Chapter **One**

Ethical Issues in Advanced Accounting

Scope of Chapter

Ethics—right conduct—has been a subject of discussion for centuries. For example:

In *Nicomachean Ethics,* Book II, Aristotle (384–322 BC) wrote:

> [I]t is no easy task to be good. . . . wherefore, goodness is both rare and laudable and noble.

In *Meditations,* Books III and VII, Marcus Aurelius (121–180 AD) declared:

> A man then must stand erect, not kept erect by others. . . . Be thou erect or be made erect.

William Shakespeare (1564–1616) provided the following speeches in two of his plays:

> *Iago.* Good name in man and woman, dear my lord,
> Is the immediate jewel of their souls,
> Who steals my purse steals trash; 'tis something, nothing;
> 'Twas mine, 'tis his, and has been slave to thousands;
> But he that filches from me my good name
> Robs me of that which not enriches him
> And makes me poor indeed.
> (*Othello,* 3.3. 155–160)

> *Mowbray,* The purest treasure mortal times afford
> Is spotless reputation: . . .
> Mine honour is my life; both grow in one;
> Take honour from me, and my life is done. . . .
> (*The Tragedy of King Richard II,* 1.1. 177–183)

Recent highly publicized accounting scandals have made it clear that ethical conduct of accountants has not met the standards inherent in the foregoing quotations. In the article "Scandal Scorecard," *The Wall Street Journal* described 12 egregious accounting frauds involving publicly owned business enterprises; many of the frauds involved the chief financial officer, controller, chief accounting officer, and other accountants of the enterprises.[1] One outcome of those and other scandals was the enactment of the federal Sarbanes-Oxley Act of 2002 (SOX), which authorized the establishment of a Public Company Accounting Oversight Board to regulate the conduct of accountants both in public practice and in publicly owned business enterprises.

The vocabulary of accounting now includes the following terms:

Cute accounting to describe stretching the ***form*** of accounting standards to the limit, regardless of the ***substance*** of the underlying business transactions or events

Cooking the books to indicate fraudulent financial reporting

[1] "Scandal Scorecard," *The Wall Street Journal,* October 3, 2003, p. B1.

Many topics of advanced accounting have been the subject of both cute accounting and cooking the books by accounting executives of business enterprises. Because the chief financial officer, the controller, the chief accounting officer, and the accounting staffs of business enterprises have the primary responsibility for preparing financial statements and financial reports and disseminating them to users, this chapter deals with the ethical standards appropriate for those preparers. In this and subsequent chapters, Securities and Exchange Commission (SEC) enforcement actions dealing with fraudulent financial reporting are described for the topics covered in those chapters.

WHAT IS FRAUDULENT FINANCIAL REPORTING?

The following covers misstatements in financial statements that are caused by fraudulent financial reporting, and the reasons for and methods of committing fraud:

> *Misstatements arising from fraudulent financial reporting* are intentional misstatements or omissions of amounts or disclosures in financial statements to deceive financial statement users. Fraudulent financial reporting may involve acts such as the following:
>
> - Manipulation, falsification, or alteration of accounting records or supporting documents from which financial statements are prepared
> - Misrepresentation in, or intentional omission from, the financial statements of events, transactions, or other significant information
> - Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure
>
> Fraud frequently involves the following: (*a*) a pressure or an incentive to commit fraud and (*b*) a perceived opportunity to do so. . . . For example, fraudulent financial reporting may be committed because management is under pressure to achieve an unrealistic earnings target.
>
> Fraud may be concealed through falsified documentation, including forgery. For example, management that engages in fraudulent financial reporting might attempt to conceal misstatements by creating fictitious invoices.
>
> Fraud also may be concealed through collusion among management, employees, or third parties. For example, through collusion, false evidence that control activities have been performed effectively may be presented.[2]

AN EXAMPLE OF FRAUDULENT FINANCIAL REPORTING

The SEC's ***Accounting and Auditing Enforcement Release No. 923,*** "Securities and Exchange Commission v. Joseph C. Allegra, David Hersh, J. Ledd Ledbetter and H. Flynn Clyburn . . ." (AAER 923), issued June 11, 1997, provides an example of fraudulent financial reporting carried out by the president and chief executive officer; the chief financial officer, treasurer, and secretary; the chief operating officer and senior executive vice president; and another executive vice president of a national provider of alternate site health care services. According to the SEC, the four officers overstated the company's net income for the quarters ended December 31, 1992, and March 31, 1993, by taking the following "cooking the books" actions:

1. Recognizing January 1993 revenues in December 1992 and April 1993 revenues in March 1993, and artificially accelerating product delivery schedules at the end of both quarters, an artifice termed ***channel stuffing.***
2. Deferring writeoffs of uncollectible accounts past the end of the appropriate quarter.

[2] *AICPA Professional Standards,* vol. 1, "U.S. Auditing Standards," sec. 316.

Also, according to the SEC, the chief financial officer (a CPA) overstated quarterly income by:

1. Recognizing in the quarter ended March 31, 1993, a gain from the sale of an asset during the quarter ended June 30, 1993.
2. Recognizing as assets certain expenses incurred during the quarters ended December 31, 1992, and March 31, 1993.
3. Making fictitious journal entries in connection with business combinations accomplished in March 1993, the effect of which was to understate doubtful accounts expense.

In a "consent decree" in which the four officers neither admitted nor denied the SEC's allegations, they agreed to numerous monetary and other penalties.

ETHICAL STANDARDS FOR PREPARERS OF FINANCIAL STATEMENTS AND FINANCIAL REPORTS

Many past efforts to develop ethical standards for accountants focused on CPAs in the practice of public accounting—primarily auditing. For example, although the first code of ethics of the American Institute of Certified Public Accountants (AICPA) was adopted in 1917, prior to 1988 few of its provisions applied to AICPA members in industry. The Institute of Management Accountants (IMA), an organization devoted primarily to the interest of accountants in industry, first issued its ***Standards of Ethical Conduct for Members*** in 1983. The Financial Executives International (FEI), an organization of financial vice presidents, controllers, and treasurers of business enterprises, first issued its ***Code of Ethics*** in 1985.

Presumably, the lack of formal ethical standards for management accountants and financial executives prior to 1983 stemmed from the view that the first line of defense against improper financial reporting was provided by independent CPAs, subject to ethics codes of their states of licensure, who audited financial statements of business enterprises, and that preparers of those statements had only a secondary role in assuring quality financial reporting. This view was prevalent even though the AICPA had long included statements such as the following in its pronouncements on auditing:

> The financial statements are management's responsibility. The auditor's responsibility is to express an opinion on the financial statements. Management is responsible for adopting sound accounting policies and for establishing and maintaining an internal control structure that will, among other things, record, process, summarize, and report financial data that is consistent with management's assertions embodied in the financial statements. The internal control structure should include an accounting system to identify, assemble, analyze, classify, record, and report an entity's transactions and to maintain accountability for the related assets and liabilities. The entity's transactions and the related assets and liabilities are within the direct knowledge and control of management. The auditor's knowledge of these matters is limited to that acquired through the audit. Thus, the fair presentation of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles is an implicit and integral part of management's responsibility. The independent auditor may make suggestions about the form or content of the financial statements or draft them, in whole or in part, based on information from management's accounting system. However, the auditor's responsibility for the financial statements he has audited is confined to the expression of his opinion on them.[3]

[3] *AICPA Professional Standards,* vol. 1, "U.S. Auditing Standards," sec. 110.02 (prior to amendment).

