THE ETHICS OF PROFESSIONAL SKEPTICISM IN PUBLIC ACCOUNTING: HOW THE AUDITOR-CLIENT RELATIONSHIP IMPACTS OBJECTIVITY

A Thesis
submitted to the Faculty of
The School of Continuing Studies
and of
The Graduate School of Arts and Sciences
in partial fulfillment of the requirements for the degree of
Master of Arts in Liberal Studies

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October 24, 2012
THE ETHICS OF PROFESSIONAL SKEPTICISM IN PUBLIC ACCOUNTING: 
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ABSTRACT 

The public accounting industry is most critically defined by the relationship between auditor and client. Historically, the investing public has relied upon audited financial statements when making investment decisions and they have leaned on the accounting profession to confirm the accuracy and completeness of this financial information. As a result, external auditors are perceived as the “gatekeepers” in protection of the investing public.

Beyond the sphere of public accounting, the accounting profession as a whole was once considered as the bearer of the highest standards of integrity among the professional services fields. The regard that this profession enjoyed, however, deteriorated in the wake of a succession of unethical, high profile scandals, in the first years of the twenty first century. There was growing concern amongst public experts that auditors were performing perfunctory reviews and approvals of client financials based on their chummy relationships with management and beginning to neglect their duties to shareholders. Auditors who are willing to compromise their independence or overlook key information in order to retain a client immediately cause the objectivity of the auditor and the accuracy of the client’s financial statements to become suspect.
The public accounting industry prides itself on the importance and necessity of professional values, ethics, independence, objectivity, and professional skepticism. Ethical codes established by field are intended to be designed to guide practitioners in serving the general public, clients, and employers. However, inappropriately close relationships have led to questionable choices. In practice, actively trying to maintain relationships may be a more powerful explanation of behavior than an individualized personal attachment to justice. Internal sanctions like guilt and shame may not be effective enforcement mechanisms when one has the social pressures and personal influences of colleagues to contend with. An understanding of the rules and norms that dictate the appropriateness of relationships can assist in comprehending how personal relationships influence an individual’s personal ethics. In an industry where building strong relationships and establishing confidences with clients is a competitive advantage for success, how do we account for the influences of personal attachments and preferential treatment on professional bias and skepticism? With such an emphasis on social interactions and personal relationships in the public accounting field, these associations can essentially redefine the professional’s rationalization of ethical choices.
DEDICATION

This thesis is dedicated to Janice Cabrera-Frias, my twin sister and best friend. Thank you for your unrelenting support, uncompromised guidance, and generous patience throughout this long process of editing and reviewing. You have helped me with this project and in every other facet of my life beyond words. For everything you have given me, I will forever be grateful. Thank you, thank you, thank you.
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABSTRACT</td>
<td>ii</td>
</tr>
<tr>
<td>DEDICATION</td>
<td>iv</td>
</tr>
<tr>
<td>INTRODUCTION</td>
<td></td>
</tr>
<tr>
<td>THE STATE OF PROFESSIONAL SKEPTICISM</td>
<td>1</td>
</tr>
<tr>
<td>CHAPTER ONE</td>
<td></td>
</tr>
<tr>
<td>MORAL THEORY AND THE ETHICS OF PERSONAL RELATIONSHIPS</td>
<td>12</td>
</tr>
<tr>
<td>CHAPTER TWO</td>
<td></td>
</tr>
<tr>
<td>PUBLIC ACCOUNTING AND PROFESSIONAL BIAS</td>
<td>39</td>
</tr>
<tr>
<td>CHAPTER THREE</td>
<td></td>
</tr>
<tr>
<td>ETHICS POLICY IN PRACTICE</td>
<td>57</td>
</tr>
<tr>
<td>CONCLUSION</td>
<td></td>
</tr>
<tr>
<td>ADDRESSING THE DISCONNECT BETWEEN POLICY AND PRACTICE</td>
<td>74</td>
</tr>
<tr>
<td>BIBLIOGRAPHY</td>
<td>86</td>
</tr>
</tbody>
</table>
INTRODUCTION
THE STATE OF PROFESSIONAL SKEPTICISM

The public accounting industry is most critically defined by the relationship between auditor and client. Historically, the public has relied upon audited financial statements when making financial decisions for investments. They have leaned on the accounting profession to confirm the accuracy and completeness of this financial information in order to make informed decisions. The main objective of financial reporting is to provide financial information to current and potential investors, creditors, and stakeholders. This information is intended to assist them in making well-reasoned investment, credit, and financial decisions as well as accurately report the economic resources and obligations of a company. As a result, auditors are perceived as the “gatekeepers” in protection of the investing public.¹ External audits—defined by their independent nature as opposed to internal audits conducted by a company on its own operations—performed by these firms are expected to be performed in accordance with globally accepted audit and ethics standards, and with appropriately implemented accounting principles. These standards of quality and a robust audit oversight function are imperative to maintaining sound auditing processes. These thorough procedures are an important element that is integral to maintaining and enhancing industry market confidence. The public places significant value on the execution of a careful inspection to determine that companies are compliant against a

set of governing rules. Consistent interpretation of auditing and ethics standards can pose several challenges, and in cases where a firm may not have rigorous quality control policies and programs firmly enough in place that are understood by all its practitioners, it is that entity’s responsibility to mitigate those obstacles in order to provide effective service.²

Beyond the sphere of public accounting, the accounting profession as a whole was once considered the bearer of the highest standards of integrity among the professional services fields. The regard that this profession enjoyed, however, deteriorated in the wake of a succession of high profile scandals, in the first years of the twenty-first century. Leading up to these misdeeds was a push by the public accounting industry to concentrate their efforts on management consulting related non-audit work. They used auditing, a loss leader at the time, to pull in non-audit business that returned greater profits. The competition between accounting firms intensified as bigger firms vied for position as the leading firm in the field. The traditional “Big Eight” accounting firms became the “Big Six”, and then the “Big Five” prior to the dissolution of the public accounting firm, Arthur Andersen—resulting in the present-day “Big Four”. Accountants were caught in the financial excesses of the late nineties, in the desire to consult companies that were keen to boost reported earnings per share. In the late nineties, there was growing concern amongst public experts that auditors were performing perfunctory reviews and approvals of client financials based on their

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chummy relationships with management and beginning to neglect their duties to shareholders. In response, accountants defended themselves by declaring that the public had unreasonable expectations of what an external audit could deliver and that true responsibility for a company’s accounts rested with its directors. An outside audit could not always be expected to discover all fraud or foresee the imminent collapse of a company.\(^3\)

This atmosphere of the accounting culture gave way to a number of fraudulent financial misstatements from companies such as WorldCom (2002), Global Crossing (2002), and Tyco (2002), and Healthsouth (2003). These events caused a major shift in the state of ethics towards the public accounting industry during the past decade. Most significant was the Enron scandal and downfall, first revealed in late 2001. Enron executives were convicted of fraud. Their auditors, Arthur Andersen soon followed in the collapse, found guilty of obstructing justice, primarily for altering an internal memo that was critical of an Enron earnings release. This conviction was eventually overturned by the Supreme Court in 2005, but it did not stop the fall of Arthur Andersen. Financial staff, analysts, bankers, executives, and even the auditors involved knew that Enron’s market value was built not on reality but on fabrication and that the company’s financial statements did not accurately represent Enron’s true financial status.

“Enron financial staff who structured the financial mechanisms and financial statements and the Arthur Andersen auditors who certified Enron’s financial statements appear to have operated under a cloak of moral self-deception.”

The Enron scandal led to an amplified state of ethical awareness, not only within the industry, but within the country. The change was more precisely due to the social and political changes that occurred during Enron, and not a shift in moral thinking. Prior to the conviction of Enron executives, the consequences of being involved in a financial/business scandal were not great. Cozy relationships between investment analysts, auditors, and corporations were tolerated while the economy and stock market were booming. After Enron, management decision making shifted to align itself with socially acceptable behavior and respect for the law in order to avoid increased sanctioning that could result from noncompliance: a refocus on ethics. There is now the increased risk of criminal prosecution, securities class action lawsuits from shareholders, and the replacement of top management and auditing firms. Practitioners now have greater respect for law and/or are much more reluctant to violate the law.

The majority of those companies that did not go bankrupt as a result of financial scandal opted to replace their auditing firms as a way to share responsibility and blame. Despite the loss of an established, familiar partnership between servicer

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and client, replacing an accounting firm can be beneficial if the change can assist the firm in regaining its reputational capital or limiting its exposure to liability. However, the impacts can also be quite costly. Replacing one firm with another can result in steep learning curves. In the case of many public accounting firms, the new firm may already be providing other pre-existing services to the company such as tax, computer systems related, or management consulting, which may have conflicting synergies with auditing. The new firm may also not have the necessary scale and/or experience in industry specialties. These stressors can greatly impact the level of quality of services provided to evaluate the financial statements of a client.

In response to public outrage, lawmakers implemented new checks and balances in an attempt to prevent future controversy. Legislators adopted the Sarbanes-Oxley Act of 2002, which applied stringent corporate governance rules to all companies with stock listed in the United States. It was intended to increase civil and criminal penalties for violations and prohibit conflicts of interest. It also created a new regulatory agency, the Public Accounting Oversight Board, to oversee the work of accountants, raising the regulatory bar as well as accountability for the accounting profession. While the intention of the Sarbanes-Oxley Act was to improve corporate governance, it received much criticism upon its implementation. Critics were concerned by increased compliance costs and related expenses, the law’s deterrence of innovation and risk taking, and the distraction it would cause CEOs and other executives from more important tasks. In addition to the passing of this legislation, the
New York Stock Exchange, NASDAQ, and the American Stock Exchange adopted new corporate governance rules as part of their listing requirements. Significant changes within the auditing and accounting industry continued. In addition to enhancing internal procedures for client audits and accessing the financial integrity of accounting reports, public accounting firms created separate entity divisions or divested their consulting businesses in order to eliminate potential conflicts of interest that could undermine their credibility as auditors.\textsuperscript{6}

More recently, there has been the concern over the public accounting sector’s role in the mortgage-backed securities that led to the housing bubble collapse and subprime loan crisis. The widespread failure of investments have led to the examination of accounting practices, pervasive misapplications of accounting standards, and a lack of effective internal controls. In the case of this financial crisis of the late 2000s, public accounting auditors were not responsible for stopping companies from making flawed lending and investment decisions—only to make sure that those decisions are properly disclosed. However, in the case of Lehman Brothers Holdings, civil-fraud charges were brought against Ernst and Young LLP for its role in the investment bank’s collapse. Several other investigations were initiated to look into the questionable practices of other companies’ auditors as well. Some accounting industry advocates believe that auditors have actually been a strong force in driving companies to justify their valuation methods to explain accounting irregularities. Others on the

opposite side of the spectrum believe that the bad investment decisions resulted from a lack of internal company controls in place, and that auditors are responsible for evaluating those internal controls. Auditors argue that they are only responsible for vetting internal controls associated with financial reporting, those which insure that what is included in financial statements is accurate, and not necessarily controls related to business transactions like securitizations. The company is therefore responsible for business decisions, while the auditors are responsible for ensuring that all pertinent information is reported to the public. Lynn Turner, a former Securities and Exchange Commission chief accountant, reported that auditors did perform better after the Sarbanes-Oxley Act, but starting in 2006, faced with a slowing economy, however, auditors reversed course and began heading back along the same road they were on before the corporate scandals of the early 2000s. Is this due to changes in social and economic climates, a shift in culture, or to something more inherent in the personal exchanges between auditors and their clients?

The ultimate concern raised by these controversies is one that has always been with the accounting profession—how to ensure that the auditor is truly independent from the company they are auditing. The foundation upon which the accounting profession is set up has always been under scrutiny. Auditors who are willing to compromise their independence or overlook key information in order to retain a client

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immediately cause the objectivity of the auditor and the accuracy of the client’s financial statements to become suspect. Evidence from the recent past shows a significant number of accountants, auditors, and executives that have misrepresented financial information, participated in financial deceptions, and hidden behind loopholes in the law.\textsuperscript{8}

There is the argument that a lack of bias is made impossible by the mere fact that the firm employs the auditor. While company shareholders formally appoint and pay for a company’s auditors, this decision is usually made by management. Auditors must also report back to management, even in cases where fraud is suspected. This lack of division has caused vocal opponents of the public accounting culture to believe that unerring objectivity cannot be facilitated by the current auditor-client structure. Individuals within the profession take an alternate position. Their attitude is that independence is not necessarily “a matter of structure or rules” but is in actuality “a state of mind.” Public accounting firms, desperate to maintain the best reputation will ultimately abide by the notions of professional integrity and partnering decency.\textsuperscript{9} Despite the principles that each side defends itself with, history shows that there are inevitably members of the profession that succumb to the corruption that arises in this setting.

