Ethics: 7 Ways CPAs Violate the NEW AICPA Ethics Requirements

By Gary Zeune, CPA

What do all these **former** CPAs have in common?

- Enron Controller Richard Causey
- HealthSouth CFOs Aaron Beam and Weston Smith
- WorldCom Director of General Accounting Buford Yates and Director of Management Reporting Betty Vinson

They all committed unethical acts. And went to prison.

New ethics rules[1] effective Nov. 30 put industry CPAs at risk for actions that are now strictly prohibited. This article will explore a few such activities. But first, why do CPAs violate the Code of Professional Conduct? Here are five common reasons:

1. "We don't see things as they are; we see them as we want them to be."[2] None of us are objective about ourselves or our work. For example, 95% of drivers think they are better than average. We fool ourselves ethically. For example, even though we break the law while driving, we think of ourselves as ethical. We won't admit that our own behaviors violate the AICPA and Ohio Accountancy Board's Code of Professional Conduct.

2. Relative to most people, CPAs are fairly smart and have power in the organization. But power often results in wrong decisions. Really smart people do really stupid stuff. If smart people didn't do dumb stuff, Elliot Spitzer would still be the governor of New York. People with a sense of power are overconfident in their abilities and consistently reject advice, leading to suboptimal decisions.

3. Illusionary superiority is a cognitive bias where people overestimate their positive qualities and underestimate their negative qualities. Multiple studies have shown that powerful people deceive themselves into decisions which are consistently worse than those made by people who feel less powerful but accept advice.[3]

4. Subordinating your judgment. Usually to a more powerful person, such as a boss or client, or obtain or maintain the status quo, such as your lifestyle or position in the entity. What's subordinating your judgment? If you would do something different if you weren't being pressured.

5. CPAs simply don't know the ethics requirements and prohibitions; which will be the focus of this article.

TAKEAWAYS

- New ethics rules effective Nov. 30 put industry CPAs at risk for actions that are now strictly prohibited.
- The "shoulds" in the Code of Professional Conduct are requirements.
- A CPA's ultimate duty is to users of his work products, NOT the employer.

ET Section 91 *Applicability*

Paragraph .01 says the bylaws of the AICPA require members to comply with the Code of Professional Conduct. As you digest the rules and violations, remember that the introduction to the revisions reads, *"A member who departs from interpretations or rulings shall have the burden of justifying such departure in any disciplinary hearing."*

Paragraph .01 .2: Requirement: CPAs will not knowingly ask or allow anyone they have authority or control over to carry out on the CPAs behalf, paid or not, any act that would be prohibited if committed by the CPA.

Violation: You can't have someone do your dirty work.

Paragraph .01 .3: A CPA is not to conclude that independence is not violated solely because of his inability to control the other person.

Violation #1: CPAs cannot justify allowing unethical behavior with, "It's not my job." Or, as AICPA's Lisa Snyder comments, if a spouse invests in a CPA's client, even though the CPA does not 'control' her spouse, she would no longer be independent.

ET Section 100-1 *Conceptual Framework for AICPA Independence Standards*

Rule .20: *Safeguards* are defined as controls that eliminate or reduce threats to independence to an acceptable level.

Violation #2: If anyone can bypass the CPA and order the CPA's subordinate to do something that the CPA will not do, then the

CPA has violated the requirement to provide such independence safeguards.

Rule 501 *Acts Discreditable* New Interpretation

ET Section 501 .10 Confidential Information Obtained From Employment or Volunteer Activities

CPAs are required to maintain confidentiality of any confidential information obtained from an employer or volunteer position. Further, CPAs are to prohibit the disclosure of confidential information to people who are not subject to the profession's ethics requirements. When a CPA changes employment, the CPA is prohibited from using confidential information from previous employment for personal gain or advantage. This prohibition does not end if you leave the subsequent job or if the disclosure is without proper authorization.

Violation #3: When a CPA departs a firm and takes another position in an entity that has an audit, it's unethical, a discreditable act, to use knowledge gained in public accounting to circumvent the audit process. For example, many times a young firm staff person doesn't know how to perform an audit step. To avoid appearing stupid to his superior, the staff member asks the controller who is a CPA with public accounting experience, how to perform the audit procedure. At best, the industry CPA has just rendered the auditor not independent. If not independent, the firm cannot issue an opinion. Even if the numbers are right (i.e., not materially misstated), the firm is not qualified to say so.