Significant Events in the Establishment of Ethical Standards for Management Accountants and Financial Executives

The Seaview Symposium of 1970

An early effort to establish ethical standards for preparers of financial statements occurred at a 1970 symposium of members of the AICPA, the FEI, the Financial Analysts Federation, and the Robert Morris Associates (an organization of credit grantors), which took place at Seaview Country Club, Absecon, New Jersey. Papers and discussions at this symposium criticized the lack of a code of ethics for members of the FEI, given that the other three participating organizations had such codes.[4]

The Equity Funding Fraud of 1973

In 1973, a major fraud, of about nine years' duration, was discovered at Equity Funding Corporation of America (Equity), a seller of mutual fund shares that were pledged by the investors to secure loans to finance life insurance premiums. During the nine-year period, at least $143 million of fictitious pretax income was generated—a period in which Equity reported a total net income of $76 million, instead of the real pretax losses totaling more than $67 million.[5] The fraud was carried out by at least 10 executives of Equity, including the chief executive officer (CEO), chief financial officer (CFO), controller, and treasurer; several of the executives were CPAs with public accounting experience. The fraudulent conduct of these CPAs, all of whom presumably had at one time been subject to the AICPA's ***Code of Professional Ethics*** during their public accounting careers, furnished clear evidence of the need for ethics codes for management accountants and other financial executives.

Action by the IMA

In 1983, the IMA issued ***Standards of Ethical Conduct for Practitioners of Management Accounting and Financial Management,*** the third in a series of ***Statements on Management Accounting.*** The current IMA standards, which are presented in Appendix 1 at the end of this chapter (pages 8 through 10), cover the management accountant's obligations as to competence, confidentiality, integrity, and objectivity, and they provide guidance for resolutions of ethical conflict. Noteworthy in the preamble to the standards (pages 8–9) is the management accountant's obligation not to condone violations of the standards by others in the organization.

Action by the FEI

The ***Code of Ethics*** first promulgated by the FEI in 1985 and as subsequently amended is in Appendix 2 (pages 10–11). Although briefer than the IMA standards, the FEI's code covers essentially the same areas of professional conduct as do the IMA standards.

Treadway Commission Recommendations

The National Commission on Fraudulent Financial Reporting (Treadway Commission), which had been sponsored by the AICPA, the IMA, the FEI, the American Accounting Association (composed primarily of accounting educators), and the Institute of Internal Auditors, issued its report in 1987. Defining ***fraudulent financial reporting*** as "intentional or reckless conduct, whether act or omission, that results in materially misleading financial

[4] John C. Burton, ed., *Corporate Financial Reporting: Ethical and Other Problems* (New York: AICPA, 1972), pp. 7, 51–52, 109, 420–421.

[5] *Report of the Trustee of Equity Funding Corporation of America,* October 31, 1974, p. 12.

statements,"[6] the Treadway Commission made 49 recommendations for curbing such reporting. The recommendations dealt with the public company; the independent public accountant; the SEC, financial institution regulators, and state boards of accountancy; and education. Stating that "the responsibility for reliable financial reporting resides first and foremost at the corporate level,"[7] the Treadway Commission included the following among its recommendations for the public company:

> ***Recommendations:* Public companies should maintain accounting functions that are designed to meet their financial reporting obligations.**
>
> A public company's accounting function is an important control in preventing and detecting fraudulent financing reporting. The accounting function must be designed to allow the company and its officers to fulfill their statutory financial disclosure obligations.
>
> As a member of top management, the chief accounting officer helps set the tone of the organization's ethical conduct and thus is part of the control environment. Moreover, the chief accounting officer is directly responsible for the financial statements, and can and should take authoritative action to correct them if necessary. He generally has the primary responsibility for designing, implementing, and monitoring the company's financial reporting system and internal accounting controls. The controller may serve as the chief accounting officer, or the chief financial officer also may perform the functions of a chief accounting officer.
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> The chief accounting officer's actions especially influence employees who perform the accounting function. By establishing high standards for the company's financial disclosures, the chief accounting officer guides others in the company toward legitimate financial reporting.
>
> Moreover, the chief accounting officer is in a unique position. In numerous cases, other members of top management, such as the chief executive officer, pressure the chief accounting officer into fraudulently manipulating the financial statements. An effective chief accounting officer is familiar with the company's financial position and operations and thus frequently is able to identify unusual situations caused by fraudulent financial reporting perpetrated at the divisional level.
>
> The chief accounting officer has an obligation to the organization he serves, to the public, and to himself to maintain the highest standards of ethical conduct. He therefore must be prepared to take action necessary to prevent fraudulent financial reporting. His efforts may entail bringing matters to the attention of the CEO, the CFO, the chief internal auditor, the audit committee, or the entire board of directors.
>
> The Financial Executives [International] (FEI) and the [Institute of Management Accountants (IMA)] play active roles in enhancing the financial reporting process by sponsoring research, technical professional guidance, and continuing professional education and by participating in the shaping of standards. Both organizations also have promulgated codes of conduct that strongly encourage reliable financial reporting. Public companies should encourage their accounting employees to support these organizations and adhere to their codes of conduct.[8]

Revision of AICPA Ethics Rules

In 1988, the members of the AICPA approved a revised ***Code of Professional Conduct*** to replace the ***Code of Professional Ethics*** that previously had been in effect. This action was triggered by the 1986 ***Report of the Special Committee on Standards of Professional Conduct for Certified Public Accountants*** (Anderson Committee), which recommended restructuring the AICPA's ethics code to improve its relevance and effectiveness.[9] A key element of the Anderson Committee recommendations was extension of applicability of the Rules of Professional Conduct of the revised ***Code of Professional Conduct*** to AICPA

[6] *Report of the National Commission on Fraudulent Financial Reporting* (New York: 1987), p. 2.

[7] Ibid., p. 6.

[8] Ibid., pp. 36–37.

[9] *Report of the Special Committee on Standards of Professional Conduct for Certified Public Accountants* (New York: AICPA, 1986), p. 1.

members who are not practicing in a CPA firm.[10] Thus, Rules 102, 201, 202, 203, 302, and 501 of the ***Code of Professional Conduct*** in Appendix 3 (pages 11 through 20) apply to ***all*** AICPA members, including those in private industry, governmental entities, nonprofit organizations, and academia.