\textsuperscript{8} Satava, et al., “Ethics and the Auditing Culture: Rethinking the Foundation of Accounting and Auditing,” 271-272.

The above mentioned financial scandals were not only legal and criminal transgressions, but based in ethical encroachments. The tenets of integrity and objectivity are the basis of the auditing profession. Members of the profession have historically been characterized by their professional values, ethics, and are attitudes and expected to abide by moral norms. The professional is expected to render opinions on the financial statements of clients with honesty, reliability, and fairness. The public accounting industry prides itself on the importance and necessity of independence, objectivity, and professional skepticism. Professional auditors need to be independent in both fact and appearance. Effectively resolving ethical dilemmas that occur only reinforces their value to the organizations. Ethical codes are designed to guide practitioners in serving the general public, clients, and employers. Moral philosophy can vary significantly among individuals depending on several factors including personal development, commitment to moral and/or religious standards, ethical education, and relative degrees of altruism and self-interest. When joining professional fields, individuals are in some cases expected to conform their preexisting moral behavior to established ethical codes. Organizations establish these rules in order to limit the variability of moral conduct amongst its members and to aid in accomplishing the organization’s goals and mission. The purpose is not only to provide guidance and benefit to the practitioners, but more importantly, to protect the persons whom the profession is serving. Some practitioners may feel constrained by these codes or by complying with certain acts that might be performed if the

stipulations did not exist. Others may have personal moral standards that are much more restrictive than the professional code and may coincide with occupational norms. These associations could lead to the eventual absorption of the profession’s standards into the individuals’ personal morals through long-term compliance and familiarity.\textsuperscript{11} There is also the opinion that despite the expectation to follow ethical norms, auditors are still rational economic agents. In this position it is likely that they will only comply with an established code of ethics if otherwise harmful to their self-interests. In this case, if the probability of detection and/or the sanctions are minimal in relation to the potential gains to be made, an auditor will not necessarily comply with the established code of ethics.\textsuperscript{12}

Moral reasoning and its resultant behavior is a function of many influences. Of those influences, the relationships which the auditor has with those he/she interacts, have an enormous impact. The principle of integrity imposes an obligation on all public accounting professionals to be straightforward and honest in all professional and business relationships. However, inappropriately close relationships have led to questionable choices. In practice, actively trying to maintain relationships may be a more powerful explanation of behavior than an individualized personal attachment to justice. Internal sanctions like guilt and shame may not be effective enforcement


\textsuperscript{12} Ionescu, “Towards a Systematic Account of Auditing Ethics,” 187.
mechanisms when one has the social pressures and personal influences of colleagues to contend with.

An understanding of the rules and norms that dictate the appropriateness of relationships can assist in comprehending how personal relationships influence an individual’s personal ethics. The intricacies of relationships involve more than a simple argument about moral behavior. They raise a series of relational and cultural issues that can have a far reaching effect on the decisions made by professionals in any field. In an industry where building strong relationships and establishing confidences with clients is a competitive advantage for success, how do we account for the influences of personal attachments and preferential treatment on professional bias and skepticism? With such an emphasis on social interactions and personal relationships in the public accounting field, these associations can essentially redefine the professional’s rationalization of ethical choices.
CHAPTER ONE
MORAL THEORY AND THE ETHICS OF PERSONAL RELATIONSHIPS

Ethical Absolutism and Ethical Relativism

In an effort to define the concept of ethics and the standards that dictate ethical conduct, there has been much scholarly debate. Ethics can be described as a system of principles that govern human conduct and behavior—a structure of values to provide guidance when considering right versus wrong. There is, though, much disagreement within the field of ethics, based on several complexities, interdependencies, and ambiguities. This applies especially to the realm of business ethics. There are several theoretical foundations that can be utilized in understanding ethical considerations and providing insight into why certain decisions are made. This is not to say that every ethical theory must map out a response to every moral problem in life. However, each of these theories can provide a distinct framework for better understanding how the mechanism of ethical reasoning leads to decision-making and rationalization of choices within individuals.

One method used in discussing ethics in terms of scholarly thought is the examination of these theories and principles in terms of the concepts of absolutism and relativism. Ethical absolutism refers to the assumption that ethical and moral principles are inherent within all individuals and can be applied universally. In contrast, ethical relativism is the theory that ethical judgments are relative to associated context, time, and situational roles. While these two notions do not necessarily dictate
moral behavior, they provide greater understanding into the motivating factors and justification behind the ethical choices.¹

Originating in classical Greece, the absolutist views of morality achieved their culmination in Kant’s categorical imperative, under which universal morality must be independent of inclinations, be capable of inspiring respect as well as approval, and have no reference to the consequences of action. However, beginning with David Hume in the eighteenth century, a modern age relativistic approach became an increasingly popular orientation of moral thought. Philosophers recommended that in place of attempting to discover universal moral principles, an emphasis should be made on examining the specific contexts and variables that influence ethical behavior. Ethical acts could be viewed in historical, cultural, situational, and individual contexts.² McDonald questions these specific contexts and their impact.

In the mixed chorus of competing moral standards and diverse ethical systems, can we discern any single principle that unifies them all, or are we left with the weak and unsatisfactory conclusion that all ethical systems are equally valid, and that a person’s choice has to be relative to his or her upbringing or education or position or country or culture?³

Ethical absolutism dictates that an omnipresent set of standards should apply universally, being equally valid in all places and all times. Behaviors are hence directed by common ethical values, which through experience, have been deemed to be

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³ McDonald, “Ethical Relativism vs Absolutism: Research Implications,” 448.
essential for successful morality by all human beings. These values may be translated as virtues intrinsic within oneself such as honesty, integrity, self-discipline, compassion, loyalty, and respect. Conduct and actions should therefore be evaluated by the same rules regardless of subsequent actions or consequences.⁴

The absolutist point of view asserts that there is only one valid ideal, and that this ideal is grounded in determinate features of human nature. Yet, while moral standards may be common to all, adherence to those standards may differ. Proponents of this absolutist philosophy recognize the vulnerabilities of individuals and understand that despite the presence of common ethical standards, what individuals believe is right will differ. However, if this is the case, can it anymore be claimed that there is fixed human nature to which these universal laws apply, that remain invariant across different social environments, or will individuals attempt to develop themselves in ways that are compatible with a particular structure of social cooperation.⁵

Ethical relativism has traditionally been viewed by some as primarily focusing on moral ideas across cultures and geographic lines. However, it can also be viewed in the more basic fashion of dealing with conditions impacted by the unique features amongst individuals, the dynamics of their interactions with each other, and the situations in which they find themselves, relative to time and location. In this sense, ethical guiding principles and behaviors differ according to the circumstances in place.

⁴ McDonald, “Ethical Relativism vs Absolutism: Research Implications,” 455-456.

⁵ Ibid., 459.
Therefore, determining which beliefs are “right” or “correct” is almost impossible to decide, as there is no one system. Holders of certain beliefs will assert that their particular system of thought is correct because their decisions have already been rationalized through their own internal ethical thought process. Supporters of ethical relativism cite individual diversity and different social settings as the catalyst for the inherent lack of consistency in ethical beliefs and actions. There are no absolute or universal moral standards. The concepts of “rightness” or “wrongness” are meaningless notions if they are isolated from the specific context within which they have arisen. A common example can be seen in the practice of bribery, or “facilitation payments” internationally. While illegal in several countries (forbidden for U.S. companies via the Foreign Corrupt Practices Act) this custom is widely practiced in certain nations that believe it to be necessary for financial performance. Under those circumstances, it is easier to rationalize the acceptability of this practice, especially when from the point of view of the participant, any consequences can only appear positive.

While many recognize the practical difficulties in ruling ethical principles universal, these difficulties do not imply that a relativistic view is the better approach. Critics of the relativist view affirm that one is unable to determine whether a decision is better or worse than another from an ethical standpoint because there is no standard, per se, by which to judge them. Without being able to perform a comparative analysis, there is no reflective evaluation process by which to revise and improve upon ethical
standards. An evaluation of this kind is viewed as necessary to effectively formulate and implement organizational decisions that have valuable ethical dimensions.  

It can be argued that while moral standards are still available and used for reference, by viewing ethics from a relativist perspective, decisions about what is right or wrong are still significantly dependent on the specific situation at hand. Ethical relativism advances the existence of variability of ethical judgments across individual, group, role, or cultural contexts. It should also be noted that while practices may appear similar across individuals and organizations, the reasoning and moral standards behind the practices can differ dramatically. There is also the idea that for each individual, what is thought to be ethical or moral is what is actually right for that individual, as their perception of ethical correctness is based on their own standards. The expectation of consistency among individuals is not predictable. This supports the notion that while intellectual considerations are highly influential, ethical reasoning may not be arrived at through cognition, but through moral emotions.

Ethical relativism can also be considered in terms of group roles. “Since individuals within society are assigned one or more roles, morality and moral reasoning become a matter of properly defining these roles and the obligations attached

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6 McDonald, “Ethical Relativism vs Absolutism: Research Implications,” 457.
7 Ibid., 448-449.
8 Ibid., 450.
9 Ibid., 450-451.
to them."

A group in this context can refer to a social group, organization, or industry. Any evaluative criterion is no longer solely dependent on individual standards, but on the role of the individual and the expectations of the group as determined by both formal and informal power relationships. Ethical standards are, as a result, not individually determined, but actually prescribed by an individual’s group membership. What is determined to be an ethical action is collectively determined via the dynamics of a relationship, and is not necessarily consistent amongst different groups. The individual develops a moral standard in conjunction with the group and not unquestionably with their conscience.

A potential negative consequence of adhering to one’s role or group standards, as opposed to one’s personal moral standards, is that it may lead to extensive psychological conflict, and furthermore, that individuals may use their role/group standards as a shield to avoid fully considering the moral dimensions of the situation, or accepting responsibility for their actions. Morality then has the possibility of transforming into an exercise in following, without question, the role/group norms that are seen as accepted practice. This form of relativism is ubiquitous in the business environment and often summed up in statements such as, “we do it because everybody else does it”, or, “it is acceptable practice in the industry”. The common practice of the group becomes the benchmark for acceptable behavior. Individuals may rarely even be

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conscious of who first set the benchmark or that it has shifted from what they would have presumed prior to the groupthink.\textsuperscript{11}

Various theories of ethical relativism concerning the impact of an individual’s role in interpersonal relationships have been developed and expanded upon over time. These theories have had an important role in providing context for an individual’s ethical reasoning when impacted by their interactions with others. In particular, ethical and behavioral systems proposed by Lawrence Kohlberg, Carol Gilligan, Icek Ajzen, Henri Tajfel, and John Turner, provide an illustrative framework for the concept of relationship ethics and how associations with other individuals influence one’s ethical reasoning and rationalization of choices. The theories put forward by these researchers provide a foundation for which to discuss how personal relationships and exchanges with individuals who are of close rapport translate to and transform the relationships and professional environment that exist within the public accounting field between accountants/auditors and their clients. These ideas will also be used to provide additional modern perspectives of how these theories can apply in a professional environment.

**The Moral Reasoning Framework**

Lawrence Kohlberg began his research with the hypothesis that individuals develop their thinking about moral situations progressively. He developed a thesis which maintained that human thinking advances through stages of development. His

\textsuperscript{11} McDonald, “Ethical Relativism vs Absolutism: Research Implications,” 452.
studies focused on a developmental sequence of stages that revealed that individuals restructure their thinking about social and moral questions similar to how they develop their cognitive structure from the concrete to the more abstract. Kohlberg maintained that these stages of development occur in all cultures and provided an explanation for how individuals develop their thinking regarding social and moral problems. Kohlberg’s theory incorporates stages of moral reasoning with each stage providing a particular perspective on social and moral problems. He suggested that different individuals are at different stages of moral maturity and that this is important in understanding why certain individuals respond differently to moral dilemmas.

Kohlberg’s theory contradicts the notion of indoctrination. His theory does not believe that individuals can be successfully imbued with virtuous character traits such as honesty and fairness. Although a person may be able to grasp certain civic virtues, they may not be able to think about important civic issues in the same way or act according to the same learned virtue. Individuals only move through the identified developmental stages when they personally begin to revise their world view. This theory represents a typology and way of understanding how a person thinks about critical ethical issues.

