Professional Ethics and Decision Making

What are your choices?

By

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Agenda

• Define Ethics
• Ethical decision making for Accountants
• Gray Area
• The fraud triangle
• Cost of fraud
• The Wall of Shame (Illegal Activity and Penalty)
• Examine recent municipal Bankruptcies (Legal Activity and Penalty)
• Effect on past promises
• Ethical Survey Results
• What is the right?
• A look at PSU’s MSA
• Questions?
Ethics Defined

• What is Ethics?
• The discipline dealing with what is good and bad and with moral duty and obligation
• A set of moral principles: a theory or system of moral values a consciousness of moral importance
• A set of moral issues or aspects (as rightness)

Merriam-Webster
Ethics defined (cont.)

• Integrity
  • “Have the courage to say no. Have the courage to face the truth. Do the right thing because it is right. These are the magic keys to living your life with integrity” (W. Clement Stone)

• Moral Principles / Moral Philosophy
  • Developing, defending, and recommending right and wrong behavior

• Acceptable standards of behavior

• Norms, Values, and the Law

• Doing what is right...all the time.
Ethics defined (even more)

• The Gray Area
  • Rules are unclear
  • Willingness to take action not in one’s best interest (at least sometimes)
  • Motives for action
    • End justifies the mean
  • Justify wrongdoing
    • Excuse to achieve one’s goals
• Situational Ethics
• Cultural values
Integrity

- Honesty (dictionary.cambridge.org)
- Strong moral principles (dictionary.reference.com)
- Incorruptibility (merriam-webster)
- Personal quality of fairness (vocabulary.com)
- Doing the right thing even when nobody's looking (urbandictionary.com)
Professional Ethics for Accountants

- Code of Professional Conduct (AICPA) Fundamental Principle
  - Independence
  - Integrity
  - Objectivity
  - Professional Competence and Due Care
  - Confidentiality
  - Professional Behavior
What is Fraud?

• Dishonest act perpetrated for personal enrichment

• The Fraud Triangle
Behavioral Indicators of Fraud

• Living Beyond Means
• Financial Difficulties
• Unusual Close Association with Vendor/Client
• Control Issues, Unwillingness to Share Duties
• Divorce/Family Issues
• Wheeler-Dealer Attitudes
• Instability, Suspiciousness or Defensiveness
• Addiction Problems
Cost of Fraud

• Facts
  • Typical lost revenue..................................................5%
  • Potential Global Projected Loss ........... $3.7 Trillion
  • Cases analyzed in 2014..........................1,483
  • Median loss per incident..........................$145,000
  • Losses resulting from these cases..........$3, Billion+
Median Loss by Scheme Type

- Financial Statement Fraud
- Corruption
- Asset Missapp

2010 | 2012 | 2014
--- | --- | ---
<table>
<thead>
<tr>
<th>Who</th>
<th>What</th>
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<tbody>
<tr>
<td>Ebbers</td>
<td>25 years</td>
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<td>Lay</td>
<td>20-30 years</td>
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<td>Fastow</td>
<td>10 years</td>
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<td>Rigas</td>
<td>15 years</td>
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<td>Kozwolski</td>
<td>8-25 years</td>
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<td>Sullivan</td>
<td>5 years</td>
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<td>Skilling</td>
<td>24 years</td>
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<td>Milken</td>
<td>10 years</td>
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Interview Responses to Why?

• Money
• Greed is Powerful Medicine
• Distorted Thinking
• Narcissistic Ego
• Human
• Bent rules
• Opportunities
Co-Offender Theory

Median Loss

- Four or more
- Three
- Two
- Single

Median Loss

- $0
- $100,000
- $200,000
- $300,000
- $400,000
- $500,000
- $600,000
Median loss based on position

- Other
- Owner/Executive
- Manager
- Employee

Amount of Loss

0 100,000 200,000 300,000 400,000 500,000 600,000 700,000

Amount of Loss
Loss based on Education

Median Loss

- High School or less
- Some University
- University Degree
- Post Graduate Degree

$0, $50,000, $100,000, $150,000, $200,000, $250,000
Median Loss based on gender

- Male
  - 2010: $230,000
  - 2012: $225,000
  - 2014: $220,000

- Female
  - 2010: $100,000
  - 2012: $105,000
  - 2014: $100,000

Initial Detection

- External Audit
- Account reconciliation
- By Accident
- Internal Audit
- Management Review
- Tip

Detection Type
Whistle Blowing

- Dodd – Frank
- $30 Million Award
- $438 Million fund

![Number of Whistle Blowers](chart.png)
<table>
<thead>
<tr>
<th>Why?</th>
<th>Why Not?</th>
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<tbody>
<tr>
<td>Cost - Benefit</td>
<td>Right vs Wrong</td>
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<tr>
<td>Rationalize</td>
<td>Fear</td>
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<td>Justification</td>
<td>Values</td>
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<td>Worth the risk</td>
<td>Character</td>
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<td>Ignorance</td>
<td>Education</td>
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<td>Arrogance</td>
<td>Idealist</td>
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<tr>
<td>Opportunist</td>
<td>Pragmatic</td>
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Current Regulations

- Securities Act of 1933
- Securities Exchange Act of 1934
- Trust Indenture Act of 1939
- Investment Company Act of 1940
- Investment Advisers Act of 1940
- Sarbanes-Oxley Act of 2002
- Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
- Jumpstart Our Business Startups Act of 2012
- Rules and Regulations
Municipal Bankruptcies

• Who - Municipalities
  • There are 89,500 municipalities countrywide

• What – Chapter 9 Bankruptcy
  • Between 1980 and 2010 there were 239 bankruptcy filings < 1%