Authority of the Public Company Accounting Oversight Board

Title I of the Sarbanes-Oxley Act of 2002 authorized the Public Company Accounting Oversight Board to establish ethical standards for audits of publicly owned companies. As of the date of this writing, no such standards had been issued.

Analysis of Ethical Standards for Management Accountants and Financial Executives

A review of the contents of the IMA, FEI, and AICPA ethics pronouncements in Appendixes 1, 2, and 3 reveals several similarities. All three require members of the respective organizations to be competent, act with integrity and objectivity, maintain confidentiality of sensitive information, avoid discreditable acts, and avoid conflicts of interest. Only the IMA and FEI codes specifically require communication of complete information to users of their members' reports; AICPA members indirectly are comparably obligated by Rule 202.

Rule 203 of the AICPA code requires compliance with generally accepted accounting principles. One might prefer that both the IMA and the FEI codes had comparable explicit provisions, given management accountants' and financial executives' primary responsibility for financial statements and financial reports.

Another difference among the three ethics codes is that the IMA and FEI standards in essence require members to *report* violations of the standards by members of their organizations to responsible officials of the organizations. The AICPA code has no such requirement.

The issues of ***conflicts of interest*** and ***discreditable acts*** are discussed further in the following sections.

Conflicts of Interest

Conflicts of interest result when individuals reap inappropriate *personal* benefits from their acts in an *official* capacity. For example, a chief accounting officer might cook the books to overstate pretax income of the employer corporation in order to obtain a larger performance bonus. Alternatively, the controller of a publicly owned corporation might engage in ***insider trading***[11] to maximize gains or minimize losses on purchases or sales of the employer corporation securities. For example, in ***Accounting and Auditing Enforcement Release (AAER) 344*** (December 10, 1991), the SEC reported the permanent disbarment from practice of the controller, a CPA, of a publicly owned company, who had allegedly engaged in insider trading and thus avoided losses of more than $73,000 on sales of the employer company's common stock. According to the SEC, the controller had acted with senior management of the company to overstate the company's earnings by more than $38,000,000 over a two-and-one-half-year period. The controller was ordered to disgorge the $73,000 and pay a penalty of the same amount.

Discreditable Acts

None of the three ethics codes presented in appendixes to this chapter defines ***discreditable acts.*** Probably the term cannot be adequately defined or circumscribed; what is a discreditable

[10] Ibid., p. 23.

[11] Section 21A of the Securities Exchange Act of 1934 defines *insider trading* as "purchasing or selling a security while in possession of material, nonpublic information . . . or . . . communicating such information in connection with a securities transaction."

act to one observer might not be so construed by another. For example, might a member of the IMA, FEI, or AICPA observing another member's substance abuse construe the act as discreditable to the abusive member, the member's employer, the organization, or other entities? Such questions are difficult to answer in a society in which some condone personal actions that are condemned by others.

Concluding Observations

In considering episodes of cooking the books, described in subsequent chapters, the reader should keep in mind that, although the Treadway Commission stated, "The incidence of fraudulent financial reporting cannot be quantified with any degree of precision,"[12] it also gave the following data:

1. The number of SEC proceedings against reporting companies from 1981 to 1986 was less than 1% of the number of financial reports filed with the SEC during that period.
2. The chairman of the Federal Deposit Insurance Corporation contended that management fraud (presumably including cooking the books) contributed to one-third of bank failures.
3. Ten percent of total bankruptcies in a study authorized by the Treadway Commission involved fraudulent financial reporting.
4. Former SEC chairman John Shad estimated that all fraudulent securities activities amount to a fraction of 1% of the $50 billion of corporate and government securities traded daily.[13]

Thus, cooking the books episodes, though serious and despicable, apparently do not indicate a wholesale breakdown of ethical conduct by management accountants and financial executives of business enterprises.

An important question to consider is: Can the codes of conduct for management accountants and financial executives established by the IMA, the FEI, and AICPA help those key players in corporate financial reporting to resist pressures, often from top management but sometimes from within themselves, to falsify financial statements and financial reports? Or is it too much to expect such individuals, whose livelihoods and careers depend a great deal on what is in those statements and reports, to be completely impartial in their preparation? Ralph E. Walters, CPA, former director of Professional Conduct for The California Society of Certified Public Accountants, has considered this thorny question:

> An obligation to be *impartial* seems to me to place a new and possibly unrealistic burden on the management accountant. Traditionally, most employees have felt an obligation, within the bounds of honesty and integrity, to put the best face upon their employer's affairs. For example, there is still some latitude in selection and judgment in the application of GAAP [generally accepted accounting principles]. Some managers consistently opt for the most aggressive principle or application. The aggregate effect is to bias the financial statements. They may be in accordance with GAAP, but the quality of earnings is suspect. They are not impartial. This condition is not uncommon in practice (it is a principal reason we need independent auditors). An accountant associated with this condition is literally violating the AICPA Code. The [IMA] Code is less clear.
>
> Is this interpretation realistic? Do management accountants generally understand this? I doubt it. In fairness to their members and to the public, the AICPA and the [IMA] need to put their heads together and agree how much objectivity management accountants can be expected to live with, including some examples in real-life situations. The positions should be consistent and must be made clear to all management accountants.[14]

[12] *Report of the National Committee on Fraudulent Financial Reporting,* p. 25.

[13] Ibid., pp. 25–26.

[14] Ralph E. Walters, "Ethics and Excellence," *Management Accounting,* January 1990, p. 12.

The questions raised in the foregoing paragraph are difficult to answer. However, the SEC has emphasized the importance of objectivity as follows, in rejecting the "good soldier" rationalization of unethical conduct by a corporate controller (a CPA):

> The Commission cannot condone [the controller's] conduct. [The controller] has or had available to him more than sufficient information to be aware that the financial statements he prepared and the periodic reports he signed were materially inaccurate. Under the circumstances, and as a senior level financial officer and the highest level CPA within [the corporation] involved in the financial reporting process, [the controller] owed a duty to [the corporation] and its shareholders not to assist in, or even acquiesce in, [the corporation's] issuance of such financial statements. Although [the controller] may have made the appropriate recommendations to his corporate supervisors, when those recommendations were rejected, [the controller] acted as the "good soldier," implementing their directions which he knew or should have known were improper.[15]

In like vein, the SEC commented as follows on the behavior of a corporate controller who, despite his knowledge of cooking the books activities directed by the company's former CEO and former CFO, took no remedial actions:

> As controller, [the CPA] had a duty to satisfy himself that [the company's] financial statements were properly stated under GAAP. [The controller] knew or recklessly disregarded facts indicating that, as a result of the fraudulent entries, [the company's] reported financial statements during fiscal year 1990 . . . were materially false and misleading. Although [the company's] former CEO and CFO devised and directed the improper practices resulting in [the company's] false recording and reporting, in the Commission's view, this does not justify [the controller's] failure to take sufficient steps to satisfy himself that the transactions were properly recorded . . . This failure was inconsistent with his duties as . . . controller.[16]

At the beginning of their professional careers, students of advanced accounting might well reflect on their sense of ethical values and decide on a course of action if they find themselves in a position such as the foregoing ones.