Kohlberg’s theory of moral reasoning is comprised of six stages of moral reasoning categorized within three levels of patterns of thinking:

1. Pre-Conventional Level: An individual is responsive to cultural rules and labels of good or bad and right and wrong, but interprets these
labels in terms of consequences of action or the power of those who establish the rules and labels—punishment, reward, and favor exchange. This level consists of the following stages:

Stage 1 – The punishment and obedience orientation: The physical consequences of action determine its goodness or badness.

Stage 2 – The instrumental relativist orientation: Right action consists of that which instrumentally satisfies one’s own needs and occasionally the needs of others.

2. Conventional Level: Maintaining the expectations of the individual’s family, group, or nation is perceived as valuable in its own right, regardless of immediate and obvious consequences. This level consists of the following stages:

Stage 3 – The interpersonal concordance of good boy–nice girl orientation: Good behavior is that which pleases or helps and is approved by others.

Stage 4 – The law and order orientation: This is an orientation towards authority, fixed rules, and the maintenance of social order.

3. Post-Conventional, Autonomous, or Principled Level: There is a clear effort to define moral values and principles which have validity and application apart from the authority of the groups or persons holding these principles or the individual’s identification with these groups. This level consists of the following stages:

Stage 5 – The social-contract legalistic orientation: Right action is defined in terms of general individual rights and in terms of standards which have been critically examined and agreed upon by the whole society.

Stage 6 – The universal ethical principle orientation: Right is defined by the decisions of conscience in accordance with self-chosen ethical principles that appeal to logical comprehensiveness and consistency.¹²

The first, the pre-conventional level, is considered to be a self-centered method of moral reasoning wherein the driving forces behind personal decisions are the maximization of personal gain, or the minimization of personal loss or pain. This level is judged to resolve moral dilemmas less satisfactorily than higher levels of moral reasoning. At the conventional level, living within a community assumes increasing significance. It begins with merely acting to please one’s peers and superiors, and develops into a strict adherence to codes and laws external to the individual. The post-conventional level reflects a moral autonomy defined by self-determined moral reasoning. Here, an individual is prepared to challenge laws they consider bad or that frustrate natural justice.\(^\text{13}\)

According to Kohlberg’s research, movement through the stages occurs through an invariant sequence, with evidence suggesting that attainment of a higher stage will always have been preceded by attainment of all of the lower stages. An individual’s development progresses because of an attraction to the next higher stage of reasoning. The individual has the capacity to comprehend reasoning presented at the next higher stage of development. This higher stage may not always be adopted or verbalized and an individual can remain anchored in one stage. A constant reconsideration and restructuring of moral reasoning provides the basic elements of this developmental theory.

Based on Kohlberg’s research, adolescents usually arrive at the conventional level and adults converge toward the post-conventional level of reasoning. Kohlberg argued that the post-conventional level of moral reasoning requires a high degree of maturation on the part of the individual, and that expectations of those levels of moral reasoning should not be anticipated until individuals are well into their late twenties, thirties, and possibly beyond—assuming that the post-conventional stages are ever attained. Actually, according to Kohlberg, less than twenty percent of the adult population reasons at the post-conventional level. It is also not uncommon for adults to remain at the pre-conventional level. The last stages of reasoning are ones that few are likely to reach as they require a level of humility and wisdom that a society or discipline which emphasizes material well-being and an exclusive focus on the self, is unlikely to foster.\(^\text{14}\) Stage Four, the stage of law and order orientation—maintaining a given social order for its own sake—and located within the conventional level, is the most common stage amongst adults. At this level of Kohlberg’s development framework, an individual’s attitude is one of conformity to personal expectations and social order. There is a loyalty to it—to actively maintain, support, and justify the order—and to identify with the persons or group involved in it.\(^\text{15}\)

Within the public accounting profession, practitioners take on the role of one cohesive unit—the firm as a representative body, not an individual—whose role is to

\[^\text{14}\text{Lovell, “Moral Reasoning and Moral Atmosphere in the Domain of Accounting,” 62.}\]

\[^\text{15}\text{Galbrath and Jones, Moral Reasoning: A Teaching Handbook for Adapting Kohlberg to the Classroom, 5-36.}\]
service the client. The individual is guided to act as an embodiment of the organization as a whole while performing their duties for the client. As such, the individual identity is structured by who they are in a social context, and matters of communal determination are achieved through public processes of interpretation. This translates to a socially filtered level of ethical reasoning where absolute rules of moral behavior cannot be predetermined because they are subject to social discourses managed by the power imbalances between the professional and the client. Decisions made between these parties not only have individual consequences, but encompass the institutional pressures of the organization as a whole. When practitioners are defending an ethical code upon which their association has established its ethical base, it generally reflects a particular notion of individualism. This liberal individualism is linked to contractualism, a facet of individualism which portrays the individual as an isolated ego, obligated to others—superiors and clients—through legally defined contracts. Beyond these contractual relationships, the idea of obligation begins to lose meaning and can be viewed as the level of reasoning through moral issues not extending beyond the conventional level (i.e., Stage Four of law and order orientation). The individual rationalizes that the right thing to do is to react according to what is expected of them by others of significance. The reason for doing what they believe is right is the need to be a good person in their own eyes as well as that of others. The socio-moral perspective is that of the individual in a relationship

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and the concern for shared feelings. From this point of view, expectations and agreements take priority over individual interests.\textsuperscript{17}

A number of studies have been performed to investigate the level of moral reasoning of practicing accountants as well as accounting students. These studies have generally found that the reasoning levels of both groups are lower than those of other reference groups, possibly due to the nature of the profession. As a result of these conclusions, scholars have suggested the implementation of target practices to raise levels of ethical reasoning, implying that professionals who have higher levels of moral reasoning will act in accordance with more appropriate ethical judgments.\textsuperscript{18}

Critics of Kohlberg’s theory believe that it articulates the moral values of only the middle classes and western society. Kohlberg responded to these challenges by testing and providing a basis for his ideas in non-western settings and non-middle-class groups. Kohlberg argued that the world could not merely be divided into honest and dishonest people. For example, it is not a character trait of dishonesty that makes an individual cheat in any particular situation. The movement from the first level of moral reasoning to the third level reflects a growing awareness of the self in relation to others; although it does not include a sense of personal judgment, but rather a reflection of general social mores and behavior that have yet to be critically evaluated.

\textsuperscript{17} Tove Pettersen, \textit{Comprehending Care: Problems and Possibilities in the Ethics of Care} (Lexington Books: Lanham: 2008), 4.

by the individual. Kohlberg’s theory also notes that in order to develop moral reasoning, individuals need to engage in discussions over moral problems as well as confront difficult decision-making situations.\(^{19}\)

**Ethics of Care**

Carol Gilligan, an ethicist and psychologist, had an interest in ethics that was spawned by her objections to Kohlberg’s empirical studies in which women were consistently scoring lower than men according to his model of moral development. As his research assistant, she found his ideas powerful, but Gilligan rejected the implication that women were inferior to men in cognitive and moral development. She began to develop her own ideas regarding female development, focusing on the value of care, which she said was defined by a stronger sense of connection with other individuals. She argued that the notion of care and the desire to maintain relationships were more powerful explanations of behavior than merely an attachment to justice.\(^{20}\)

While Gilligan’s initial perspectives on the ethics of care were founded in female-centric origins, later generalizations of her theories as well as expansions upon her concepts by proponents can be applied across genders in terms of the impact of personal relationships on individual ethical reasoning. Gilligan underlined that the

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care perspective is “neither biologically determined nor unique to women”\textsuperscript{21}. The care perspective emphasizes an empathic association with others. Individuals are seen as connected in relation to their interactions with others, with others being seen and understood in their own situations and contexts. Within this perspective, ethical and moral problems are generally constructed as issues of relationships, responses, and how to take action in particular terms of others. When approaching problems, an individual endeavors to maintain the existing relationships and connections between interdependent persons. There is the concern over promoting the welfare of others, preventing any harm from coming to them, or of relieving their burdens and suffering. From this point of view, the individual has an interest in the outcome of the relationship and whether it is maintained or restored. These ideas differ from the justice perspective in which individuals are defined as separate in relation to others and problems are resolved by invoking impartial rules, principles, or standards.\textsuperscript{22}

Gilligan’s views on the theory of care begin from childhood. Just as children cannot survive without the caregiver-child relationship, interdependence is a common human experience. Throughout life, connections between oneself and others is both fundamentally important and a basic feature of human lives. In addition to this interdependence, there is also the role of emotions in comprehending ethics of care. According to Gilligan, care has both cognitive and affective dimensions. It is an interplay of both thinking and feeling. They are not dissociated, as in the course of

\textsuperscript{21} Pettersen, Comprehending Care: Problems and Possibilities in the Ethics of Care, 8-9.

\textsuperscript{22} Ibid.
development, individual processes are transformed into interpersonal ones. The acquisition of ethically relevant knowledge occurs through human connections intermingled with feelings.\textsuperscript{23}

Other ethical philosophies which differ in this perception view emotions with great distrust and moral inferiority. The presence of emotions is associated with a lack of control and the clouding of judgment, making the moral agent partial. Gilligan’s unwillingness to distinguish between emotion and understanding imply indispensability—feelings are not necessarily primary but nonetheless cannot be removed from the equation.\textsuperscript{24}

In the mindset of care, the individual should ask themselves how they would feel if they were in the same position, aiming to perceive the needs of others in the others’ terms. When deciding what decisions are ethical from this reference, the goal of the individual is to recognize the position the other is in, while still seeing oneself as different and not allowing judgment to be overwhelmingly influenced by the others perspective. Both frames of reference need to be integrated via co-feeling, by which an individual can achieve knowledge of the other person’s viewpoint and emotions, and at the same time learn more about one’s self. Co-feeling goes beyond simple sympathy or empathy in linking emotions. It encompasses the overall notion of care. Having achieved co-feeling may also result in the agent performing an action they do not like

\textsuperscript{23}Pettersen, \textit{Comprehending Care: Problems and Possibilities in the Ethics of Care}, 51-52.

\textsuperscript{24}Ibid., 53-54.
or do not want to do, motivated instead by the concern for the perceived good of another.  

Cognitive abilities and emotions are mainly developed not as an individual process, but in relation to others. Together they show that an agent’s ethical values are not the result of rational choice alone, but of the interplay between emotions, reflections, and experiences. Becoming a mature moral agent is not an individual process. Contextual sensitivity is also a determining factor in the agent’s reading of particular circumstances involved. In a professional environment, concerns regarding severing ties with clients arise over ensuring that the ending of the relationship does not harm the interests of the individual as well as the organization they work for. In such situations abandonment and detachment in private relationships can be a problem. Depending on the how intimate the relationship is, the agent may be concerned with protecting the interests of his client, not necessarily due to formal regulations as a result of an increased awareness of how vulnerable to and dependent on the agent’s own manner or conduct the client may be. Therefore, individuals may be as vulnerable in professional as in private relationships. In the case of public accounting profession, relationships and relationship building are the nucleus of the industry and are critical to its success. Strong relationships lead to new engagements as well as secure existing ones. Establishing relationships beyond surface connections, 

25 Pettersen, Comprehending Care: Problems and Possibilities in the Ethics of Care, 55-56, 60.
26 Ibid., 61-62.
27 Ibid., 165-168.
with an emphasis on personal bonding and rapport building is heavily promoted. As a result, the professional feels a sense of duty and obligation to preserve this association and their client’s confidences, as well as to protect them from harm. Especially in cases where the consequences are abstract and do not involve immediately perceivable dangers, a professional may find themselves at an ethical impasse where preserving a relationship greatly outweighs all other potential concerns.

**Theory of Planned Behavior**

Icek Ajzen and Martin Fischbein were prominent theorists in the field of behavioral intentions. Their work involved reflecting on an individual’s decision to follow a course of action, including the development of an index categorizing how willing an individual was to perform a behavior. Ajzen and Fischbein’s views that the influence of attitude on behavior is mediated through behavioral intentions are the basis for their theory of reasoned action. This theory maintains that attitude is a determinant of intention and that social pressure is also likely to determine people’s intentions. Behavioral intentions are determined by attitudes—overall positive and negative evaluations of behavior—and the perceived social pressure from significant others, or *subjective norms*.  

