Jamnik, Anton

Ethical code in the public accounting profession

Revista Cultura Económica Año XXIX, Nº 81-82, diciembre 2011

Ethical code in the public accounting profession

ANTON JAMNIK

Revista Cultura Económica
Año XXIX • Nº 81/82
Diciembre 2011: 80-90

I. Introduction

The American Heritage Dictionary defines profession as "the body of qualified persons in an occupation or field". A major characteristic of a "qualified person" is the specialized knowledge of the profession: medical knowledge for medical doctors, accounting knowledge for certified public accountants (CPAs). Professionals have an ethical responsibility to have acquired the specialized knowledge before offering their professional services. Professionals are also expected to keep abreast of the knowledge enhancements by continuing professional education. Another characteristic of professionals is that they possess the mental attitude of serving the public with the best of their ability so as to earn the public trust. How does a profession enforce these ethical responsibilities? By self-monitoring, supported by a viable code of conduct. In fact, the existence of a code of professional conduct is considered a hallmark of any profession.

The Code of Professional Conduct of the American Institute of Certified Public Accountants (AICPA) is the primary source of guidance for accountants in public practice. Similar codes, issued by the Institute of Management Accountants (IMA) and the Institute of Internal Auditors (IIA), govern accountants and auditors in private practice. In recent times, the accounting profession has developed several recognized subspecialties, such as Certified Personal Financial Planner, or Certified Fraud Examiner. Each of the subspecialties have also adopted professional codes of conduct that are consistent with AICPA's Code of Professional Conduct. The focus of this chapter is on professional accountants in public practice. Consequently, we limit our discussion to the CPAs who are obliged to adhere to the Code of Professional Conduct of the AICPA. The AICPA Code (hereafter, the Code) is designed to serve a multitude of purposes:

- A message that the professional CPA has a duty to serve the public (Collins and Schulz, 1995: 32)
- A means of conferring legitimacy upon the professional body, i.e., the AICPA (Preston et al., 1995: 509)
- Protecting public interest or a client where the professional delivers a specialized service which cannot be easily measured or judged as to its quality (Preston et al., 1995: 508; Neale, 1996: 223)
- Providing a filtering mechanism to limit the number of professionals to those who are willing and capable of adhering to the Code and unattractive to those who do not abide by it (Neale, 1996: 223).

In the remainder of this chapter, first, we briefly discuss the types of services that are provided by CPAs. Of particular importance to the discussion of ethics, is ethics audit services as an emerging area of assurance services that major public accounting firms have begun to offer in recent years. Second, we provide a brief discussion of the AICPA's Code of Professional Conduct with a focus on its principles, but also examples of its rules. Third, the elaborate professional ethics enforcement program is discussed, where

illustrative cases and descriptive statistics about the AICPA's disciplinary actions over a 20-year period are provided. The chapter ends with a concluding section where some observations about controversial ethical issues facing the profession are discussed.

1. Public accounting services

The AICPA has approximately 350,000 members, all of whom are CPAs. To be a CPA, most states require that an individual has had some experience in public accounting. The most distinguishing characteristic of a public accounting practice is to provide audit services for financial statements of various businesses. These financial statements are normally used by the CPA's clients to provide information to stockholders, potential investors, creditors, and regulatory agencies. However, not all CPAs remain in public practice. A large number of members of the AICPA are in industry, such as those working in accounting departments of private or public companies. Others are in private practice (they provide clients with unaudited financial statements, tax and business consulting), government or education. While there are some minor differences in the ways in which these members keep their AICPA membership in "good standing", they all are required to adhere to the provisions of the Code. (For example, members in public practice are generally subject to more stringent continuing professional education requirements than those in industry or education.) However, due to the importance of the public trust to the profession, those in public practice are scrutinized more closely than others. For this reason, it is important to identify various areas of services provided by the CPAs in public practice with some emphasis on those in ethics audit services. CPAs in public practice provide these services:

- Audit services
- Compilation and review services
- Attestation services
- Management advisory services, including internal audit services
- Tax services
- Assurance services, including ethics audit services

The purpose of an *audit service* is to add credibility to financial statements of clients by issuing a report on the fair presentation of the financial statements taken as a whole. A vast majority of clients receive a standard three paragraph audit opinion (called an "unqualified" opinion), which is essentially a bill of health. Variations of this opinion indicate that the auditor is either taking some exceptions (called "modified wording" or a "qualified opinion", depending on the extent of the exception), or states that the financial statements are not presented fairly (called an "adverse opinion"). If the auditor finds that he/she is not independent from the client, then a "disclaimer of opinion" is issued. The Auditing Standards Board of the AICPA is responsible for developing the *Statements on Auditing Standards* that must be followed by auditors in the conduct of their audits. It is important to note that the issuance of an independent audit opinion can *only* be made by a CPA. The other services listed below can be provided by individuals that are not CPAs.