Appendix 1

IMA Standards of Ethical Conduct for Members*

In today's modern world of business, individuals in management accounting and financial management constantly face ethical dilemmas. For example, if the accountant's immediate superior instructs the accountant to record the physical inventory at its original costs when it is obvious that the inventory has a reduced value due to obsolescence, what should the accountant do? To help make such a decision, here is a brief general discussion of ethics and the "Standards of Ethical Conduct for Members." Ethics, in its broader sense, deals with human conduct in relation to what is morally good and bad, right and wrong. To determine whether a decision is good or bad, the decision-maker must compare his/her options with some standard of perfection. This standard of perfection is not a statement of static position but requires the decision-maker to assess the situation and the values of the parties affected by the decision. The decision-maker must then estimate the outcome of the decision and be responsible for its results. Two good questions to ask when faced with an ethical dilemma

[15] *AAER 93,* " . . . In the Matter of Michael R. Maury," March 26, 1986.

[16] *AAER 538,* " . . . In the Matter of Michael V. Barnes," March 11, 1994.

* **Source:** Ethics Hotline (for members only) © 2000, Institute of Management Accountants, Inc.

are, "Will my actions be fair and just to all parties affected?" and "Would I be pleased to have my closest friends learn of my actions?"

Individuals in management accounting and financial management have a unique set of circumstances relating to their employment. To help them assess their situation, the Institute of Management Accountants (IMA) has developed the following "Standards of Ethical Conduct for Members."

STANDARDS OF ETHICAL CONDUCT FOR MEMBERS

Members of IMA have an obligation to the public, their profession, the organizations they serve, and themselves to maintain the highest standards of ethical conduct. In recognition of this obligation, the IMA has promulgated the following standards of ethical conduct for its members. Members shall not commit acts contrary to these standards nor shall they condone the commission of such acts by others within their organizations.

Members shall abide by the more stringent code of ethical conduct, whether that is the standards widely practiced in their country or IMA's Standards of Ethical Conduct. In no case will a member conduct herself or himself by any standard that is not at least equivalent to the standards identified for members in IMA's Standards of Ethical Conduct.

The standards of ethical conduct for IMA members are published in SMA (Statement on Management Accounting) 1C.

Competence

Members have a responsibility to:

- Maintain an appropriate level of professional competence by ongoing development of their knowledge and skills.
- Perform their professional duties in accordance with relevant laws, regulations, and technical standards.
- Prepare complete and clear reports and recommendations after appropriate analyses of relevant and reliable information.

Confidentiality

Members have a responsibility to:

- Refrain from disclosing confidential information acquired in the course of their work except when authorized, unless legally obligated to do so.
- Inform subordinates as appropriate regarding the confidentiality of information acquired in the course of their work and monitor their activities to assure the maintenance of that confidentiality.
- Refrain from using or appearing to use confidential information acquired in the course of their work for unethical or illegal advantage either personally or through third parties.

Integrity

Members have a responsibility to:

- Avoid actual or apparent conflicts of interest and advise all appropriate parties of any potential conflict.
- Refrain from engaging in any activity that would prejudice their ability to carry out their duties ethically.
- Refuse any gift, favor, or hospitality that would influence or would appear to influence their actions.
- Refrain from either actively or passively subverting the attainment of the organization's legitimate and ethical objectives.

- Recognize and communicate professional limitations or other constraints that would preclude responsible judgment or successful performance of an activity.
- Communicate unfavorable as well as favorable information and professional judgments or opinions.
- Refrain from engaging in or supporting any activity that would discredit the profession.

Objectivity

Members have a responsibility to:

- Communicate information fairly and objectively.
- Disclose fully all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, comments, and recommendations presented.

RESOLUTION OF ETHICAL CONFLICT

In applying the standards of ethical conduct, members may encounter problems in identifying unethical behavior or in resolving an ethical conflict. When faced with significant ethical issues, members should follow the established policies of the organization bearing on the resolution of such conflict. If these policies do not resolve the ethical conflict, such members should consider the following courses of action.

- Discuss such problems with the immediate superior except when it appears that the superior is involved, in which case the problem should be presented initially to the next higher managerial level. If a satisfactory resolution cannot be achieved when the problem is initially presented, submit the issues to the next higher managerial level. If the immediate superior is the chief executive officer, or equivalent, the acceptable reviewing authority may be a group such as the audit committee, executive committee, board of directors, board of trustees, or owners. Contact with levels above the immediate superior should be initiated only with the superior's knowledge, assuming the superior is not involved. Except where legally prescribed, communication of such problems to authorities or individuals not employed or engaged by the organization is not considered appropriate.
- Clarify relevant ethical issues by confidential discussion with an objective advisor (e.g., IMA Ethics Counseling Service) to obtain a better understanding of possible courses of action. Consult your own attorney as to legal obligations and rights concerning the ethical conflict.
- If the ethical conflict still exists after exhausting all levels of internal review, there may be no other recourse on significant matters than to resign from the organization and to submit an informative memorandum to an appropriate representative of the organization. After resignation, depending on the nature of the ethical conflict, it may also be appropriate to notify other parties.

Appendix 2

FEI Code of Ethics

FEI's mission includes significant efforts to promote ethical conduct in the practice of financial management throughout the world. Senior financial officers hold an important and elevated role in corporate governance. While members of the management team, they are

uniquely capable and empowered to ensure that all stakeholders' interests are appropriately balanced, protected and preserved. This Code provides principles to which members are expected to adhere and advocate. They embody rules regarding individual and peer responsibilities, as well as responsibilities to employers, the public, and other stakeholders. Violations of FEI's Code of Ethics may subject the member to censure, suspension or expulsion under procedural rules adopted by FEI's Board of Directors.

All members of FEI will:

1. Act with honesty and integrity, avoiding actual or apparent conflicts of interest in personal and professional relationships.
2. Provide constituents with information that is accurate, complete, objective, relevant, timely and understandable.
3. Comply with applicable rules and regulations of federal, state, provincial, and local governments, and other appropriate private and public regulatory agencies.
4. Act in good faith, responsibly, with due care, competence and diligence, without misrepresenting material facts or allowing one's independent judgment to be subordinated.
5. Respect the confidentiality of information acquired in the course of one's work except when authorized or otherwise legally obligated to disclose. Confidential information acquired in the course of one's work will not be used for personal advantage.
6. Share knowledge and maintain skills important and relevant to constituents' needs.
7. Proactively promote ethical behavior as a responsible partner among peers, in the work environment and the community.
8. Achieve responsible use of and control over all assets and resources employed or entrusted.
9. Report known or suspected violations of this Code in accordance with the FEI Rules of Procedure.
10. Be accountable for adhering to this Code.