Ajzen’s theory of planned behavior expanded on the theory of reasoned action by including perceived behavioral controls as a determinant of both behavioral

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intention and behavior. His expanded model examined the influence of personal, social and organizational factors on ethical intentions. Specifically, the model was designed to test the direct effects of attitudes, subjective norms, perceived behavioral control, moral sensitivity, and ethical climate.\textsuperscript{29} The theory of planned behavior proposes

(a) that the best predictor of behavior is the person’s intention or decision to perform it (e.g., “I intend to do X”), (b) that intentions are determined by people’s evaluations of performing behavior (attitude; e.g., “Doing X would be good/bad”) and by their perceptions of social pressure to perform it (subjective norm; e.g., “People who are important to me think that I should do X”) and (c) that external variables (variables not contained in the model) only have indirect effects on behavior—these variables are either moderate, or their effects are mediated by, components of the model.\textsuperscript{30}

This model incorporates both social influences and personal factors as predictors of social and health behaviors. Social influences are conceptualized in terms of the pressures that individuals perceive from other individuals important to them to perform, or not to perform, a behavior. This is compounded by beliefs about the extent to which these others want them to perform a behavior. The concern is with perceived social pressure—the person’s potential to gain approval or suffer sanctions from significant others for engaging in a behavior. As a result, the opinions and actions of


\textsuperscript{30} Pettersen, \textit{Comprehending Care: Problems and Possibilities in the Ethics of Care}, 102.
significant parties involved provide information that people may use in deciding what to do.\textsuperscript{31}

The beliefs of the individual about whether important others would support the behavior will determine their motivation to act. The desire to comply varies from person to person. Additional factors can also influence the relationship between intention and behavior. These include the passage of time, the gathering of new information as it becomes available, as well as the level of commitment and confidence between the individuals.\textsuperscript{32} Individuals may also believe that they have little control over their chosen behavior depending on the extent of their motivations.\textsuperscript{33}

A 2005 study published in the \textit{Journal of Business Ethics} applied Azjen’s theories to the role of ethical climate and organizational factors on accounting professionals. The study attempted to gain a better understanding of the factors that directly influence accountants’ ethical intentions. Findings suggested that the theory of reasoned action provides a useful framework for exploring factors that influence public accountants’ ethical intentions. It also noted that there is a direct relationship between subjective norms and attitudes.\textsuperscript{34}

\textsuperscript{31} Pettersen, \textit{Comprehending Care: Problems and Possibilities in the Ethics of Care}, 43-45.


\textsuperscript{33} Ibid., 167.

\textsuperscript{34} Ibid., 178.
An individual’s intentions to behave ethically or unethically are strongly related to the individual’s perceived organizational environment specific to the situation and normative beliefs. If auditors, in their interactions with clients evaluate a suggested behavior as positive, and believe that others—with whom they have a close relationship—want them to perform the behavior, the likely result is higher intention and motivation to perform that behavior. The impact of professional and client pressures can result in the auditor feeling an obligation to the wishes of the client. If an individual perceives a situation as unfair, they may engage in behavior otherwise perceived as unethical, because they do not believe they are in the wrong. As such, there are strong correlations between these significant relationships as indicators of behavior, ethical or otherwise. Heightened sensitivities to social influences can impact behavior because an individual’s intentions may appear in their own minds as ethical, despite the normative consensus of society.

Social Identity Theory

Identity theory places emphasis on the meaning attached to the multiple social roles that people play and seeks to address how people sort through and prioritize the various roles in a given situation. Social identity theory, originally formulated by Henri Tajfel and John Turner, defines these identities as category-based to which people feel attached.\(^{35}\) The social identity theory posits that individuals classify

themselves into multiple social groups such as occupation, organization, division, gender, nationality, ethnicity, and age. These multiple identities are distinct and may either be compatible or compete with one another.\(^\text{36}\) Individuals utilize these social identity self-categorizations as a point of departure for thinking and relating, thus increasing the likelihood that the individual will internalize the group’s norms and values. When an individual adopts a particular identity, it affects the way they interpret information and make decisions.\(^\text{37}\) Moralization is then promoted by a concern for shared, defining values—through an internalized focus on values and conformity—based especially on the significance one places on being a member of a particular social group.\(^\text{38}\)

Social identities explain how individuals conceive of themselves, how they identity with and form commitments to particular groups, and how they respond and act in relation to other groups in terms of different interests, ideologies, values, and expectations.\(^\text{39}\) Social identity, in turn, may be a stronger binding tie than profession-determined, economically oriented roles or stakeholder priorities.\(^\text{40}\)


\(^{37}\) Ibid.


\(^{40}\) Ibid., 81.
The tendency to moralize another’s behavior can result in injuries to shared identity. The perception is that there is a potential threat to social identity by perceiving fellow members within the group as immoral. There are also motives for conventionalizing unethical behavior as opposed to moralizing it, especially when using the power of reward and coercion.\(^{41}\)

Researchers have found organizational identification in a variety of settings, including work groups. This cognitive-based identification construct supports the idea that professionals, including individuals such as auditors, have multiple identities. Social identity theory predicts that employees in service organizations where direct interaction with clients is a major part of the work will begin to identify with their clients. Auditors may work at the same client on a daily basis for long periods and on a recurring yearly basis. This is even more likely within the public accounting field, where firms and clients stress that auditors must understand the client’s business, accounting, and information systems, as well as know its key personnel, in order to perform an effective and efficient audit.\(^{42}\) An additional factor that may affect a practitioner’s client identification is client image. Individuals tend to identify with groups that have an appealing image, which leads to heightening the individual’s own image and self-esteem within the group.\(^{43}\)

\(^{41}\) Bell and Hughes-Jones, “Power, Self-regulation and the Moralization of Behavior,” 503, 506.

\(^{42}\) Bamber and Iyer, “Auditor’s Identification with Their Clients and Its Effect on Auditors’ Objectivity,” 4.

\(^{43}\) Ibid., 6.
The Social Psychology of Personal Relationships

In his *Nicomachean Ethics*, Aristotle’s Treatise on Friendship concludes that friendship is one of the best things human life has to offer. It is its own sense of virtue. As essentially social beings, it is necessary to our leading truly happy lives. Being necessary for a fully satisfying life, most would not voluntarily choose to be without friends. He roots this practice, and how it contributes to ethics and morality, in the natural history of our species.\(^4\)

Personal relationships are steeped in cultural, attitudinal, societal, normative, conversational, economic, and cognitive contexts that can subtly modify individual tendencies to process information in particular ways as those individuals accommodate the inputs of other minds. Social psychology attests to the fact that relationships are outside the scope of single minds. Gathering information from single individuals alone distorts our understanding of relationships. To comprehend them fully, the behaviors, practices, and processes that make up a social experience must be explored. This investigation will also involve an exploration of the ways in which exterior influences impinge upon individual minds. The psychological similarities between individuals are best understood as partly played out by social contexts and not as a purely cognitive relationship that exists between individuals. Relationships should also be considered in terms of culture and environment. An individual’s surrounding culture

and environment (i.e., social, workplace, family) provides individuals with their vocabulary for relationships. Expressions of feelings towards other individuals are likely to be modified by context. The construction of the form for a relationship is not only a matter of cognition, but also of coordination of one’s own behavior with that of a friend, partner, network, or wider social group. Consequently, any resulting behavior is responsive to places, times, and social rules. All of these constructions are essentially manipulations of defining systems that involve sharing and coordination of meaning with others, which further involve the coordination of expectations of both one’s own and others’ behavior.\(^{45}\)

In examining inclinations to respond to particular patterns in a specific manner within the context of a given relationship, relationship specific motives must be considered. These relationship specific motives are especially evident in situations involving personal dilemmas between the well-being of the individual and the well-being of the other person in the relationship. One important motive concerns trust. When an individual reacts in a dilemma that results in the overall good of the relationship, such behavior is seen to positively strengthen the existing commitment and increase the chances for pro-social actions in the future.\(^{46}\) In this relational identity orientation, the satisfaction of the individual’s psychological needs depends on the

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\(^{46}\) Ibid., 101.
well-being of the other party with no motivation to pursue the common good beyond the limit of that relationship.

Psychologists have argued that humans have a pervasive, near universal need to belong. Human beings have a drive to form and maintain lasting, positive, and significant interpersonal relationships. Possessing this sense of belonging leads to (1) being eager to forming new bonds and disliking breaking them, (2) devoting considerable cognitive processing to interpersonal interactions and relationships, and (3) feeling threatened by real, potential, or imagined changes in one’s status of belonging with negative effects linked to decreases in the level of belonging.\textsuperscript{47} Individual behaviors, both ethical and social, are impacted and adjust with the need to maintain successful relationships.

Interpersonal relations, in the area of organizational behavior, are a prominent topic in service-oriented industries. In exploring the nature of relationships in terms of stakeholders, behaviors are driven to a large extent by institutional pressures that are beyond the control of the organization and have ethical consequences for the employees in terms of how they self-evaluate in a service capacity. Psychologists have begun exploring how impersonal service delivery compares with more personal service delivery. Studies have consistently found that clients that have a personal relationship with greater interaction with a specific service provider were more satisfied with the

service delivery than those who did not have personal relationship. These influences have a great impact on how companies choose to do business and how the importance of relationships is promoted in the workplace, specifically in the public accounting industry. Building strong lasting relationships is key to business success.

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CHAPTER TWO
PUBLIC ACCOUNTING AND PROFESSIONAL BIAS

Ethical behavior is difficult for researchers to measure or to analyze, especially as they play out in real-life scenarios. Due to the inherent challenges in quantifying what is ethical and what is not, results are often imprecise. Much of the work that has been done is theoretical and involves the creation or application of ethics models. In order to draw conclusions from this research—based on the many variables involved—one must rely on judgment and assumptions as they study an individuals’ actions, reactions, and reasoning for their behavior.¹

The concept of independence, in professional auditing, is wider and more ethically challenging than simply maintaining an arm’s length relationship with clients.² The concept of independence in the public accounting profession is understood as freedom and separation from those factors that may compromise an auditor’s ability to make unbiased audit decisions. This includes maintaining an appropriate level of objectivity—making unbiased, conflict of interest-free audit judgments, as opposed to acquiescing to client wishes—as well as professional


skepticism.³ This not only applies to accountants, but to all employees representing the accounting firm in an external auditing capacity. It is important to examine how public accounting professionals, as facilitating agents for the firm, interact with each other, with clients, and with other participants in their working relationships. When participating in an auditing engagement, auditors do not work in isolation. It is crucial to understand how the people, tasks, and environment that auditors experience influence the auditors’ judgment and performance. Motivations for an individual’s actions may not always have solely self-serving intentions. Interactions between these professionals and important stakeholders are likely to be multifaceted and strategic, as each party has a particular set of interests, seeks to influence each other, and correspondingly needs to form expectations about the other participating party’s reactions.⁴

The correlation between individual morals and professional ethics can also be affected by the identity and uniformity of its members’ morals. Members of the same organization may have similar morals because they selected their particular career based on the organizations’ reputation within the public.⁵ Professional identity is


defined as the component of a person’s social identity in which individuals self-classify based on their profession. Professional identity involves the strength of an individual’s identification with or involvement within a profession. A practitioner’s professional commitment is positively associated with rule observance attitudes, which include adhering to professional practices, standards, and codes of ethics. This professional identity may further manifest itself through a desire to protect the profession from reputational damage. This desire to protect the profession may also motivate its members to avoid public disclosure of violations of ethical guidelines.6

Previous studies involving business ethics and morality in business have suggested that pressure to compromise personal standards is felt most at the middle and lower management levels. Others have noted that competition can cause professionals to ignore ethical considerations, with pressures from superiors to achieve results causing unethical behavior. Ethical standards tend to be highest with the youngest practitioners within the field as well as with those in the final decades of their careers. Individuals who participated in unethical practices considered relatively minor also have a tendency to later attempt more serious offenses. If earlier attempts yield no repercussions, a person has a greater chance of assuming that more serious transgressions will also have minimal consequences.7


There may be some difference between the ethical applications of policy of less experienced practitioners and the more seasoned ones, so it is important to consider interpersonal communication and its relation to personal ethics within organizations. Professionals may agree with the professions’ ethical code at the beginning of their careers, only to then discover the code’s shortcomings as they attempt to apply it over time. Conversely, some professionals may develop a greater appreciation for the code as they encounter ethical conflicts throughout their career.\(^8\) Among professionals in the industry, there is also the opinion that as practitioners move up in rank at their respective firms, they progressively align their morals and ethics with the regulations of the profession. This conscious or subconscious affiliation of career success to a sense of community causes them to positively identify with the policies that define the organization.\(^9\) As more tenured professionals, they may have faced difficult ethical situations throughout their careers. As a result, they may also understand that ethics rules should be utilized as adaptable guidelines that are open to interpretation. A strict adherence to institutionalized rules may not automatically deliver the intended ethical consequences.\(^10\)

There are significant obedience and conformity pressures that public accounting professionals face across all levels. Based on multivariate analyses


\(^9\) Ibid., 76.