A *compilation* is the presentation of financial information, in the form of financial statements, without the CPA expressing any opinion on them. A *review* is where a CPA has conducted only limited procedures and can give only limited assurance that the financial statements require no material modification. Compilation and review services are normally for non-public companies that may not require full audited statements, but do want some limited assurance about the reliability of their financial statements.

The Statement of Standards for Attestation Engagements, *Attestation Standards* (AT Section 100) defines an attest engagement as "one in which a practitioner is engaged to issue or does issue a written communication that expresses a conclusion about the reliability of a written assertion that is the responsibility of another party". If the written communication is about historical financial statements, then the attestation is the same as an audit. However, a client may want an opinion on its representations related to its own internal controls, or investment performance history, or remaining reserves in an oil field. In these types of engagements, the CPA will still be held to the same level of professional standards as if they were auditing financial statements.

Management advisory services, including internal audit services, are often referred to

as *consulting services.* Most of the consulting is related to the internal operations or planning for a client. A practitioner has developed an expertise in a client's affairs and is probably also an expert in the client's industry. This background makes the practitioner a logical choice to consult on matters related to accounting information systems (including hardware and software choices), inventory planning and flows, executive compensation arrangements, or designing pension and profit-sharing plans.

Tax services relate to corporations, other businesses, and individuals. The services can be limited to only the preparation of federal, state, and local tax returns, but frequently include advice on merger and acquisition, tax planning for current tax minimization or estate planning, and representation in tax audits from the Internal Revenue Service. The tax services area is an example where a practitioner is not required to be strictly independent from the client. The practitioner is expected to be an advocate for the client and to minimize the client's total tax liability.

Assurance services, including ethics audit services are defined by an AICPA special committee as "independent professional services that improve the quality of information, or its context, for decision makers" (Palfais, 1996: 16). Assurance services can include audit and attestation, but also includes other non-traditional services. Assurance services are centered on improving the quality of information, and frequently involve situations when one party wants to monitor another, even when both parties work for the same company (Pallais, 1996). Ethics audit services would be an example of the latter service and will be discussed further in a later section.

A recent meeting of the National Association of State Boards of Accountancy concluded that regardless of the type of service provided, CPAs are required to have seven "competencies" (Haberman, 1998: 17): four of these competencies are technical in nature (e.g., the ability to assess the achievement of an entity's objectives); one relates to decision making, problem solving, and critical thinking, and another one concerns the ability to communicate the scope of work, findings and conclusions. But the one that is most relevant to ethics is "an understanding of the Code of Professional Conduct". Also, in a National Future Forum held in January 1998, five core values were identified for CPAs: continuing education and life-long learning, competence, integrity, attunement with broad business issues, and objectivity (CPA Vision Project, 1998). Of particular importance to this chapter are integrity and objectivity that are part of the Code as well. This Code is discussed in the next section.

Among the services identified above, assurance services have gained much attention in recent years as an area of significant growth for the accounting profession. These services are provided to improve the quality of information or its context, for decision makers. An example of these assurance services is the CPA *WebTrust*℠ service, by which CPAs assess the reliability of information in company web sites, and if the information is found to be reliable, the *WebTrust*℠ seal is stamped on the client's web site.

The AICPA's Special Committee on Assurance Services (also known as the Elliott Committee after its chairman, Robert Elliott) has proposed many areas of assurance services. Of special interest to ethicists is "assessment of ethics-related risk and vulnerabilities" (Elliott and Pallais, 1997: 63). Some accounting firms (e.g., Arthur Andersen, KPMG Peat Marwick) have already begun offering ethics audit services. According to KPMG Peat Marwick, the ethics audit has four components (KPMG, 1997).