Source: Financial Executives International Code of Ethics

Appendix 3

AICPA Code of Professional Conduct*

COMPOSITION, APPLICABILITY, AND COMPLIANCE

The Code of Professional Conduct of the American Institute of Certified Public Accountants consists of two sections—(1) the Principles and (2) the Rules. The Principles provide the framework for the Rules, which govern the performance of professional services by members. The Council of the American Institute of Certified Public Accountants is authorized to designate bodies to promulgate technical standards under the Rules, and the bylaws require adherence to those Rules and standards.

The Code of Professional Conduct was adopted by membership to provide guidance and rules to all members—those in public practice, in industry, in government, and in education—in the performance of their professional responsibilities.

Compliance with the Code of Professional Conduct, as with all standards in an open society, depends primarily on members' understanding and voluntary actions, secondarily on reinforcement by peers and public opinion, and ultimately on disciplinary proceedings, when necessary, against members who fail to comply with the Rules.

OTHER GUIDANCE

Interpretations of Rules of Conduct consist of interpretations which have been adopted, after exposure to state societies, state boards, practice units and other interested parties, by the professional ethics division's executive committee to provide guidelines as to the scope and application of the Rules but are not intended to limit such scope or application. A member who departs from such guidelines shall have the burden of justifying such departure in any disciplinary hearing. *Interpretations* which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

Ethics Rulings consist of formal rulings made by the professional ethics division's executive committee after exposure to state societies, state boards, practice units and other interested parties. These rulings summarize the application of Rules of Conduct and Interpretations to a particular set of factual circumstances. Members who depart from such rulings in similar circumstances will be requested to justify such departures. *Ethics Rulings* which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

Publication of an Interpretation or Ethics ruling in *The Journal of Accountancy* constitutes notice to members. Hence, the effective date of the pronouncement is the last day of the month in which the pronouncement is published in *The Journal of Accountancy.* The professional ethics division will take into consideration the time that would have been reasonable for the member to comply with the pronouncement.

A member should also consult, if applicable, the ethical standards of his state CPA society, state board of accountancy, the Securities and Exchange Commission, and any other governmental agency which may regulate his client's business or use his report to evaluate the client's compliance with applicable laws and related regulations.

SECTION I: PRINCIPLES

Preamble

Membership in the American Institute of Certified Public Accountants is voluntary. By accepting membership, a certified public accountant assumes an obligation of self-discipline above and beyond the requirements of laws and regulations.

These Principles of the Code of Professional Conduct of the American Institute of Certified Public Accountants express the profession's recognition of its responsibilities to the public, to clients, and to colleagues. They guide members in the performance of their professional responsibilities and express the basic tenets of ethical and professional conduct. The Principles call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage.

Article I: Responsibilities

In carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgments in all their activities.

As professionals, certified public accountants perform an essential role in society. Consistent with that role, members of the American Institute of Certified Public Accountants have responsibilities to all those who use their professional services. Members also have a

continuing responsibility to cooperate with each other to improve the art of accounting, maintain the public's confidence, and carry out the profession's special responsibilities for self-governance. The collective efforts of all members are required to maintain and enhance the traditions of the profession.

Article II: The Public Interest

Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism.

A distinguishing mark of a profession is acceptance of its responsibility to the public. The accounting profession's public consists of clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of certified public accountants to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on certified public accountants. The public interest is defined as the collective well-being of the community of people and institutions the profession serves.

In discharging their professional responsibilities, members may encounter conflicting pressures from among each of those groups. In resolving those conflicts, members should act with integrity, guided by the precept that when members fulfill their responsibility to the public, clients' and employers' interests are best served.

Those who rely on certified public accountants expect them to discharge their responsibilities with integrity, objectivity, due professional care, and a genuine interest in serving the public. They are expected to provide quality services, enter into fee arrangements, and offer a range of services—all in a manner that demonstrates a level of professionalism consistent with these Principles of the Code of Professional Conduct.

All who accept membership in the American Institute of Certified Public Accountants commit themselves to honor the public trust. In return for the faith that the public reposes in them, members should seek continually to demonstrate their dedication to professional excellence.

Article III: Integrity

To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.

Integrity is an element of character fundamental to professional recognition. It is the quality from which the public trust derives and the benchmark against which a member must ultimately test all decisions.

Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle.

Integrity is measured in terms of what is right and just. In the absence of specific rules, standards, or guidance, or in the face of conflicting opinions, a member should test decisions and deeds by asking: "Am I doing what a person of integrity would do? Have I retained my integrity?" Integrity requires a member to observe both the form and the spirit of technical and ethical standards; circumvention of those standards constitutes subordination of judgment.

Integrity also requires a member to observe the principles of objectivity and independence and of due care.

Article IV: Objectivity and Independence

A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.

Objectivity is a state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Independence precludes relationships that may appear to impair a member's objectivity in rendering attestation services.

Members often serve multiple interests in many different capacities and must demonstrate their objectivity in varying circumstances. Members in public practice render attest, tax, and management advisory services. Other members prepare financial statements in the employment of others, perform internal auditing services, and serve in financial and management capacities in industry, education, and government. They also educate and train those who aspire to admission into the profession. Regardless of service or capacity, members should protect the integrity of their work, maintain objectivity, and avoid any subordination of their judgment.

For a member in public practice, the maintenance of objectivity and independence requires a continuing assessment of client relationships and public responsibility. Such a member who provides auditing and other attestation services should be independent in fact and appearance. In providing all other services, a member should maintain objectivity and avoid conflicts of interest.

Although members not in public practice cannot maintain the appearance of independence, they nevertheless have the responsibility to maintain objectivity in rendering professional services. Members employed by others to prepare financial statements or to perform auditing, tax, or consulting services are charged with the same responsibility for objectivity as members in public practice and must be scrupulous in their application of generally accepted accounting principles and candid in all their dealings with members in public practice.

Article V: Due Care

A member should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member's ability.

The quest for excellence is the essence of due care. Due care requires a member to discharge professional responsibilities with competence and diligence. It imposes the obligation to perform professional services to the best of a member's ability with concern for the best interest of those for whom the services are performed and consistent with the profession's responsibility to the public.

Competence is derived from a synthesis of education and experience. It begins with a mastery of the common body of knowledge required for designation as a certified public accountant. The maintenance of competence requires a commitment to learning and professional improvement that must continue throughout a member's professional life. It is a member's individual responsibility. In all engagements and in all responsibilities, each member should undertake to achieve a level of competence that will assure that the quality of the member's services meets the high level of professionalism required by these Principles.