\(^10\) Ibid., 76-77.
performed, it was noted that professional identity and moral intensity were significant factors in evaluating the willingness and likelihood of reporting ethical violations. It was also noted that the level of commitment of an individual to the organization versus to colleagues, was also a deciding factor in determining their inclination to report wrongdoings, with greater organizational loyalties leading to greater reporting of violations. Practitioners must evaluate trade-offs of commitments to their colleagues—internal as well as clients—against those of their firm in deciding how to approach unethical behavior.\textsuperscript{11}

In considering the layers of workplace influence as it relates to commitment, employee commitment to top management, supervisors, and work groups contributed significantly more than organizational commitment as a predictor of several behaviors. In analyzing this influence in terms of clusters—made up of colleagues, the organization, and the profession—it has been shown that while commitment varies on an individual basis, the level of commitment with which a person will self-identify tends to be stronger with colleagues, then the organization, and least strong with the profession. Individuals may exhibit varying levels of organizational commitment depending on factors that include length of employment and job satisfaction. In contrast, colleague commitment involves a sense of responsibility, reliability, and readiness to support colleagues. These complex relationships lead to multiple influences on how an individual will approach an ethical violation. In parallel with the

\textsuperscript{11} Taylor and Curtis, “An Examination of the Layers of Workplace Influences in Ethical Judgments: Whistleblowing Likelihood and Perseverance in Public Accounting,” 22.
ethics of care concept that asserts that an individual craves being a part of relationships, people also need to be committed to something. If a person becomes less committed to their organization, they may channel their commitment in other directions, such as to their colleagues. Certain circumstances may prompt accounting firm professionals to act on behalf of their colleagues, regardless of the welfare of the firm as a whole, creating conflicting allegiances. Individuals must weigh all of these influences, attending to each of the layers during their decision process, to arrive at the primary motivating factor for their behavior.\textsuperscript{12} When contemplating what decision to make when influences are in conflict against one another, ethical or unethical, the professional must choose between their commitments to the two parties—colleague and organization—weighing the harm to the organization against the harm to the colleague. Balancing potential harm with potential benefits to different parties must be a goal. In this case, a prioritization of loyalty must be determined, for either team allegiance or for conscientious individualism.\textsuperscript{13} Past studies have not found a significant positive correlation between ethical violations reporting and commitment to the organization or firm loyalty.\textsuperscript{14} Individuals tend to identify themselves with groups whose values appeal to them, rather than with an abstract organization.\textsuperscript{15} These motivations for individual actions can also be viewed in a utilitarian sense, where

\textsuperscript{12} Taylor and Curtis, “An Examination of the Layers of Workplace Influences in Ethical Judgments: Whistleblowing Likelihood and Perseverance in Public Accounting,” 23-25.

\textsuperscript{13} Ibid., 25.

\textsuperscript{14} Ibid.

\textsuperscript{15} Bamber and Iyer, “Auditors’ Identification with Their Clients and Its Effect on Auditors’ Objectivity,” 4.
individuals choose to make ethical decisions that benefit the most people in a scenario, regardless of the societal constraints in place (i.e., ethics codes or laws). As utilitarianism places its focus on the greatest good, justice may become secondary.\textsuperscript{16}

Previous study findings suggest that when considering commitment to one’s own moral beliefs, or moral intensity, an auditor’s behavior is issue-contingent. One’s business ethics cannot be separated from one’s personal ethics.\textsuperscript{17} Measures of magnitude and probability influence individual ethical judgments and differ amongst auditors.\textsuperscript{18} In certain circumstances, a practitioner may decide to make a decision based on their own internal moral judgments, despite how the judgment would be viewed against the established ethical code.

It has been asserted that in order to make ethical decisions, an individual must have sufficient perseverance, be able to withstand fatigue, and be able to overcome obstacles in order to follow through on their moral intentions. Making an ethical decision is a process rather than an event, and the decision may be repeated in various forms. The notion of persistence is important in this respect because the process often occurs in multiple stages, including responding to those involved and subsequent


\textsuperscript{17} Lewis, “Defining ‘Business Ethics’: Like Nailing Jello to a Wall,” 377.

reporting to superiors.\textsuperscript{19} Fear of widespread retaliation and negative reactions by individuals within the firm and at the client is also a factor when considering making difficult ethical decisions. As the accounting firms’ role is of a service provider, with the firm being employed by the client, and the client paying for the engagement, there is the concern of keeping the client happy and maintaining a strong, cooperative association. There is the fear that by challenging the client, regardless of how measured the reasoning behind the action, the client would react in a disagreeable manner. Depending on the ensuing ramifications, participating stakeholders cannot always be trusted to respond appropriately. Even when the wrongdoing is damaging to groups external to the organization, the client as well as those within the organization may view the whistleblower as the cause for losses.\textsuperscript{20}

The Independent Standards Board was established by the American Institute of Certified Public Accountants (AICPA) and the Securities and Exchange Commission (SEC) to perform thorough and open studies regarding issues of auditor independence and to improve independence standards for auditors of public companies. The board has identified auditor familiarity with the client as one of five major threats to auditor independence. In order to foster greater auditor independence and objectivity, the Sarbanes-Oxley Act of 2002 incorporated legislation that banned firms that provided independent auditing services from also providing various other impartial consulting services.

\textsuperscript{19} Taylor and Curtis, “An Examination of the Layers of Workplace Influences in Ethical Judgments: Whistleblowing Likelihood and Perseverance in Public Accounting,” 22.

\textsuperscript{20} Ibid.
activities as well as tightening partner rotation requirements. Partners are only permitted to serve a public client for a limited period of time in order to maintain auditor independence and quality of audit services. This regulation is only required of the lead client service partner, as the ultimate reviewer of the audit engagement, and is not mandated for any other practitioners serving the client. The assumption behind this regulation is that close ties between auditor and client are inappropriate because they impair the auditors’ objectivity and professional skepticism while performing the audit. However, auditors need some familiarity with their client in order to understand them well enough to plan and perform an efficient and effective audit.\(^\text{21}\)

Social identity theory dictates when service organization employees who have worked for a client for an extended period of time begin to identify with their clients, there are circumstances in which the these employees know their client’s company better than their own employing company, leading to identity and loyalty problems.\(^\text{22}\) It is common for auditing professionals to begin with and stay on as part of the auditing engagement team at a company from their initial employment as consultants, through their careers into senior management and above. They normally work on site at the client for the majority of the auditing period and are encouraged to not only build strong relationships with their client contacts but to embed themselves within the client


\(^{22}\) Ibid., 4.
culture. Oftentimes practitioners view clients as potential future employers.\textsuperscript{23} When considering leaving their current employers, many professionals seek opportunities that they are familiar with and that fit their skills. Key strategic clients are often an accounting firm’s largest clients, and practitioners will spend long, continuous periods of time working for these clients. In turn, because of the accounting firm’s economic dependence on the client, there may be a financial incentive to align with the client’s position.\textsuperscript{24} These clients are often also considered desirable because of the visibility and valuable work experience they provide.\textsuperscript{25} Interpersonal relationships built between these practitioners and their clients on the basis of incentive presents a risk to independence, impairing objectivity and reducing professional skepticism, when the likelihood of the practitioner acquiescing to the client-preferred treatment increases the more they identify with the client.\textsuperscript{26}

In-group bias suggests that individuals cooperate with members of their own group to a greater extent than with non-group members.\textsuperscript{27} Individuals may want to make decisions based on the wishes of others within their group (e.g., fellow engagement team members or key client contacts) because they rely on those

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\textsuperscript{23} Bamber and Iyer, “Auditors’ Identification with Their Clients and Its Effect on Auditors’ Objectivity,” 4.
\textsuperscript{24} Ibid., 8.
\textsuperscript{25} Ibid., 6.
\textsuperscript{26} Ibid., 7.
\textsuperscript{27} Taylor and Curtis, “An Examination of the Layers of Workplace Influences in Ethical Judgments: Whistleblowing Likelihood and Perseverance in Public Accounting,” 23.
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relationships. An auditor’s dependence on established relationships within the client firm may lead to insufficiently assessing source credibility. An auditor may give undue credence to client representations and fail to quantify explanations in order to determine the adequacy of those explanations. They may over-rely on procedures performed by their client contacts and rationalize the need for no additional follow-up, especially in the circumstances where analytical procedures are used.\textsuperscript{28} Time pressures, internally-driven or from the client, have also been found to be conducive to negative auditor performance.\textsuperscript{29} In many organizations with results-oriented environments, there is often an implicit directive received from the top that much more weight should be placed on job completion than on any legal or ethical means needed to accomplish it.\textsuperscript{30} It has been revealed that professionals who identify with a client are more likely to underreport actual hours worked on a project because they do not want the client to pay for work performed inefficiently.\textsuperscript{31} This climate can also breed an environment where client demands have a strong influence over actions taken by professionals.


\textsuperscript{29} Ibid., 50.


\textsuperscript{31} Bamber and Iyer, “Auditors’ Identification with Their Clients and Its Effect on Auditors’ Objectivity,” 4.
auditors. Less experienced auditors are more likely to concede when facing high-risk engagement clients who will presumably pressure the auditor more.\textsuperscript{32}

According to research performed on moral development, an accountant’s level of moral development actually declines when they move from a supervisory level to a partner level, with levels of moral development being inversely related to rank within the accounting firm.\textsuperscript{33} This can be attributed to increased pressure on partners to capitalize on their established client relationships in order to acquire additional service engagements to obtain greater profits for the firm. As a partner, their stake in the profitability of the firm is greater, and therefore, has greater influence on their decision-making.

Managing partners who define and promote firm values and policies, audit supervisors vying to maximize engagement profitability in their quest for a partner appointment, and lower level employees who are unsure where the ethical lines of audits are drawn, all face serious pressures as they make audit-related decisions in a fiercely competitive marketplace.\textsuperscript{34} For auditing firms providing services that are not specifically in the scope of the financial audit, there are other considerations. The


\textsuperscript{34} Satava, Caldwell, and Richards, “Ethics and the Auditing Culture: Rethinking the Foundation of Accounting and Auditing,” 274.
availability of this type of work has been on a rate of decline as more and more companies award these types of jobs to competitor firms as a means to uphold independence in the public eye. Auditors are under tremendous pressure to retain client business for both audit services and supplementary non-audit services provided by their firm.\textsuperscript{35} These conflicting priorities make withstanding client pressure in currently held engagements even more difficult.

Although it is understood that there are a complex web of interpersonal relationships that may be the driving force behind ethical behavior, how do these influences and interdependencies ultimately lead to unethical decision-making by practitioners? How do the external pressures from the significant personal interactions individuals have with others allow them to rationalize unethical behavior? These questions give rise to the construct that powerful stimuli and sway by significant others lead individuals in psychologically reconstructing situations to justify and suppress their moral intensity.

Individuals that choose to behave unethically typically do possess conventional values. They are able to commit delinquent acts by subscribing to certain rationalizations that define these acts as appropriate to the situation. Under these circumstances, the self-regulatory mechanisms governing moral conduct do not come into play unless activated by the individual. There are psychosocial maneuvers by which moral self-sanctions are selectively disengaged from unethical conduct. In

\textsuperscript{35} Satava, Caldwell, and Richards, “Ethics and the Auditing Culture: Rethinking the Foundation of Accounting and Auditing,” 274.
essence, this concept of ethical fading through self-deception allows an individual to trick themselves into behaving under certain influences, while, at the same time, believing that their moral principles are being upheld. These rationalizations facilitate moral disengagement by providing reasons for why the specific unethical acts are justifiable or excusable exceptions to general normative rules.\textsuperscript{36} This practice is consistent with cognitive dissonance theory which argues that individuals will go to great lengths to change their attitudes to reconcile their behavior or enhance the value of their choices, when two cognitions relevant to a decision are dissonant.\textsuperscript{37}

The moral justification for one’s behavior involves cognitive reconstruction of the behavior itself. People often do not intend to engage in unethical behavior until they have first justified to themselves the morality of their actions. As part of this process, unethical behavior is made personally and socially acceptable by placing it in the context of valued purposes. The practitioner neutralizes their wrongdoing by appealing to a higher loyalty; this higher loyalty is the allegiance to the bonds of their relationships. This is commonly expressed by the concept of “necessary evil” in which people reason that ethical norms have to be sacrificed for more important causes.\textsuperscript{38}

With respect to their moral awareness, the individual may perceive the moral intensity of an issue differently by reconstruing the harm and social consensus involved. For


\textsuperscript{37} Moore, “Moral Disengagement in Processes of Organizational Corruption,” 132.