• Where – New England to California
  • Central Falls, RI – San Bernadino, CA

• Why – Money?
  • Liabilities exceed assets – Some pensions involved

• What happened in the end?
Prominent Municipal Bankruptcies

- Vallejo, CA – 2008 financial crisis was last straw – faced $16.6 million deficit
- Detroit, MI
- Stockton, CA
- San Bernadino, CA
- San Jose, CA
- Jefferson County, AL
- Harrisburg, PA
- Scranton PA
- New York City, NY
Vallejo California

- 120,000 residents
- Police Captain earning $306,000 annually
- Police Lieutenant earning $247,644 annually
- Average Firefighter salary is $171,000
- 21 Firefighters earning more than $200,000 annually
- 292 city employees earning over $100,000
- Police and firefighter pensions guaranteed after five years!
- Pension obligations and overtime were 74% of City’s $80 mill budget
Vallejo California

• Outcome
  • Slashed spending
    • Cut personnel and services
    • Cut 60 police officers
    • Cut funding for senior center, youth groups, art organizations
    • Abandoned downtown, waterfront, little new business
  • Never addressed pension problem
    • Did not cut payments to California Public Employees Retirement System (CALPERS)
    • Still Financially stressed
    • Could enter another Chapter 9?
Detroit Michigan

- Population 700,000 (current) was 1.8 million in 1950
- Largest municipal bankruptcy in history
- Total debt $18 billion
- Annual budget $2.5 billion
- Unfunded pension liabilities $3.5 billion
- Unfunded retiree healthcare benefits $6 billion
- Total assessed property value fell 77% over past 50 years
- Expenditures did not keep pace with decline.
Detroit Michigan

• Outcome
  • Cut $7 billion in unsecured liabilities
  • Now has enough cash to pay bills
  • $165 million in legal expenses for chapter 9 proceedings
  • Pensions cut by 4.5% for general retirees (non for police & firefighters)
  • Elimination of 2.25% COLA increases (includes ½ cut for police & fire)
  • Clawback $212 million in excessive interest (guaranteed 7.9% on annuity)
  • Cuts to health care benefits to retirees
  • Future pension obligation (2024 estimated at 100 to 200 million)
  • Privitization of city assets (parking garages).
Stockton, San Bernardino, San Jose, California

- Unfunded Pensions
- Unfunded Health Care Promises
- Overspending
- Failed financial expectations
Can all municipalities file Chapter 9?

<table>
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<tr>
<th>States with No Statutes:</th>
<th>16 States set conditions for Municipal Bankruptcy</th>
<th>12 States provide Blanket Authorization</th>
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<td>Alaska</td>
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Survey

- I believe that reducing or eliminating prior promises to government workers, as allowed by the court is the right thing to do.
- [https://www.polleverywhere.com/multiple_choice_polls/fdTCDFZ7zbmYiaJ](https://www.polleverywhere.com/multiple_choice_polls/fdTCDFZ7zbmYiaJ)
  
  A. Strongly Disagree
  B. Disagree
  C. Neutral
  D. Agree
  E. Strongly Agree
Discussion Questions

• When is it okay to renege on a promise?
Discussion Questions

• What options exist when there is insufficient funds to pay future obligations?
Discussion Questions

• Is Selling municipal assets to settle debt a valid option?
Discussion Questions

• Should the state share responsibility for failed cities and towns?
Discussion Questions

• What is the best formula to avoid potential insolvency?
Discussion Questions

• When should government officials be held accountable for financial failure?
Discussion Questions

• What do you want to share?
According to the Ethics Resource Center, what percentage of workers observed ethical misconduct at their workplace during 2013?

A. 14%
B. 27%
C. 41%
D. 73%
National Business Ethics Survey

• According to the Ethics Resource Center, what percentage of workers observed ethical misconduct at their workplace during 2013?

• C. 41%
What today’s students say

• Would Consider Committing Fraud;

• Would not Consider Fraud;
What today’s accounting students say

- Would Consider
  - 50%
- Would not Consider
References

Association of Certified Fraud Examiners. (2014). *2014 Report to the Nations on Occupational Fraud and Abuse.* Copyright 2014 by the Association of Certified Fraud Examiners, Inc.”. ACFE.


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Other references and links

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http://www.reuters.com/article/usa-california-stockton-idUSL1N0VF2J620150205

➔Detroit, MI

http://www.washingtonexaminer.com/top-10-reasons-detroit-went-bankrupt/article/2533299
Interview Questions?

1. Why would someone risk the penalties for knowingly committing Financial Statement Fraud?
2. When signing the financial statements, what checks would you perform to insure that the statements are correct?
3. Thinking about Enron, Worldcom, Martha Stewart, Bernie Maddoff, and others who have gone down this path, do you think there is/are a common factor(s) that they all have in common? If yes what might that factor(s) be? If no, what differences might exist to make each case unique?
4. Making decisions where the most people benefit and the fewest suffer is a methodology referred to as utilitarianism. Do you think in any of these situations, that the decision makers were concerned about happiness of others or were they more concerned about their own happiness and needs? Explain.
5. If you could have all the money you accumulated by way of financial statement deliberate misstatements, except for say 25%, and you knew that once caught you would spend 8 years in a federal prison, how much would make this sentence worth-while? What’s your number?
6. What advice do you have to future CEOs regarding “cooking the books”?
7. Looking back on your experiences, describe a time when your personal values conflicted with what you were expected to do in a particular, non-trivial management decision. What did you do?
8. What would you have done differently if given another chance with the same situation as in question 7?