Competence represents the attainment and maintenance of a level of understanding and knowledge that enables a member to render services with facility and acumen. It also establishes the limitations of a member's capabilities by dictating that consultation or referral may be required when a professional engagement exceeds the personal competence of a member or a member's firm. Each member is responsible for assessing his or her own competence—of evaluating whether education, experience, and judgment are adequate for the responsibility to be assumed.

Members should be diligent in discharging responsibilities to clients, employers, and the public. Diligence imposes the responsibility to render services promptly and carefully, to be thorough, and to observe applicable technical and ethical standards.

Due care requires a member to plan and supervise adequately any professional activity for which he or she is responsible.

Article VI: Scope and Nature of Services

A member in public practice should observe the Principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.

The public interest aspect of certified public accountants' services requires that such services be consistent with acceptable professional behavior for certified public accountants. Integrity requires that service and the public trust not be subordinated to personal gain and advantage. Objectivity and independence requires that members be free from conflicts of interest in discharging professional responsibilities. Due care requires that services be provided with competence and diligence.

Each of these Principles should be considered by members in determining whether or not to provide specific services in individual circumstances. In some instances, they may represent an overall constraint on the nonaudit services that might be offered to a specific client. No hard-and-fast rules can be developed to help members reach these judgments, but they must be satisfied that they are meeting the spirit of the Principles in this regard.

In order to accomplish this, members should

- Practice in firms that have in place internal quality-control procedures to ensure that services are competently delivered and adequately supervised.
- Determine, in their individual judgments, whether the scope and nature of other services provided to an audit client would create a conflict of interest in the performance of the audit function for that client.
- Assess, in their individual judgments, whether an activity is consistent with their role as professionals.

SECTION II: RULES

Applicability

The bylaws of the American Institute of Certified Public Accountants require that members adhere to the Rules of the Code of Professional Conduct. Members must be prepared to justify departures from these Rules.

Definitions[17]

[Pursuant to its authority under the bylaws (BL § 3.6.2.2) to interpret the Code of Professional Conduct, the Professional Ethics Executive Committee has issued the following definitions of terms appearing in the code effective November 30, 1989.]

Attest engagement. An attest engagement is an engagement that requires independence as defined in AICPA Professional Standards.

Attest engagement team. The attest engagement team consists of individuals participating in the attest engagement, including those who perform concurring and second partner reviews. The attest engagement team includes all employees and contractors retained by the firm who participate in the attest engagement, irrespective of their functional classification (for example, audit, tax, or management consulting services). The attest engagement team excludes specialists as discussed in SAS No. 73, *Using the Work of a Specialist* [AU section 336], and individuals who perform only routine clerical functions, such as word processing and photocopying.

Client. A client is any person or entity, other than the member's employer, that engages a member or a member's firm to perform professional services or a person or entity

[17] As adopted, January 12, 1988, unless otherwise indicated

with respect to which professional services are performed. For purposes of this paragraph, the term "employer" does not include—

a. Entities engaged in the practice of public accounting; or
b. Federal, state, and local governments or component units thereof provided the member performing professional services with respect to those entities—
  i. Is directly elected by voters of the government or component unit thereof with respect to which professional services are performed; or
  ii. Is an individual who is (1) appointed by a legislative body and (2) subject to removal by a legislative body; or
  iii. Is appointed by someone other than the legislative body, so long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body.

Close relative. A close relative is a parent, sibling, or nondependent child.

Council. The Council of the American Institute of Certified Public Accountants.

Covered member. A covered member is—

a. An individual on the attest engagement team;
b. An individual in a position to influence the attest engagement;
c. A partner or manager who provides nonattest services to the attest client beginning once he or she provides ten hours of nonattest services to the client within any fiscal year and ending on the later of the date (i) the firm signs the report on the financial statements for the fiscal year during which those services were provided or (ii) he or she no longer expects to provide ten or more hours of nonattest services to the attest client on a recurring basis;
d. A partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement;
e. The firm, including the firm's employee benefit plans; or
f. An entity whose operating, financial, or accounting policies can be controlled (as defined by generally accepted accounting principles [GAAP] for consolidation purposes) by any of the individuals or entities described in (*a*) through (*e*) or by two or more such individuals or entities if they act together.

Financial institution. A financial institution is considered to be an entity that, as part of its normal business operations, makes loans or extends credit to the general public. In addition, for automobile leases addressed under interpretation 101-5, *Loans From Financial Institution Clients,* an entity would be considered a financial institution if it leases automobiles to the general public.

Financial statements. A presentation of financial data, including accompanying notes, if any, intended to communicate an entity's economic resources and/or obligations at a point in time or the changes therein for a period of time, in accordance with generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles.

Incidental financial data to support recommendations to a client or in documents for which the reporting is governed by Statements on Standards for Attestation Engagements and tax returns and supporting schedules do not, for this purpose, constitute financial statements. The statement, affidavit, or signature of preparers required on tax returns neither constitutes an opinion on financial statements nor requires a disclaimer of such opinion.

Firm. A firm is a form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the American Institute of Certified Public Accountants that is engaged in the practice of public accounting. Except for purposes

of applying Rule 101: *Independence,* the firm includes the individual partners thereof. [Revised November, 2001.]

Institute. The American Institute of Certified Public Accountants.

Interpretations of rules of conduct. Pronouncements issued by the division of professional ethics to provide guidelines concerning the scope and application of the rules of conduct.

Member. A member, associate member, or international associate of the American Institute of Certified Public Accountants.

Practice of public accounting. The practice of public accounting consists of the performance for a client, by a member or a member's firm, while holding out as CPA(s), of the professional services of accounting, tax, personal financial planning, litigation support services, and those professional services for which standards are promulgated by bodies designated by Council, such as Statements of Financial Accounting Standards, Statements on Auditing Standards, Statements on Standards for Accounting and Review Services, Statements on Standards for Consulting Services, Statements of Governmental Accounting Standards, and Statements on Standards for Attestation Engagements.

However, a member or a member's firm, while holding out as CPA(s), is not considered to be in the practice of public accounting if the member or the member's firm does not perform, for any client, any of the professional services described in the preceding paragraph.

Professional Services. Professional services include all services performed by a member while holding out as a CPA.

RULES

Rule 101 Independence

A member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by Council.

Rule 102 Integrity and Objectivity

In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

Rule 201 General Standards

A member shall comply with the following standards and any interpretations thereof by bodies designated by Council.

A. ***Professional Competence.*** Undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.

B. ***Due Professional Care.*** Exercise due professional care in the performance of professional services.

C. ***Planning and Supervision.*** Adequately plan and supervise the performance of professional services.

D. ***Sufficient Relevant Data.*** Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

Rule 202 Compliance with Standards

A member who performs auditing, review, compilation, management consulting, tax, or other professional services shall comply with standards promulgated by bodies designated by Council.