\textsuperscript{38} Barsky, “Investigating the Effects of Moral Disengagement and Participating on Unethical Work Behavior,” 62.
example, if an auditor chooses to accept a known lie by a client on a particular accounting method, they may reconstruct the act as important in order to avoid a larger network of consequences, such as preventing a client employee from suffering supervisory reprimand or termination. The harm done in accepting the false statement as accurate appears lesser in magnitude compared to the consequences that may impact the client, the party to which the auditor has a greater emotional investment. This moral justification serves to lower perceived costs and heighten the perceived benefits of engaging in deception.\(^{39}\) In the case of previous high profile, financial scandals in which company financials were misstated, the individuals involved in these acts could be said to have done so for the benefit of employees and shareholders.

An alternative impetus for a practitioners’ rationalization of unethical behavior occurs when an individual denies responsibility for their actions due to circumstances beyond their control. These circumstances may be facilitated by factors that include management orders, peer pressure, or the belief that others are acting in a similar manner.\(^ {40}\) In some corrupt cultures, those who participate in these sorts of collusions are often termed “good team players”.\(^ {41}\) This displacement of responsibility can also interfere with an individual’s intention to act ethically by decreasing the moral intensity of a situation. An individual’s decision to be involved in deceptive behavior


\(^{40}\) Ibid., 63.

\(^{41}\) Moore, “Moral Disengagement in Processes of Organizational Corruption,” 130.
is perceived as less harmful than it really is and, potentially, normatively acceptable. As a result, a practitioner may depart from impartiality with respect to the ethical dilemmas they face, and employ cognitive strategies and tactics that enable them to legitimatize the pursuit of behavior they feel will benefit them and others. A practitioner may follow the orders of a supervisor despite objections they may have over whether the orders are ethical because they feel there may be significant repercussions to this relationship. The practitioner may feel that this could negatively affect the ongoing work dynamic and possibly even affect their own ascent up the corporate ladder. In contrast, the individual is receptive to the rewards that they will receive if they act in the interests of others. There can be organizational payoffs to simplifying one’s moral reasoning and minimizing ethical concerns. Practitioners may further rationalize this behavior by placing the responsibility on their supervisor as the first person to initiate the ethical lapse. Reward structures in many organizations prioritize short-term gains over long-term survival, as well as profits over all else. While acting unethically does not guarantee increased profits, in some circumstances, it is likely it could lead in this direction.

Moral disengagement should be considered interactive, an outcome of the interplay between personal and social influences. It is important to think of this concept as a malleable property of individuals, a result of the continued reciprocal

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influences of the individual on their environment and vice versa. It is not necessarily a reflection or measure of the internal morals of the individual. This rationalization of unethical behavior is also context dependent. It relies on the notion that individuals segment their moral lives, applying different sets of ethical standards in different contexts. The practice of cognitively restricting the unethical actions that one engages in can result in individuals making habitual use of similar justifications in the future and embedding those practices within their normative behavior. If a practitioner is constantly exposed to the same culture and relationships over time, they will then be more prone to repeating the same types of decisions as they have in the past. An otherwise ethical individual can become effectively socialized into wrongdoing.

This is not to say that this will be the case for all practitioners. Individuals are not equally likely to participate in these idiosyncratic practices. When forming relationships, professionals differ in the level of intimacy with which they maintain their relationships. The level of allegiance in significant relationships depends on emotions, compatibility, and interests involved. Additionally, individuals that have a greater propensity to morally disengage may be more likely than others to make key early decisions that can lead to more easily committing unethical actions. Also, individuals with higher levels of cognitive complexity, such as those in the higher

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45 Ibid.

46 Ibid.
stages of Kohlberg’s moral reasoning framework, will find it more difficult to engage in this type of moral disengagement, applying principles in a more logically comprehensive manner. On the other hand, some professionals may unfortunately not be able to separate themselves from the many compulsory influential factors that can lead unethical conduct.

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47 Moore, “Moral Disengagement in Processes of Organizational Corruption,” 133.
CHAPTER 3
ETHICS POLICY IN PRACTICE

The method by which individuals demonstrate professional identity—the strength of an individual’s identification with or involvement in a profession—is through adherence to the standards and practices of the profession.\(^1\) A professional code of ethics serves as the document that offers guidance and serves as a moral anchor for members in workplace situations where they encounter novel and confusing ethical dilemmas. This framework should act as a compass, providing not the ultimate destination, but a direction through more informed or alternative courses of action.\(^2\)

Public accounting ethics codes are designed to promote integrity, objectivity, public responsibility, client confidentiality, and professional skepticism.

In order to achieve its intended function, an ethical code of conduct should include but not be limited to a) consistent, normative standards for employees, b) guiding principles and standards of behavior required of the organization’s members, c) a communication system that allows management to consistently reiterate to the employees of the company the standards of behavior with which they are expected to conform, d) guidance to employees who find themselves confronted with difficult choices in the midst of performing their duties, e) policies that establish an appropriate


moral tone within the company, and f) a self-regulatory instrument for organizations. The code fosters pride in the organization and strengthens corporate identity and allegiance among its members. This can only be achieved if the code is effectively socialized amongst members of the firm and embedded within its organizational climate, institutionalizing the established morals and values into the corporate culture.³

Upon joining the profession, individuals are expected to observe the professional ethics codes and policies of the organization. One method by which this can be achieved is through a mentoring process in which new employees learn from authority figures who act as mentors.⁴

The main purpose of an ethics code is to provide guidance to practitioners. When faced with decisions having ethical implications, practitioners can look to their ethical codes, policies and training to ascertain the company’s recommended action. As a result, an effective and enforced ethical code should provide the profession with a degree of stability and consistency in the ethical decision-making of its members.⁵

Ethics codes are also used as managerial tools as well as legal self-defense mechanisms that companies use in order to protect themselves from having to take legal


⁵ Ibid., 69.
responsibility over the actions and behaviors of individual employees as well as to
insulate themselves against significant criminal fines.\textsuperscript{6}

The intent in creating an effective ethics policy structure is that the individual
will eventually adopt the profession’s code as part of their own personal morals. The
apprehension is that instead the practitioner will only abide by the rules out of
obligation or fear of punishment while continuing to maintain personal ethics that
differ from those of the company. If the personal morals of the employee have no
semblance to the standards defined within the ethics code, practitioners will be more
inclined to disregard or violate the firm’s rules. Certain practitioners may align their
personal morals with the firm’s ethical codes early in their careers and then become
disillusioned with the system as the code is repeatedly revised.\textsuperscript{7} As a result, it is
recommended that codes not be revised unless critically necessary.\textsuperscript{8} Changes made to
ethical codes are often due to recent economic and social events, governmental
influence, and growth and change within the profession. They also may be indicators
of the trend towards good citizenship by institutions concerned with maintaining the

\textsuperscript{6} Chua and Rahman, “Institutional Pressures and Ethical Reckoning by Business Corporations,”
313-314.

\textsuperscript{7} Beets, “Personal Morals and Professional Ethics: A Review and an Empirical Examination of
Public Accounting,” 70.

\textsuperscript{8} Ibid., 81.
public trust. These changes may also assist in ensuring a company’s existence in an environment filled with internal and external pressures.\textsuperscript{9}

Another significant argument for establishing a professional code of ethics is the concern that some individuals will act exclusively in their own self-interest if not restricted in their behavior. An ethics code can influence this egocentrism by requiring adherence to rules which are there to benefit all members of the organization. Ethics rules, however, should not be only be designed for members of the profession, but for the public that that they serve. As a consequence, codes designed to adequately serve both professionals and society may find the interests of the two occasionally in conflict.\textsuperscript{10} Such an irresolute impression demonstrates that participants in business activities sometimes lose sight of the fact that they are interdependent on each other for success and need to cooperate with one another to achieve their objectives. Employees cannot succeed without the cooperation of external and internal participants, superiors, and subordinates. Economic agents cannot operate in an ethical vacuum.\textsuperscript{11}

The method by which an organization responds to and handles dissent from its employees can be an excellent litmus test for evaluating the integrity of its

\textsuperscript{9} Chua and Rahman, “Institutional Pressures and Ethical Reckoning by Business Corporations,” 308.


\textsuperscript{11} Chua and Rahman, “Institutional Pressures and Ethical Reckoning by Business Corporations,” 309.
commitment to being an organization that empowers its employees.\textsuperscript{12} When professionals do not adhere to established ethical rules, both clients and the public may not be adequately served and protected.\textsuperscript{13} In a society that emphasizes accountability in social contracts, the public expects that business organizations have ethical codes that specify the guiding principles and standards of behavior required of their members. While individual provisions differ, codes of ethical conduct require that their respective followers maintain a higher standard of conduct than called for by law.\textsuperscript{14}

Professional associations and the public expect that auditors obey a code of ethics not only because of fear of legal sanctions and reprimands, but also because of inner conviction.\textsuperscript{15} In the same manner in which strong bonds can cause an individual to act unethically, the use of informal sanctions can also have this same effect as they stem from other types of relationships that practitioners may have. External informal sanctions originating from members within the moral community can manifest as social pressures, disrespect, or exclusion from the community.\textsuperscript{16} These relationships,

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\textsuperscript{12}Alan Lovell, “Moral Reasoning and Moral Atmosphere in the Domain of Accounting,” \textit{Accounting, Auditing, and Accountability Journal} 8, no. 3 (1995): 68.
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\textsuperscript{13}Beets, “Personal Morals and Professional Ethics: A Review and an Empirical Examination of Public Accounting,” 70.
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\textsuperscript{14}Chua and Rahman, “Institutional Pressures and Ethical Reckoning by Business Corporations,” 308.
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\textsuperscript{16}Ibid., 6.
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however, are fairly intangible and individuals may be less immediately self-aware of their existence.

In addition to the standards set by individual public accounting firms, the profession is regulated by the Code of Professional Conduct established by the American Institute of Certified Public Accountants (AICPA), Generally Accepted Auditing Standards (GAAP) established by the Financial Accounting Standards Board (FASB), standards from the Public Company Accounting Oversight Board (PCAOB), and state ethics laws and regulations. These laws and regulations provide guidelines for auditors regarding what behavior is acceptable within the profession. While individual public accounting ethics codes are partially derived from and must adhere to these occupational and government regulator related codes, most practitioners tend to have the most familiarity with the ethics policies promoted by their individual firm.