- An assessment of the ethical climate of the client encompassing culture, environment, motives, and pressures
- An assessment of performance incentives - the issue is whether the performance incentives provide a motivation to behave outside the moral norm
- The communication of the message about what is acceptable or unacceptable ethical behavior - this communication covers issues of ethical policies, procedures, and training downstream from management to employees; it also covers the nature of upstream communication from employees to management
- Compliance where the policies, procedures, and offices involved in the enforcement of the client's ethics program are assessed.

Although an ethics audit is designed for

a company's internal purposes, it is clear that there could be external ramifications. The fact that a company has conducted an ethics audit may have positive implications with outside regulatory agencies, suppliers, customers, or prospective employees.

Ethics audit services are partly governed by *Statements on Auditing Standards* promulgated by the Auditing Standards Board (1997). However, there are significant differences between ethics audits and financial audits. For example, an ethics audit is used to identify a client's areas of vulnerability in comparison with its industry benchmarks. This is different from the comparison of a company's ethical performance with absolute ethical philosophies. It is also different from a financial audit where the fairness of financial statements is assessed against generally accepted accounting principles. KPMG Peat Marwick LLP states that an ethics audit is a "positive confirmation of the existence and effective implementation of best ethical practices" (KPMG, 1996).

A concern about the multitude of services provided by CPAs is that conflict of interest may arise from an auditor performing the financial audit, as well as other services. This is said to threaten auditor independence. As discussed in the next section, independence is one of the major rules in the Code. In the past, it was not uncommon for auditors to decline engagements or not provide additional services if there was any threat, real or perceived, to their independence. We will return to a discussion of the magnitude of this issue in the final section. Suffice it is to say here that today, it is common for CPAs to avoid this problem by offering various services from separate divisions of the audit firm, so as to minimize issues of conflict of interest. In one case, the accounting firm split into two separate entities: Andersen World-wide split into Arthur Andersen to provide audit and tax services and Andersen Consulting to provide management advisory services. Recently, however, Andersen Consulting has alleged that Arthur Andersen is also providing management advisory services to its big clients against the contract that resulted in the split of Andersen in the first place.

2. AICPA's code of professional conduct

The AICPA's mission statement charges its CPA members with the responsibility to "serve the public interest in performing the highest quality of professional services" (AICPA, 1988: vii). The Code calls for honorable behavior, even at the sacrifice of personal interest. Various steps are necessary to prepare the CPA for these services. These steps include education, certification, licensing, and practice, but also a mental ability and commitment to discharging one's responsibility with care and diligence. (Note that all states require CPAs in public practice to be licensed. A CPA may choose *not* to be a member of the AICPA, and thus not subject to the AICPA Code. However, most state licensing authorities have adopted the AICPA Code as their ethical and professional standards).

The AICPA's Code of Professional Conduct states, in its preamble, that being a member is voluntary, but by accepting membership one assumes an obligation to the public, clients, and colleagues. To guide behavior, the AICPA has instituted a Code that has four components:

- Principles of professional conduct
- Rules of conduct
- Interpretations of rules of conduct
- Rulings by the Professional Ethics Division of the AICPA and its Trial Board.

Table 14.1. AICIPA's Principles of Professional Conduct

Principle and AICPA Directives

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

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

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

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

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

6. SCOPE AND NATURE OF SERVICES
- A member in public should observe the Principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.[1]

There are six principles in the Code. These principles and the AICPA directives related to them are listed in table 14.1. They provide the basic foundation of ethical and professional conduct that is expected of the CPA. However, due to their conceptual nature, these principles are not enforceable. Nevertheless, they point to the importance of public interest (Principles 1 and 2) and the requisite moral characteristics of CPAs in public practice (Principles 3-6).

The Rules of Conduct and the Interpretations of the Rules of Conduct are more specific in nature than the Principles, and as such, they are enforceable. A detailed discussion of these rules and their interpretation is beyond the scope of this chapter but may be found in the AICPA publications and standard auditing texts. To show the general tenet of the rules, we provide a summary here:

Section 100: Independence, Integrity, and Objectivity (e.g., Rule 102-2 prohibiting conflict of interest)

Section 200: General Standards and Accounting Principles (e.g., Rule 201-1 requiring competence)

Section 300: Responsibilities to Clients (e.g., Rule 301-1 prohibition of dissemination of any confidential client information obtained during the course of an audit)

Section 500: Other Responsibilities and Practices (e.g., Rule 501-1 forbidding retention of client records)

Section 400, related to responsibilities to colleagues. It doesn't have any rules at this time. However, concurrent with the issuance of the new Code in 1988, the AICPA also approved a mandatory quality peer review program, where CPA firms provide reviews of the quality of practice in other CPA firms and present recommendations for improvement. The AICPA also established a number of practice-monitoring committees to facilitate these peer reviews for CPA firms.