Rule 203 Accounting Principles

A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

Rule 301 Confidential Client Information

A member in public practice shall not disclose any confidential client information without the specific consent of the client.

This rule shall not be construed (1) to relieve a member of his or her professional obligations under rules 202 and 203, (2) to affect in any way the member's obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a member's compliance with applicable laws and government regulations, (3) to prohibit review of a member's professional practice under AICPA or state CPA society or Board of Accountancy authorization, or (4) to preclude a member from initiating a complaint with, or responding to any inquiry made by, the ethics division or trial board of the Institute or a duly constituted investigative or disciplinary body of a state CPA society or Board of Accountancy.

Members of any of the bodies identified in (4) above and members involved with professional practice reviews identified in (3) above shall not use to their own advantage or disclose any member's confidential client information that comes to their attention in carrying out those activities. This prohibition shall not restrict members' exchange of information in connection with the investigative or disciplinary proceedings described in (4) above or the professional practice reviews described in (3) above.

Rule 302 Contingent Fees[18]

A member in public practice shall not

1. Perform for a contingent fee any professional services for, or receive such a fee from, a client for whom the member or the member's firm performs
   a. an audit or review of a financial statement; or
   b. a compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member's compilation report does not disclose a lack of independence; or
   c. an examination of prospective financial information;
   or
2. Prepare an original or amended tax return or claim for a tax refund for a contingent fee for any client.

The prohibition in (1) above applies during the period in which the member or the member's firm is engaged to perform any of the services listed above and the period covered by any historical financial statements involved in any such listed services.

[18] Laws or board of accountancy rules of some states prohibit the receipt of contingent fees by CPAs. (Author's note)

Except as stated in the next sentence, a contingent fee is a fee established for the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of such service. Solely for purposes of this rule, fees are not regarded as being contingent if fixed by courts or other public authorities, or, in tax matters, if determined based on the results of judicial proceedings or the findings of governmental agencies.

A member's fees may vary depending, for example, on the complexity of services rendered.

Rule 401 [Reserved]

Rule 501 Acts Discreditable

A member shall not commit an act discreditable to the profession.

Rule 502 Advertising and Other Forms of Solicitation

A member in public practice shall not seek to obtain clients by advertising or other forms of solicitation in a manner that is false, misleading, or deceptive. Solicitation by the use of coercion, over-reaching, or harassing conduct is prohibited.

Rule 503 Commissions and Referral Fees[19]

A. Prohibited Commissions

A member in public practice shall not for a commission recommend or refer to a client any product or service, or for a commission recommend or refer any product or service to be supplied by a client, or receive a commission, when the member or the member's firm also performs for that client

a. an audit or review of a financial statement; or

b. a compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member's compilation report does not disclose a lack of independence; or

c. an examination of prospective financial information.

This prohibition applies during the period in which the member is engaged to perform any of the services listed above and the period covered by any historical financial statements involved in such listed services.

B. Disclosure of Permitted Commissions

A member in public practice who is not prohibited by this rule from performing services for or receiving a commission and who is paid or expects to be paid a commission shall disclose that fact to any person or entity to whom the member recommends or refers a product or service to which the commission relates.

C. Referral Fees

Any member who accepts a referral fee for recommending or referring any service of a CPA to any person or entity or who pays a referral fee to obtain a client shall disclose such acceptance or payment to the client.

Rule 504

[There is currently no rule 504.]

[19] Laws or board of accountancy rules of some states prohibit the payment or receipt of commissions by CPAs. (Author's note)

Rule 505 Form of Organization and Name

A member may practice public accounting only in the form of organization permitted by law or regulation whose characteristics conform to resolutions of Council.

A member shall not practice public accounting under a firm name that is misleading. Names of one or more past owners may be included in the firm name of a successor organization.

A firm may not designate itself as "Members of the American Institute of Certified Public Accountants" unless all of its owners are members of the Institute.

Review Questions

1. What are ***cute accounting*** and ***cooking the books***?
2. Why is the Equity Funding Corporation of America fraud significant for management accountants and financial executives?
3. Identify the four components of ethical conduct for management accountants, set forth in ***Standards of Ethical Conduct for Members*** of the Institute of Management Accountants.
4. How did the National Commission on Fraudulent Financial Reporting (Treadway Commission) define ***fraudulent financial reporting***?
5. What Rules of Professional Conduct of the American Institute of Certified Public Accountants apply to all members of the AICPA, including management accountants?
6. Do the ethics codes of the Institute of Management Accountants and the Financial Executives International require their members to comply with generally accepted accounting principles? Explain.
7. What is ***insider trading*** of corporate securities?
8. Does the Securities and Exchange Commission accept a "good soldier" rationalization for fraudulent financial reporting? Explain.
9. What are the obligations of management accountants regarding ***conflicts of interest***?
10. Does the ***Code of Ethics*** of the Financial Executives International require FEI members to maintain the confidentiality of information acquired in the course of their work in all circumstances? Explain.
11. Does the ***Code of Professional Conduct*** of the American Institute of Certified Public Accountants require AICPA members in industry to maintain the appearance of independence? Explain.
12. What classes of accountants are subject to regulation by the Public Company Accounting Oversight Board?

Exercises

(Exercise 1.1) Select the best answer for each of the following multiple-choice questions:

1. The bylaws of the AICPA require members to adhere to the Code of Professional Conduct section entitled:
   a. Principles
   b. Rules
   c. Interpretations
   d. Ethics Rulings

2. A rule of the AICPA Code of Professional Conduct that does not apply to AICPA members in private industry is:
   a. Rule 101 Independence.
   b. Rule 102 Integrity and Objectivity.
   c. Rule 201 General Standards.
   d. Rule 203 Accounting Principles.
   e. None of the foregoing.
3. Conduct of a member's personal affairs is addressed in the ethics code or codes of:
   a. The American Institute of Certified Public Accountants only.
   b. The Financial Executives International.
   c. The Institute of Management Accountants only.
   d. None of the three organizations cited above.
4. According to the National Commission on Fraudulent Financial Reporting (Treadway Commission), the responsibility for reliable financial reporting lies first and foremost:
   a. At the corporate level.
   b. With the SEC.
   c. With independent auditors.
   d. With state boards of accountancy.
5. Does ***fraudulent financial reporting*** include:

	Cooking the Books?	Cute Accounting?
a.	No	Yes
b.	No	No
c.	Yes	Yes
d.	Yes	No

6. According to the AICPA, are financial statements of a business enterprise that have been drafted by the enterprise's independent auditors on its behalf the representations of the enterprise's:

	Management?	Independent Auditors?
a.	Yes	Yes
b.	Yes	No
c.	No	Yes
d.	No	No

7. ***Standards of Ethical Conduct for Members*** of the Institute of Management Accountants deal with all of the following except:
   a. Competence
   b. Confidentiality
   c. Independence
   d. Integrity
   e. Objectivity
8. The ***Report of the National Commission on Fraudulent Financial Reporting*** did not include recommendations for:
   a. Financial institution regulators.
   b. Legal counsel of business enterprises.
   c. Educators.
   d. State boards of accountancy.