The public accounting profession commonly requires individuals to work as part of a team encompassing strong professional and organizational cultures and requiring its members to operate under collective professional standards. However, despite the extensive, authoritative standards available to guide the conduct and ethical decisions of public accounting firm professionals, numerous incidents in the press, along with extensive academic research indicate that these standards have not been

completely successful in eliminating ethical violations by practitioners.\textsuperscript{18} Ethics codes employed by public accounting firms are seen to some extent as a defensive strategy, implemented in order to quell public fears of self-governance being abused. These ethical codes are viewed as a shield beneath which various forms of behavior can be tolerated.\textsuperscript{19}

Ethical codes are also intended to serve as deterrents to unethical behavior by establishing the threat of sanctions and by making it the duty of members to report any errant colleagues so that each member assumes some sort of responsibility for upholding the collective group’s integrity. It can also be used as a vehicle to strengthen the firm’s collective front against external pressures such as unreasonable demands from clients.\textsuperscript{20} In order to self-police and ensure that employees will adhere to the established ethics policies, organizations often appeal to the practitioners’ professionalism, encouraging them to voluntarily exercise self-discipline above and beyond personal and legal requirements. The expectation is that members of the firm will act in accordance with ethical codes of conduct out of duty and obligation to the profession as well as their own personal morals.\textsuperscript{21}

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\textsuperscript{18}Taylor and Curtis, “An Examination of the Layers of Workplace Influences in Ethical Judgments: Whistleblowing Likelihood and Perseverance in Public Accounting,” 21.
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\textsuperscript{21}Beets, “Personal Morals and Professional Ethics: A Review and an Empirical Examination of Public Accounting,” 68.
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Moral transgressions cannot be detected expeditiously by auditors through mutual monitoring without the practice of specific inspections. Information is received regarding auditor activities usually only occurs in the case of a change in auditors, which is a rare event.\textsuperscript{22} Accounting financial scandals are rarely cited by critics with the technical incompetence of auditors as the main problem. What has been fundamentally questioned is the condition of the moral base of the profession. Practitioners in assurance engagements (i.e., independent audit engagements) are expected to act with integrity, objectivity, straightforwardness and honesty in all professional and business relationships without bias, conflict of interest or undue influence from others overriding professional or business judgments.\textsuperscript{23} They are also obliged to obey the moral norms of honesty, truthfulness, and fairness.\textsuperscript{24} Practitioners are expected to exhibit these traits in both fact and appearance.\textsuperscript{25} There are also underlying stereotypes of the isolated, exploitative, materialistic, untrustworthy public accounting professional who requires control and constant monitoring. This categorization results in undermining the capacity of workers to make their own judgments about what they should or should not do if their actions are to constantly be overseen. These situational pressures can then act as inhibitors to


\textsuperscript{23} Ibid., 2.

\textsuperscript{24} Ibid., 6.

\textsuperscript{25} Ibid., 2.
moral development. Most groups establish moral rules for the purpose of reducing the variation in the ethical conduct of its individual members. Group leaders and/or the collective group of members establish norms that are expected to homogenize the ethical behavior of members as such conduct relates to the interests of the group. Professional ethics codes are designed to guide practitioners to act both in the interest of the profession while simultaneously serving the general public, clients, and employers ethically. In adopting and promoting this ethics code the professional group employs a utilitarian theory of ethics. The traditional rule-based and legalistic approach towards addressing ethical violations in regulating auditing has been described as the root cause of the financial reporting frauds of the last decade. Ethical codes were believed to contain too many technicalities that led auditors to seek loopholes. Some scholars suggest that a principle based approach to the decision process is a better ethical foundation for auditors as they interact with their clients in evaluating financial statements. As the element of personal perception becomes more critical to the client-auditor relationship, including increasing expectations about the auditor’s role, the audit function is inevitably affected. This is a result of the conflict that exists between people who see the world as rule-oriented and those who view it as outcome-oriented. The Sarbanes-Oxley Act has widely been described as an


effort to move from a rule-based to a principle-based approach to auditing. However, there are still those that contend that the Sarbanes-Oxley Act is flawed and will not be sufficiently effective to maintain ethical standards. There is also the contention that creative minds who lack moral sense will always find ways to circumvent the spirit of the law.\textsuperscript{29} Does this then mean that there is no hope for achieving ethical excellence within the profession? Some theorists suggest that business ethics is impossible because morality cannot be applied to corporations. Because corporations are not persons and only persons can be held morally responsible, given the position of the individual as a representation of the corporation, persons within the organization cannot have moral obligations.\textsuperscript{30}

Instead of serving as a reliable resource and providing effective methods through which internal employees can make ethical decisions, ethical codes are a way for corporations to communicate to external stakeholders their commitment to conform to recognized business practice. In highly institutional environments, organizational changes are shaped by responses to formal and informal external pressures or by conforming to normative standards established by external institutions. There are pressures by competing organizations and organizations that depend upon them as well as societal and cultural pressures created within the institutional environment where the


firm must operate. As a result, there is a tendency to homogenize and adopt common ground with these competing forces.\textsuperscript{31}

Contemporary studies of ethics have shown that business executives do not uniformly agree on how to define business ethics. This confusion over what business ethics means leads to differences in both the practiced and spoken ethic.\textsuperscript{32} Empirical evidence shows that human nature is neither solely altruistic nor solely egoistic, so there is a need for moral norms to be encompassed within a code of ethics that understands this reality.\textsuperscript{33} Moral norms remind the imperfect rationalists who are tempted to break a norm that it may be wise in the long run to obey that norm. They also remind the imperfect altruists in a situation of moral temptation that it could compromise their personal integrity or the fairness of their moral feelings. This helps trigger acceptable behavior that coincides with their own internal ethical compass.\textsuperscript{34}

Researchers report mixed results with organizational programs that include written standards, anonymous advice resources, anonymous reporting lines, and training. Drawing upon the areas of psychology and organization theory, this research provides a case for how improperly constructed, albeit well-meaning, ethics programs can disable rather than enable employees to act appropriately when confronted with


\textsuperscript{32} Lewis, “Defining ‘Business Ethics’: Like Nailing Jello to a Wall,” 378.


\textsuperscript{34} Ibid., 16.
situations which pose difficult ethical questions. At their core, ethics programs are control systems that are designed to align an employee’s behavior with management’s values. This can be achieved through an agreement of shared values between management and employees where employees are required to use their individual judgment, or by less successful coercive mechanisms in which management alone dictates employee behavior.\(^{35}\) In order to maintain integrity within the profession, a reassessment of what constitutes ethical behavior, how such behavior is motivated, and recognition of the rights and interests of affected parties is imperative to establishing effective ethical discussion.\(^{36}\)

In order to better understand how public accounting firms choose to address ethical conduct and policy within their organizations, it is useful to review the codes of conduct from the Big Four accounting firms: Deloitte, Ernst and Young (E&Y), Klynveld Peat Marwick Goerdeler (KPMG), and Price Waterhouse Coopers (PWC). While each code of conduct is similar in nature there are varied nuances in terms of which ethical components were chosen to be highlighted in each of their documents. Each document, while establishing itself as a guide and resource to reference when making appropriate choices within the organization, also makes mention of its limitations. The documents point out that they are not “intended to address every


\(^{36}\) Satava, Caldwell, and Richards, “Ethics and the Auditing Culture: Rethinking the Foundation of Accounting and Auditing,” 279.
questionable situation or dilemma” that may be encountered. Firms also expect auditors to seek the additional “advice and support of others in addressing some of the situations that arise during the normal course of daily business life.” The codes emphasize the values and principles that the firms have established as foundations for suitable conduct. Primary importance is placed on the ideals of independence, integrity, honesty, and respect. Other values include objectivity, professional skepticism, professional behavior, and confidentiality. The codes also highlight what is expected of the firm employees. These include practitioners being trustworthy, responsible, accountable, and good corporate citizens. In addition to providing guidelines for ethical decision-making, the PWC and Deloitte public accounting firm ethics codes also provide a series of questions that practitioners can ask themselves in order to determine if the decisions they are making adhere to the ethical norms of the firm. Questions include, “does it feel right?”, “can you sleep at night,” and “would you be embarrassed if others knew you took this course of action?”


Each code makes generalizations regarding ethics and includes limited references to how relationships in the work environment should be considered in ethical situations. There is specific mention of conflicts of interests that may occur when personal interests are placed ahead of those of the individual firm. These considerations are made mostly in reference to suppliers, financial interests, and employment of family members. KPMG affirms that employees should “never compromise our values no matter how strong the internal or external pressures may be to perform, meet goals, or fulfill expectations.”\textsuperscript{40} E&Y asserts that “no client or external relationship is more important than ethics, integrity, and the reputation” of the firm. This includes a zero tolerance policy for clients that pressure or threaten firm employees in their effort to exercise their professional duties. They also mention that professionals should not be afraid to deliver unwelcome information.\textsuperscript{41} Deloitte’s code of ethics maintains that “prejudice, bias, conflict of interest, or undue influence of others must not be allowed to override objective professional or business judgments.”\textsuperscript{42}

Whereas these codes of ethics include minor references to the role of relationships, they do not do so in a manner that addresses situations in which the influence of the relationship may lead the practitioner to rationalize questionable behavior as being ethical. They more often address weaker relationships and personal


\textsuperscript{41} Ernst and Young, “Global Code of Conduct,” 7.

connections in which two casual acquaintances may meet a few times for short periods of time, and may never have to see each other again. The codes do not clearly address stronger associations where cooperation, trust, intimacy, and empathy have developed between parties as a result of frequent interaction. In these instances where the frequency of interaction and trust increase, so do opportunities for unethical behavior.\textsuperscript{43} If specific scenarios involving the impacts of interpersonal biases and loyalties within relationships are discussed and addressed amongst practitioners, whether through policy or related training, professionals are more likely to react to future situations in the manner the firm finds most favorable. These scenarios include situations in which practitioners may build strong rooted relationships with clients after working together over several years or where the professional believes that loyalty to team members and management means abiding by their rules despite concerns over their ethical nature. Will only a vague mention of general relationships in ethical guidelines lead the third year auditor to sufficiently examine or report a missing approval for an invoice that was the result of a mistake by the client’s accounting clerk who the auditor happens to have developed a close friendship with since his/her first year on the client when they would socialize on weekends? Or, as another example, a circumstance in which a firm partner accepts a weak explanation from the client’s chief financial officer—who also happens to be a former colleague and mentor—regarding the questionable financial instruments of a company. He/she wants to trust his peer’s judgment, especially when

the company is on the verge of being contracted for additional services that could amount to millions of dollars for the firm. Of even greater importance is if these professionals feel that the likelihood of getting caught is minimal. The impulse to act unethically only intensifies without the fear of tangible consequences. While the above mentioned codes include a couple of sentences regarding the consequences of disobeying the policy (e.g., termination), they do not stress individual accountability in a manner that will clearly express to the practitioner the severity of their actions if they do act unethically. Making ethical decisions that are considered firm-appropriate is simpler on paper than when translated to the high pressure daily operations of these firms.

Despite what public accounting firms put on paper as their ethics policy, greater importance should be placed on the value of acculturation. Acculturation is the implicit education into a certain moral value system. Individuals within public accounting firms become acculturated by the daily behavior they see around them. They see this behavior, whether good or bad, as rational and acceptable within their field. Moral education in the professional environment comes from exposure to the value systems displayed in educational institutions, the industry, in the firm itself, and specifically from senior management. Codes of ethics are published and distributed, but if they are not internalized as values by individuals and manifested in individual behavior, the codes will have little impact on practitioners. The messages promoted by the ethics code need to be viewed by organization employees as consistent with,
measurable by, and comparable to the perceived daily behaviors of team members.\textsuperscript{44} Ethics policy and expectations need to be stressed to practitioners frequently and on a regular basis in a manner that is consistently understood by everyone. This includes establishing a comprehensive set of training tools, seminars, participant discussions, and individual consultations. The more familiar an individual is with the code, the greater their chances of abiding by the code when making difficult workplace decisions. Conceptualization of the ethics code cannot merely be relegated to such intangible concepts as honesty and integrity, but should be clearly described in specific circumstances and consequences. Employees also need to be provided a judgment-free, neutral, and open environment in which to discuss and provide feedback on any potential ethical situations they may have or think of in order to address what choices to most responsibly and appropriately take.

CONCLUSION
ADDRESSING THE DISCONNECT BETWEEN POLICY AND PRACTICE

Human behavior is derived from a myriad of forces including individual motivations, personal relationships, the social structure in which one is embedded, and the organizational system of policies and practices.¹ “The focus on individual morality in an organizational setting is simply wrong—that one cannot aggregate individual actions to produce collective action.”² Unethical behaviors by employees do not result entirely from individual moral deficiencies but is predominantly a result of entrenched structures that encourage immoral acts. The individual within the organization is the moral agent, but the firm and its configuration exert significant influence on ethical behavior. Kohlberg similarly stated that “individual moral action usually takes place within a social or group context and that this context usually has a profound influence on the moral decision making of individuals.”³ Individual moral judgment and actions directly arise from the group experience—the influence of the group and the moral atmosphere on the person. The moral rules and norms that bind individuals do so because they are socially shared and because they embody the authority of the group. The individual retains the ultimate moral agency for their actions, but it must also be recognized that their social environment also has a profound influence. The personal


³ Ibid.
costs of failing to comply with others’ directives can be quite high and agents may feel psychologically compelled to consent.\textsuperscript{4} Tasks, auditor personality, and interpersonal interactions are all interdependent. The effects of these interpersonal interactions are likely to depend on the personal attributes of the auditor and on the tasks they work on. In the same respect, an auditing practitioners’ performance depends on the nature of the work performed by the auditor, and also on the others interacting with the professional within and outside of the audit team.\textsuperscript{5}

Public concern over ethical behavior within the accounting industry and in business institutions as a whole has increased dramatically as a result of the public becoming more educated and inquiring, institutional activities becoming more transparent, corporate activities becoming more pervasive, and communication channels becoming more widespread.\textsuperscript{6} Society and public stakeholders expect organizations and their leaders to endow professional activity with meaning, prescribe standards of behavior, and establish expectations for how individuals should treat one another. Accounting firms promote auditor adherence to an ethical system that facilitates trust among its adherents, creates a foundation that is ultimately pragmatic,

\footnotesize\textsuperscript{4} VanSandt and Neck, “Bridging Ethics and Self Leadership: Overcoming Ethical Discrepancies Between Employee and Organizational Standards,” 366.


and includes responsibilities, aims, values, and commitments. A strong corporate culture with imbedded ethical values is a central driver of behavior in organizations.