Violation #4: The SEC sued[4] Deloitte and Deloitte M&A tax partner Arnold McClellan and his wife, Annabel, also ex-, alleging that they passed confidential information about at least seven acquisitions planned by Deloitte's clients to her sister and sister's husband.[5] The SEC alleged Mrs. McClellan illegally made $3 million.[6] The sister and her husband in turn allegedly used the inside information to make more than $20 million.[7]

In October 2011, without admitting guilt, Mrs. McClellan agreed to pay $1 million to settle the SEC lawsuit.[8] She told prosecutors that Mr. McClellan was not aware that she overhead him discussing confidential information. The SEC dropped the charges against him, but his career is over. He's now an ex-Deloitte Tax LLP partner. Think how close he came to being pursued for insider trading. All his wife would have had to do was tell the SEC or the judge, "Of course he knew. How do you think I got the information?" But what was Arnold's discreditable act? Because he trusted his wife, he allowed her to overhear his confidential conversations. Here's a secret. Trust is NOT a control. It's a feeling. There's no exemption in the code of conduct for ethics violations because you trusted someone. Even family.

Violation #5: Statements on Auditing Standards and the Code of Professional Conduct often include the phrase "a member should". "Most CPAs read "should" the same way it's used in everyday life; a suggestion, option or recommendation. But what does "should" mean? In auditing standards "should" is "presumptively mandatory". In other words do something different than the auditing standards at your own peril. But "should" is different in the Code of Conduct. AICPA Professional Ethics Director Lisa Snyder, CPA, said unlike everyday usage, any ethics rule that says "a member should" is a requirement.

"While the PEEC has not adopted the ASB's drafting conventions yet, we do consider 'should' as being a requirement," she said. "When something is a suggestion, we will generally say the member 'should consider.'" Lisa also pointed out that the Code acknowledges that members may depart from certain rules or guidelines but have the burden of justifying such departures in any disciplinary hearing. The problem is that most CPAs don't switch their brains to interpret 'should' in auditing standards and the code of conduct to mean a requirement so they fail to comply with a requirement, which leads to ethics violations.

As CPAs, our ultimate duty is to users of our work product, NOT the company that pays us. This is the independence requirement that creates the same conflict when clients pay for a review or an audit. You can't be independent when you have a vested interest. CPAs are required to be independent, to be ethical.

Violation #6: Ethics violations often come from thinking that materiality is the dollar amount or percentage of a number relative to the whole (e.g., percentage of sales). Just because an amount is small does NOT mean it's immaterial. If the user, such as a bank loan officer, would make a different decision with the correct information, then the little number is material.

Violation #7: Ever heard, "It's my company and I can do whatever I want?" That's simply not true. Even though your boss might own the company, she may NOT do whatever she wants. We don't live in a true free market society, we live in a regulated free market. So when you allow her to charge clearly personal expenses to the company you've allowed her to deliberately violate internal controls. Please explain how you are an ethical CPA and represent to your auditors that controls are adequate. Further, because the deductions were for personal expenses, how are you ethical yet work for someone who deliberately defrauds the IRS, for even minor amounts?

© Gary D. Zeune, CPA, 2011. Zeune is a nationally recognized speaker and writer on fraud, auditing and ethics. He also founded The Pros & The Cons, the nation's only speakers' bureau for white-collar criminals at www.TheProsAndTheCons.com.

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[1] *Journal of Accountancy*, Official Releases, REVISIONS TO THE CODE OF PROFESSIONAL CONDUCT, November 2011, page 101.

[2] Adapted from "We don't see things as they are; we see them as we are," Anais Nin, French-born American author, 1903-77.

[3] "The Detrimental Effects of Power on Confidence, Advice Taking, and Accuracy", *Organizational Behavior and Human Decision Processes,* vol. 116, no. 2.

[4] U.S. v McClellan, 10-5412, U.S. District Court (San Francisco)

[5] "Did Arnold McClellan's Wife Act Without His Knowledge? April 11, 2011

[6] "SEC breaks up in-law insider trading ring", Fortune.com, Nov. 30, 2010

[7] "Did Deloitte Compromise Independence in McClellan Insider Trading Scandal?" Francine McKenna, *Forbes*, Dec. 7, 2010

[8] "Ex-Deloitte Partner's Wife Settles SEC Case for $1 Million"*Bloomberg*, Oct. 25, 2011