of freedom of speech. Currently, there is no AICPA restriction on the type of media, frequency, size, or artwork that can be used by members in advertising. Any advertisement is permitted that is informative and objective. The only provision is that the members use good taste and that the advertisements are professionally dignified. (Gray. 1989).

The rulings to the advertisement rule state that a CPA may have his/her firm's name printed on publications if the form follows the rules. A firm can also designate itself as "Accredited Personal Financial Specialists" if all the partners have the AICPA designation. (AICPA. 1988).

The rule on commissions states that "members in public practice should not accept payment for referrals of products or services of others and should not pay to obtain a client". An exception to this is when a member pays a client for the purchase of an accounting practice." (AICPA. 1988).

The rulings state that a CPA cannot accept commissions from a referred supplier, but can accept fees from the client for the effort of finding a supplier. Also, a member cannot pay a
management specialist for client referrals. Also, a member cannot refer clients to a business run by the member's spouse.

The final rule discusses the form and name that a CPA firm may take. A CPA firm can only be in the form of a proprietorship, partnership, or professional corporation. This rule also states that the name of the firm cannot be misleading. The name can include past partners, a fictitious name, or indicate specialization as long as the name is not misleading. The firm cannot designate itself as a member of the AICPA unless all the partners are members. (AICPA. 1988).

The rulings state that if the form is that of an association, then the firm cannot indicate that it is a partnership. The term "non-proprietary partner" cannot be used. A violation of this rule occurs when a partnership with a computer corporation provide services only to clients of a CPA.

Now that the Code of Professional Conduct is fully understood, some case studies that raise ethical questions can be applied to the Code and to the decision-making models.
Case Studies

In public practice, most accountants will run into an ethical dilemma involving the rules of confidentiality and independence sometime during their careers. In this section ethical dilemmas are presented that could occur in public practice and that are addressed by the Code of Professional Conduct.

Dilemmas in keeping confidential information confidential arise when the confidentiality rule conflicts with another obligation that the accountant may have. For example, if as a controller, you switched jobs from one competitor to another, and your present employer asks for confidential information about your past employer, you might feel torn between the responsibility of doing your job to the best of your ability and showing loyalty to your present employer and keeping the confidential information about your past employer confidential. Another example of conflicting duties was introduced in a case study by Sellers and Milam. An accountant that was doing a tax return for a client found a large error from a prior year where the accountant was the auditor. The accountant asked the client to correct the information but the client refused. The CPA disregarded the confidentiality issue. He reported the matter to the Treasury Department. The results of a survey from Sellers and Milam indicated that students agreed with the accountant's actions while the AICPA did not. (1981).

Another case study on confidentiality and inside information is presented below. This was taken from Cottell and Perlin's,
Accounting Ethics. A woman was employed by a large regional CPA firm. She had been dating a man who worked as a manager of another CPA firm in the same city. The couple's relationship had become serious, and they had spoken about marriage several times. One night, while they were out, the man told the woman that one of his clients were going to issue a new line of products that would make the price of the client's stock go up. In order to have enough money for the couple to get married, the man had purchased several shares of the stock. When the woman got upset about the man's actions, he said that the "laws are for the big players" in regards to insider trading violations. The questions that a CPA needs to ask his/herself is if the woman has a duty to report her fiance to the authorities or the AICPA? Would she have a duty to report him if he worked for the same firm as she did? If we look at the Code of Professional Conduct, we know that the answer to both of these questions is yes. The real question is, what would you do in light of your own ethics and values as well as the rules of the Code of Professional Conduct. (1990. pp.25-26).

The final case study on confidentiality is presented in Sellers and Milam's, Accounting Student Perceptions of Business and Professional Ethics. In this case, a CPA firm disagreed with a client on the amount of income that the client should present in it's income statement. The report was prepared for a bank that valued the CPA firm's decisions. When the CPA firm refused to change its stance on the issue, the client dismissed the firm and engaged another CPA firm. The bank wanted to know why the former
firm was dismissed. The former auditors were afraid that their firm's reputation would be damaged, so they openly discussed the reasons for their dismissal from the client with the bank. According to the Code, this action by the auditors was in direct violation of the confidentiality rule. (1981. p.40). In this case the CPA's had to balance the need to keep the confidentiality rule with the need to serve the public interest. This case sums up some of the difficult decisions that public accountants may have to make during their careers in regards to confidentiality.

Most public accountants will run into an ethical issue that involves the independence rule sometime during their professional career. In one case study, the management advisory services and audit department of a public accounting firm had an independence problem. When the auditors were auditing a client's financial statements, they found a large unfavorable material quantity variance. The auditors believed that this variance should be placed on the income statement as a non-recurring item. A couple of years before this audit took place, the MAS department of the same accounting firm had overhauled the clients cost accounting system. The new system was directly responsible for the unfavorable balance. When the audit partner talked to the MAS partner about this variance, the MAS partner said that they could not afford to lose the client and that it would be better for the accounting firm if they prorated the variance among the inventory accounts and cost of goods sold so that the variance would wash out of the system. This method of prorating would be correct under
actual cost theory, and the head office believes that the "actual
cost theory has as much, if not more, support than standard cost
as this case we can see why providing management advisory services
and auditing services can become an ethical issue involving
independence. In this case it is difficult for all involved to
maintain their objectivity and integrity. While most independence
issues should be easily resolved, we can see by this case that it
is not always easy to do the right thing.