A robust corporate culture and identification with the organization does have an impact on ethical behavior outcomes. While a social identification with one’s profession is associated with greater auditor objectivity, professional identification alone is not enough to mitigate the negative effects of client identification on auditor objectivity. For any substantial change in the accounting profession to occur, action-oriented dialogue involving practitioners, academics, enforcement staffs, boards of directors, and political decision-makers needs to take place as a critical step towards implementing the changes necessary in the culture of the current business climate. Suggestions for addressing the spectrum of organizational cultural factors that make up the ethical perspectives of those involved in the auditing relationship must acknowledge that ethical deficits facing the business are systematic and require change on various fronts. A piece-meal incremental approach may require a change in thinking in order to have a greater impact on the current business environment.

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10 Satava, Caldwell, and Richards, “Ethics and the Auditing Culture: Rethinking the Foundation of Accounting and Auditing,” 279.

11 Ibid., 280.
Threats to auditor objectivity are not merely the result of overt client actions to undermine the auditors’ work or economic dependence on engagement profitability. They also arise from the need for auditors to become familiar with their clients. Client relationship building and identification developed through daily interaction with client key contacts can affect attempts to appropriately define the audit committee as the customer to which they are ultimately responsible for, and not client management as the customer. The accounting firm is hired by a company’s audit committee and formally reports to that committee. Auditor specific safeguards, such as managing the blocks of time an auditor spends at a particular client, may be more accessible to audit firm control.\footnote{Bamber and Iyer, “Auditors’ Identification with Their Clients and Its Effect on Auditors’ Objectivity,” 19.} Factors that also increase client identification and should be safeguarded against include the number of firm alumni working for the client, whether the client’s chief financial officer is a firm alumnus, and whether the firm also provides tax services to the client.\footnote{Ibid., 20.}

When auditors are willing to compromise their objectivity or overlook key information in order to maintain a client relationship, retain the client or secure additional services from the client, this is an ethical violation and should cause significant concern regarding auditor independence. A proposed method for improving auditor independence is to ban firms from offering any additional services that are not specifically within the scope of the financial audit. This includes services that are

\footnotetext{\textsuperscript{12} Bamber and Iyer, “Auditors’ Identification with Their Clients and Its Effect on Auditors’ Objectivity,” 19.}

\footnotetext{\textsuperscript{13} Ibid., 20.}
considered impartial—within the boundaries of independence—and extraneously beneficial for the financial audit.\textsuperscript{14} This would reduce impacts to auditor objectivity that arise when firms engage in vying for as many additional services allowable as possible in order to increase profits. Those in the public accounting industry with a stake in its profitability do not believe that this non-specific audit work damages the existing audit work being performed and that such change would reduce competition for auditing work, as the importance of independence is constantly stressed amongst practitioners.\textsuperscript{15} Another option, reducing partner compensation for selling additional services, may ameliorate financial disincentives for objectivity, but is unlikely to affect any loss of objectivity arising from an auditors’ cognitive-based identification with the client.\textsuperscript{16}

There is also the concern over accounting firms being selected and commissioned by the clients for which they are performing independent assurance services. Critics of this structure suggest the radical idea of setting up a government office that would take over the authority of companies to choose their own auditors. This government body would appoint and auditing private firm. In addition to reducing the level of bias inherent in the current arrangement, this system would lead to an increased recognition in the public interest of the audit. While this solution has


\textsuperscript{15} Ibid.

\textsuperscript{16} Bamber and Iyer, “Auditors’ Identification with Their Clients and Its Effect on Auditors’ Objectivity,” 3.
its advantages, it would also be problematic. Taxpayers would object to the public cost and question whether their money was benefiting shareholders. Bureaucrats would also have concerns over increased government control over private industry.\textsuperscript{17} Another proposal to reduce the threat to auditor objectivity advocates required rotations in order to limit audit firm tenure. This rotation is aimed at preventing the audit firm from becoming too dependent on a client over time. However, a 2003 study by the U.S Government General Accountability Office, responsible for improving the performance and accountability of the federal government, questioned whether potential benefits from mandatory audit firm rotations would outweigh the resulting financial costs and loss of institutional knowledge. Current research finds that audit firm tenure is associated with higher audit quality. Alleged audit failures and litigation risk is higher in the early years of an engagement. Additionally, for a sample of auditor-client relationships that has lasted for more than four years, the length of time the firm audited the client was positively associated with the perception of quality by investors.\textsuperscript{18}

While adjustments to the public accounting structure are viable options, changing the ethical mindset of practitioners to combat outside forces and make right decisions in spite of undue influences for may be a better approach. The accountants and auditors of the future need to possess a foundation of understanding of what

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\textsuperscript{17} Anonymous, “Accountancy: All Change,” 20. \\
\textsuperscript{18} Bamber and Iyer, “Auditors’ Identification with Their Clients and Its Effect on Auditors’ Objectivity,” 8.
\end{flushright}
constitutes ethical behavior. This education in colleges and universities needs to be mandated in order to positively affect students’ moral reasoning abilities and judgment about ethical accounting behavior. Individuals need to be made aware of the various negative influences that they will experience and how to approach decision-making, prior to entering the workforce. There should also be a mandate requiring existing practitioners that serve in an audit function to complete periodic continuing education courses in business ethics in order to effectively confront issues over time. While this practice is already be in place within public accounting firms, these courses need to be designed to specifically address how to combat pressures and influences as well as identify vulnerabilities from significant relationships in order to be effective when practitioners encounter relationships that can have an effect on their objectivity. Additionally, conducting a recurring cultural audit of the firm to monitor attitudes regarding ethics policies in place, for all levels, will demonstrate the accounting profession’s willingness to evaluate itself seriously and to further increase credibility. These cultural audits can be a critical resource in identifying the impact of values, practices, and assumptions on the behaviors of organization members. The deterioration of values must also be addressed with key corporate leaders who acknowledge their roles in creating corporate cultures that may promote unethical behaviors.\textsuperscript{19} The organization needs to increasingly understand how its structures or

\textsuperscript{19} Satava, Caldwell, and Richards, “Ethics and the Auditing Culture: Rethinking the Foundation of Accounting and Auditing,” 279-280.
processes might encourage unethical behavior to serve its interests or create favorable conditions for corruption.

Organizations also need to consider combating against moral disengagement—an individual’s predisposition to create conditions that allow them to restructure their actions to appear less harmful, minimize their role in the outcomes of their actions, or attenuate the distress that they cause to others, thereby disengaging the self-sanctions that drive individual moral behavior.\textsuperscript{20} Accountability may be a means of addressing this behavior as it is believed to lead to more ethical conduct. An employee is likely to behave more ethically if their actions are viewed as their own. They may be more prone to act immorally if they are shielded by the cloak of a corporate agency.\textsuperscript{21} When outside perspectives are known prior to forming one’s own opinion, conformity becomes the coping strategy of choice. The desire for social approval from known audiences shifts the decision-makers’ focus away from the potential effectiveness of outcomes to the justifiability of outcomes. Therefore, the importance of establishing and communicating that employees be held accountable for their actions within the organization is great. If employees are frequently made aware of the fact that they will have to justify their conduct to organizational superiors with sanction power, as well as


\textsuperscript{21} VanSandt and Neck, “Bridging Ethics and Self Leadership: Overcoming Ethical Discrepancies Between Employee and Organizational Standards,” 365.
know exactly what the organization expects of them in terms of ethical behavior, more pro-social behavior on the part of the employee will result.\textsuperscript{22}

Taking into account a more academic approach, scholars promote the financial support by accounting professional organizations, regulatory bodies, and firms for research between academics and practitioners. These examinations will consist of effective business ethics, audit practices, accounting firm culture, corporate governance, and other related concepts. The one-sided research currently in place—by individual entities with minimal collaboration from other groups—does not necessarily demonstrate the insights or commitments of professionals and therefore may have minimal impact on ethical issues. The problems of business ethics are applied problems and therefore needs a cross-functional approach.\textsuperscript{23}

Scholars and practitioners have also suggested that auditing and accounting should move towards becoming more principle-based than rule-based. Accounting professionals tend to follow a rule-based approach even when they do not consider this course of action to be morally right.\textsuperscript{24} While there are positive signs of movement towards this, some current codes that have incorporated principle-based language are

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\item \textsuperscript{22} Beu and Buckley, “The Hypothesized Relationship Between Accountability and Ethical Behavior,” 62-63.
\item \textsuperscript{23} Satava, Caldwell, and Richards, “Ethics and the Auditing Culture: Rethinking the Foundation of Accounting and Auditing,” 280.
\item \textsuperscript{24} Ibid., 272.
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“mere verbiage and lip service and not sufficient”.25 Alternatively, participation by employees and the opportunity for workers to voice their opinions regularly about policy and decisions that affect them has characteristically been considered a critical element of procedurally fair decision-making systems. It has also been shown to have a strong effect on employee job attitudes. Participation has a number of cognitive effects that are likely to impact moral awareness and is increasingly finding importance within the accounting industry. It allows an individual to think more broadly and strategically about behavioral options when an objective is specified. Participation can enhance ethical recognition by encouraging an active evaluation of the process needed to accomplish the goal.26

While still minimal, great promise can be found in the latest research that examines how auditors interact with each other, with clients, and with other participants in the financial reporting process. Work interactions have only recently become a focus of research, and understanding how stress and emotions affect auditor judgment and decision-making have been insufficiently researched. Auditors do not work in isolation, so it is crucial to understand how the people, tasks, and environments auditors interact with and in influence an auditor’s performance and ethical behavior. Extensive literature exists relevant to interaction theory in social psychology.

25 Satava, Caldwell, and Richards, “Ethics and the Auditing Culture: Rethinking the Foundation of Accounting and Auditing,” 279.

26 Moore, “Moral Disengagement in Processes of Organizational Corruption,” 64.
organizational behavior, sociology, and economics that can be drawn upon when examining ethical issues within the accounting profession.27

An individual’s expectations of others are strongly influenced by knowledge, skills, abilities, and personality, as well as by the history of the relationship with this individual and with the organization. This complex web of interpersonal relationships is a driving force behind ethical behavior in this setting. It is subject to the realities of work interdependence, organizational and job-specific norms. Workplace behavior takes place in a social context and involves mutual expectations, mutual influence processes, mutual understanding, and predictable behavior. Thus, while firms have a formal code of ethics, there are other audiences that are possibly more important to the individual.28 Practitioners need to be guided toward moral awareness despite influences from interpersonal relationships. This requires the recognition that the issue at hand may involve factors that could detrimentally affect others’ welfare or operate against one’s own or society’s ethical standards. It also involves the understanding that one’s actions could contribute to those detrimental effects, and the sensitivity to realize how the outcomes of one’s actions may be at odds with internal (i.e., self-regulatory) or external (i.e., societal) moral standards.29

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28 Beu and Buckley, “The Hypothesized Relationship Between Accountability and Ethical Behavior,” 62.

Firms exist in an environment that is filled with dependence, uncertainty, complexity, threat, and volatility. Their survival depends on their ability to avoid, buffer, or change their environment, especially in light of the environmental forces bearing upon firms to act ethically.\textsuperscript{30} In order to sustain the integrity of the accounting profession, a reassessment of what constitutes ethical behavior, how such behavior is motivated, and the recognition of the rights and interests of affected parties is imperative to the profession.\textsuperscript{31}


\textsuperscript{31} Satava, Caldwell, and Richards, “Ethics and the Auditing Culture: Rethinking the Foundation of Accounting and Auditing,” 279.
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