The final component of the Code, Rulings by the Professional Ethics Division and the Trial Board of the AICPA, relates to the AICPA's activities to enforce the rules and their interpretations. These issues are discussed in the next section.

3. Enforcement of the Code of Conduct

Violations of the Code can be diverse and numerous. A detailed listing and discussion of these violations is beyond the scope of this chapter. Here are several examples:

A CPA was engaged to prepare the financial statements of a company and then audited those same financial statements - a violation of the rule of independence.

A practitioner prepared a fraudulent tax return on a client's behalf.

A practitioner did not have the necessary technical skills to perform required work for an engagement - a violation of competence.

A CPA did not release documents to a client - a violation of Rule 501-1 requirements.

These violations result in disciplinary actions by the AICPA, such as admonishment, termination or suspension of membership in the Institute. Since 1975, the Joint Trial Board of the AICPA has been the source of disciplinary action with the participation of some state societies. This cooperation has recently been expanded to include virtually all 50 states and has resulted in the establishment of the Joint Ethics Enforcement Program (JEEP) since 1995. JEEP maximizes the resources for investigation and eliminates duplication (News Report, 1995).

Penalties for violation of the Code range from a recommendation that a member take remedial or corrective action, to a permanent expulsion from the AICPA. For example, a member who has violated the Code may be

recommended by the Professional Ethics Division to take a continuing professional education course. If the member does not comply with the recommendation, the Ethics Division may refer him/her to the Trial Board for a hearing. The Trial Board may suspend a member for up to two years or expel him or her for violating the Code. In cases where a punishable crime by imprisonment for more than one year has occurred, the member is automatically suspended or terminated from AICPA membership. A similar penalty can be imposed for filing a false income tax return on a client's behalf.

The disciplinary actions of the Joint Trial Board are publicized in the AICPA's newsletter, *The CPA Letter*. Generally, this means that a similar action has been taken by the professional state society of CPAs in the state where the violator has membership. (Note that a CPA can have membership in more than one state society. Furthermore, a CPA can get licensing from various state boards of CPA for practice in multiple states.) These state societies have codes of professional conduct for their membership that are identical with, or similar to the AICPA Code (AICPA, 1997: 6).

On the surface, the actions taken by the AICPA and/or state societies of CPAs may appear to be insignificant in nature, since membership in these associations is voluntary and one can resign at any time. In reality, an action such as termination of membership, may indeed tarnish one's reputation as a CPA to the extent that one would voluntarily leave the profession altogether. Also, considered the fact that the practice of public accounting requires licensing by governmental regulatory agencies such as state boards of public accountancy. The AICPA and/or state society's actions to terminate or suspend membership may precede or succeed revocation or suspension of practice licenses by state boards of accountancy. Thus, the CPA may be barred from practice, involuntarily, for a period of time or forever, depending on the nature of the violation.

State boards of public accountancy have been set up to enforce state accounting laws. These boards are generally charged with the responsibility of overseeing the accounting profession in their states. Consequently, they have mechanisms by which complaints against CPAs are documented, investigated, and adjudicated. These complaints "can come from a variety of sources, including clients, third parties such as federal, state and local governments; and other CPAs, especially successor accountants and auditors. The state board must investigate each complaint to assess its merit and, if necessary, determine the appropriate corrective action" (Ruble, 1997).

The disciplinary actions taken by state boards of accountancy and state societies of CPAs may also be the result of court action against a member. For example, a criminal conviction in a court of law may automatically result in suspension or termination of membership in state societies and the AICPA, as well as loss of practice license by the state board of public accountancy.

As stated earlier, violations of the AICPA Code may require a hearing by the Ethics Division of the AICPA or its Trial Board. State societies of CPAs have similar mechanisms, and they cooperate closely with the AICPA. Virtually, all states boards have joined with the AICPA to create the Joint Ethics Enforcement Program (JEEP). This program has developed a detailed manual for effective and efficient treatment of code violations. According to the AICPA's professional standards and the provisions of the JEEP manual (AICPA, 1997), there are two distinct methods of dealing with member violations. The first is suspension or termination of membership without a hearing, i.e., automatic disciplinary actions. The second is the AICPA disciplinary action process where provisions are made for a hearing.