9. Are conflicts of interest addressed *directly* in the ethics codes of the:

	IMA?	FEI?	AICPA?
a.	Yes	Yes	Yes
b.	Yes	No	Yes
c.	No	Yes	Yes
d.	No	No	Yes

10. Compliance with generally accepted accounting principles is required by the ethics code of the:
    a. AICPA only.
    b. AICPA and FEI.
    c. AICPA and IMA.
    d. AICPA, FEI, and IMA.
11. According to ***Standards of Ethical Conduct for Members*** of the Institute of Management Accountants, management accountants faced with significant ethical issues should first:
    a. Discuss the issue with the immediate superior, except when it appears the superior is involved.
    b. Clarify relevant concepts by confidential discussion with an objective adviser.
    c. Discuss the issue with the audit committee of the board of directors.
    d. Follow the established policies of the business enterprise bearing on the resolution of such issues.
12. The section of the American Institute of Certified Public Accountants Code of Professional Conduct that governs the performance of professional services by AICPA members is the:
    a. Principles
    b. Rules
    c. Bylaws
    d. Technical standards

Cases

(Case 1.1) Suppose you were to participate in a debate of the following resolution:

Resolved, that the following sentence from the Preamble to Section I: Principles of the AICPA Code of Professional Conduct is overly idealistic in today's society:

> The Principles call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage.

Instructions

Would you support the affirmative or the negative side of the debate? Explain.

(Case 1.2) In his *Meditations,* the Roman emperor Marcus Aurelius Antoninus wrote as follows (Books III and VII):

> A man must stand erect, not be kept erect by others. . . .
>
> Be thou erect or be made erect.

Instructions

Evaluate the usefulness of the ethics rules of the AICPA, FEI, and IMA in relation to the foregoing quotations.

(Case 1.3) Chief executive officers (CEOs) of business enterprises often pressure enterprise chief financial officers (CFOs) or controllers to cook the books.

Instructions
Evaluate the ethics rules of the IMA, FEI, and AICPA as guidelines for resisting the pressures described above.

(Case 1.4) General Instruction D(2)(a) of Form 10-K, Annual Report, requires the report, filed with the SEC, to be signed by the registrant company's principal financial officer and controller or principal accounting officer. Similarly, General Instruction G of Form 10-Q, Quarterly Report, requires the report, filed with the SEC, to be signed by the principal financial or chief accounting officer of the registrant company.

Instructions
How should the chief financial officer (CFO) and the controller of an SEC registrant enterprise view the obligation to sign the registrant's Form 10-K and Form 10-Q reports to the SEC? Explain.

(Case 1.5) According to Ralph E. Walters (page 7 of the text): "An obligation to be *impartial* seems to me to place a new and possibly unrealistic burden on the management accountant."

Instructions
Do you agree with Walters? Explain.

(Case 1.6) An earlier version of the Financial Executives International ***Code of Ethics*** required FEI members to conduct their *personal affairs,* as well as their *business affairs,* with honesty and integrity. The current version does not have that requirement.

Instructions
Did the FEI err in removing the foregoing requirement from its ethics code? Explain.

(Case 1.7) Vernon Cass, chief financial officer of Tingley Corporation, a publicly owned enterprise, asked his subordinate, John Conroy, CPA and controller of Tingley, if any accounting changes might be made before the forthcoming close of the fiscal year to enhance Tingley's earnings for the year. Conroy suggested that he might extend economic lives of plant assets, reduce the percentage used to estimate doubtful accounts expense based on net credit sales, and defer, rather than expense, certain advertising costs that consistently had been recognized as expenses in prior years. Cass instructed Conroy to formalize a proposal incorporating those suggestions, for consideration by the audit committee of Tingley's board of directors.

Instructions
Evaluate the actions of Vernon Cass and John Conroy. (Suggestion: Consider the provisions of ***APB Opinion No. 20,*** "Accounting Changes," and ***Statement on Auditing Standards No. 57,*** "Auditing Accounting Estimates," in your discussion.)

(Case 1.8) The following excerpt is from ***Standards of Ethical Conduct for Members*** of the Institute of Management Accountants:

> If [an] ethical conflict still exists after exhausting all levels of internal review, there may be no other recourse on significant matters than to resign from the organization and to submit an informative memorandum to an appropriate representative of the organization.

Instructions
What is your opinion of the foregoing excerpt? Explain.

(Case 1.9) Certified public accountants (CPAs) typically are subject to codes of ethics or conduct enacted by state boards of accountancy that license the accountants.

Instructions

Given that CPAs are subject to oversight by state boards of accountancy, what is the incentive—if any—for CPAs in management accounting to be members of the AICPA, the FEI, or the IMA? Explain.

(Case 1.10) You are the chief financial officer of Playthings, Inc., a newly organized, publicly owned manufacturer of toys and games. Roy Weber, the chairman of the audit committee of the company's board of directors, asks you to consider at what point, under generally accepted accounting principles, the company can recognize revenue for "bill and hold" sales of toys to retailers. He stresses that it is imperative for the company to comply with federal and state securities laws.

Instructions

Prepare a memorandum to answer the audit committee chairman after you have researched the following:

Statement of Financial Accounting Concepts No. 6, "Elements of Financial Statements," pars. 78, 79.

Statement of Financial Accounting Concepts No. 5, "Recognition and Measurement in Financial Statements of Business Enterprises," pars. 83, 84.

Uniform Commercial Code, secs. 401, 501.

SEC Accounting Series Release No. 292, " . . . In the Matter of Arthur Andersen & Co."

SEC Accounting and Auditing Enforcement Release No. 108, " . . . In the Matter of Stewart Parness."

SEC Accounting and Auditing Enforcement Release No. 817, " . . . In the Matter of Cypress Bioscience Inc. . . ."

(Case 1.11) In a September 1998 speech, former Securities and Exchange Commission Chairman Arthur Levitt used the term *cookie-jar reserves* to describe a "cooking the books" technique used by some publicly owned companies to manage earnings. The technique involved establishing fictitious liabilities for bogus expenses or realized and earned revenues in a highly profitiable quarter or fiscal year, and reversing the liabilities in subsequent low earnings periods.

Instructions

a. Obtain and study ***SEC AAER 1140,*** "In the Matter of W. R. Grace & Co., Respondent" (June 30, 1999) and describe the "cookie-jar reserves" technique used by Grace.

b. Review the ***Staff Accounting Bulletins*** issued by the SEC subsequent to June 30, 1999, and briefly describe the provisions of a ***Bulletin*** dealing with the Grace matter and the SEC staff's resultant requirements.