These cases were intended to show how difficult it can be to
make the right choices. Even when the Code of Professional Conduct
guides us in making the right choice, our own value system can get
in the way of doing what we know is right. For example, in the
case involving insider trading, we all know what the Code of
Professional Conduct has to say and what our own ethic code tells
us to do, yet most of us would have a hard time turning in our
fiancé in order to follow the highest ethics. In all of these
difficult situations, it is best to make a rational choice by
following an ethical decision-making model through from the first
step to the last in order that we might clarify our thinking and
weigh how our responses will affect us, our peers, and the rest of
society, now and in the future.
Case Studies - Not Addressed by the AICPA's Code

The whistle-blowing issue has just recently become part of the mainstream on ethics. The ethical codes seem to give us little guidance on making these kind of decisions. The different codes tell us that as accountants we should not participate in unethical, immoral, or illegal situations, but the codes also have guidelines on keeping the information confidential in these situations. The accountant must not divulge any confidential information gained during the course of their duties unless they receive a subpoena or a summons. For example, the NAA's standards tell the accountant to try and resolve the ethical question internally. If this is impossible because upper management and/or owners are involved in the ethical issue, then the accountant may have no recourse but to resign. If the owners of the corporation you are employed with are cheating the government by falsifying documents in order to gain more money in a governmental contract, the NAA's ethic code tells you not to participate and to keep the information confidential. Your only recourse would be to resign from your position. While whistle-blowing in the business community involves very hard decisions, the whistle blower usually suffers immensely and receives little support from the rest of the community.

"A significant gap that needs attention is lack of a good support sytem. Much lip service is paid to ethical conduct, but we are often; in fact, not supportive and sometimes are down right intolerant of the individual who sticks his or her ethical neck out". (Walters. 1990).

This area needs to be addressed more specifically by the AICPA in the Code of Professional Conduct. "Most people want to do what's
right, but sometimes they're in doubt, or they're afraid of ridicule, censure, or career damage". (Walters. 1990).

A classic example of a CPA who turned whistle-blower was addressed in Newsweek magazine in July, 1989. A CPA had a client that he had worked with for several years. The CPA was simultaneously giving the IRS confidential information on the client while having a working relationship with that client. The client subsequently was heavily fined and faced a jail sentence based on the information that the CPA divulged. The client was suing the CPA for lack of loyalty and for using confidential information. The AICPA agrees with the client based on the confidentiality rule.

How can the concept of mentoring involve ethics? Mentoring is the process of developing a relationship between a senior manager and someone who is at a lower level in the organization. The senior, or mentor, will aid and assist the junior level person in his/her career. Usually these relationships develop out of mutual trust, respect, and friendship. Some public accounting firms have tried to formalize this natural process through formal internal counseling programs. According to Cottell and Perlin, this formal process has been a failure for two reasons. First, neither of the people involved in the relationship proved to each other that they were trustworthy. Secondly, most of the auditors, or counselors work with more than two or three individuals at the same time. These relationships cannot be true mentoring because they did not evolve naturally out of free choice and the emotional components
are left out. (1990). Recently, when a public accounting firm was asked if they had a mentoring program, the manager called them "be my best buddy clubs", and expressed the opinion that he felt they were ineffective because of the same reasons listed above.

How can the mentoring issue be an ethical question? From several viewpoints, mentoring can become a source of ethical conflict. For example, the role of mentoring can raise ethical questions in promotion practices, in race and sex implications, in teaching of vices, and in independence problems. (Cottell and Perlin. 1990). When promoting someone within a firm, managers should be objective and select the best qualified candidate. With mentoring, this is not what always happens. Proteges can become the prime candidates for promotions whether or not they are the best qualified. (Cottell and Perlin. 1990).

The race and sex implications are caused by the fact that most senior management are white and male. Like the rest of society, mentors tend to develop relationships with those who are the most like them. Most people develop relationships with others who have similar cultural, racial, and other backgrounds. In the case of mentoring, mentors are mostly white males and as such, develop relationships primarily with other white males. This could play a role in keeping women and minorities out of top management. Thirdly, the teaching of vices by the mentor to the protege is common. If a true mentoring relationship occurs, the protege will accept the values of the mentor even if they are not necessarily the values of the profession. (Cottell and Perlin. 1990).
Finally, the independence implication arises because a great majority of public accountants "go private" and work as controllers with clients they had served as auditors. When the mentor or protege is the auditor and the other one is the controller of the firm being audited, independence could be impaired because the objectivity of the auditor could easily become impaired. (Cottell and Perlin. 1990).

In conclusion, there are many more ethical dilemmas that one could encounter. There obviously exists a need for the accounting students to know the different ethic codes and have high moral ethics of their own. It is clear that there are many ethical dilemmas that could and will be encountered during a career in accounting. Accountants must be prepared to deal with those dilemmas if they expect to be successful in the business community.
Sources Cited