The automatic sanctions are generally the result of court actions or other governmental (e.g., Securities and Exchange Commission) actions against CPAs. As soon as notification is received by the secretary of the AICPA, a suspension or termination notice is automatically mailed to the member via registered or certified mail. If the member does not appeal, then the action is viewed as final and publicized in *The CPA Letter*. However, if the member appeals in writing, then the Trial Board forwards the appeal to an *ad hoc* committee for a decision. If the appeal is granted, then the case is forwarded to the Ethics Division for appropriate action. Otherwise, the automatic decision is affirmed and publicized in *The CPA Letter*. The disciplinary action is termination in cases of:

• crime punishable by imprisonment for more than a year;

• willful failure to file an income tax return when required by law;

• filing false or fraudulent income tax return on own or client behalf; and

• willful aid in preparation and presentation of a false and fraudulent income tax return of a client.

Membership will be revoked or suspended without a hearing if the member's practice license is suspended or revoked as a disciplinary action by a governmental agency.

The cases that do not result in automatic suspension or termination of membership are Code violations that have been brought to the attention of state societies or the AICPA through complaints made by individuals, clients, or other CPAs. JEEP processes these cases. The member can plea guilty and/ or resign from the AICPA and state society membership. In this case, the Trial Board may recommend acceptance of the member's resignation, but require that the member appear for a hearing by the Trial Board at a later date. If the member does not plead guilty or the Trial Board does not accept the member's resignation, a panel is set up by the Trial Board for investigation of the case. The Trial Board may choose not to accept a member's resignation due to the seriousness of a violation. They may feel that, to serve the public interest, the member needs to be publicly expelled. The panel may decide that no action is necessary, or may schedule a hearing. The result of the hearing may be that no action is necessary or that the member must be admonished, suspended, terminated, or must perform some activity such as taking a certain amount of hours of continuing professional education. The member can appeal this decision within thirty days, and if granted, the Trial Board will review the decision and will uphold it, change it, or find the member innocent and inform the member of its decision. If the decision is that a violation had occurred for which disciplinary action is taken, then the decision is publicized in *The CPA letter.*

4. Illustrative disciplinary actions

To illustrate the disciplinary actions against CPAs, we first present the facts about an individual who was found to have violated the AICPA Code. We present descriptive data to show the extent of the disciplinary actions taken over a 20-year period. This information is extracted from a disciplinary action database we have compiled from an examination of *The CPA Letter* published from 1977 until 1996.

Case 353 occurred in 1990. The individual was found to have violated the AICPA Code by having assisted in the preparation of a false tax return and having obstructed justice by lying about it (i.e., perjury). The information came from conviction in the court of law and automatically resulted in termination of AICPA membership.

A summary of the 20-year data is presented in table 14.2. The data is classified by the type of disciplinary action (termination, suspension, and other) and by the source of action (automatic or hearing). The averages per year are also provided. These are calculated by dividing the raw numbers by 20 years (1977-1996). Finally, we have divided the average yearly disciplinary actions by the average number of members in the AICPA over the 20-year period to find the average number of disciplinary actions per 10,000 AICPA members.

Several observations from table 14.2 are interesting to note. First, a majority of cases were automatic disciplinary actions. Out of the 488 terminations, 330 were automatic as compared with 158 that resulted from the Joint Trial Board hearings. Similarly, of the 250 cases of suspension, 138 were automatic as compared with 112 that resulted from hearings. The exception was “other” cases that resulted in admonishment, censure or other types of disciplinary actions. None of these cases was the result of an automatic disciplinary action. Thus, overall, of the 803 cases, 468 were subjects of automatic action as compared with 335 hearings by the Joint Trial Board.

Second, a related observation is that a majority of the cases, automatic or hearing, resulted in the termination of the violator from the AICPA membership. Of the 468 automatic cases, 330 resulted in termination of membership. Similarly, 158 of the 335 hearing cases resulted in termination of the violator. Suspension was next followed by «other» disciplinary actions.

Table 14.2 AICPA's disciplinary action statistics 1977-1996

	Source			
Disciplinary action	***Automatic***	***Hearing***	***Total***	***Average per 10,000***
Termination	330 (16.5/year)	158 (7.9/year)	488 (24.4/year)	1.1
Suspension	138 (6.9 /year)	112 (5.6/year)	250 (12.5/year)	0.5
Other (e.g., admonish or censure)	0 (0/year)	65 (3.25/year)	65 (3.25/year)	0.1
Total	468 (23.4/year)	335 (16.75/year)	803 (40.15/year)	
Average per 10,000	1.0	0.7	1.7	1.7
Membership size:	1977 130	331		
	1996 324	938		
Average	227	634		

Source: Disciplinary Action Database compiled by the authors from the CPA Letter.

Third, the average per 10,000 membership indicates that overall, only 1.7 people (1 automatic and 0.7 from hearing) were disciplined per year. Out of these 1.1 were terminated, 0.5 were suspended, and 0.1 were subjected to other disciplinary actions.

A conclusion from this data is that violations of the Code by the AICPA members are rare. The assumption is that all major cases are detected and adjudicated by the AICPA, state boards of accountancy, and state societies of CPAs. There are, of course, unreported or undetected violations of the Code as well. Thus, the true level of ethical behavior is not possible to observe. However, it is in the best interest of a self-regulating profession to expose unethical behavior. With this in mind there are several significant overall ethical controversies facing the profession and these are discussed in the next section.

5. Controversial ethical issues in the accounting profession

As discussed in the previous sections, the accounting profession has developed a code of conduct and has an elaborate disciplinary program in place to enforce the Code.

Surveys of CPAs (e.g., Cohen and Pant, 1991) indicate that the Code and its enforcement are viewed as effective for the professional body. This does not, however, mean that the profession has been free from criticism. While CPAs, in general, do not believe that unethical behavior leads to success, they do perceive that opportunities exist in the accounting profession to engage in unethical behavior. This is because surveys of CPAs indicate that some clients request fraudulent alteration of tax returns or financial statements (Finn et al., 1988).

Critics allege that these client pressures, causing ethical problems for the profession, are partly due to the professionals having abandoned the legitimacy of ethical character, that was the norm in the early 1900s. Critics support this allegation by noting that, in the early 1900s, there were virtually no general auditing or accounting standards, while today there is a large complicated set of standards and rules. Critics claim that today's CPAs rely on "following the rules" rather than focusing on what is the best, fairest, or clearest

presentation of accounting information. As technical expertise has become the cornerstone of the CPA practice, the legitimacy of technique has replaced the legitimacy of character (Abbott, 1988: 190). Even within this technical expertise, critics argue that some CPAs have ignored their clients' creative accounting, in which earnings have been manipulated in some cases. For example, Lomas Financial Corporation has filed a US$300 million lawsuit against its auditors, alleging that two audit partners collaborated with the management of Lomas Financial Corporation to conceal risky financial practices that contributed to the company's failure (MacDonald, 1997).

Similarly, a large potential area of concern for CPA firms is the exposure to lawsuits from consulting engagements. The largest lawsuit yet filed against a CPA firm (US$4 billion) was related to a consulting engagement by an accounting firm to develop and implement a "turnaround plan" for Merry-Go Round Enterprises (MacDonald, 1997). The suit alleges fraud, fraudulent concealment, negligence, and lack of independence. These are issues that are normally raised in an audit engagement lawsuit. William Brewer, an attorney, states "It's an unusual suit. Big Six accounting firms have generally not been sued for their consulting work. However, it's a sign of the times. You'll see many more of these cases in the future as accountants hold themselves out as business consultants" (MacDonald, 1997: 312).

In other cases, rapid changes in the information technology have brought the CPA's knowledge under question. The new information technology has also changed the public need for CPA services. For example, whereas traditional audited financial statements were issued three or four months after the closing of the client's fiscal year, the new technology has made it possible to provide the information on line and in real time. As mentioned earlier, the profession has responded by developing the *WebTrust*[sm] service to respond to this need.

Perhaps the most significant ethical challenge to the profession is the question of independence. It has been alleged that auditors systematically violate the Code's independence rule. The Code is clear in its direction of the need for independence, not only in fact (which is unobservable), but also in appearance, which can be observed by third parties. The auditor may, in fact, exercise independence from the client even if he or she has financial interest in the company. However, to assure independence in appearance, the auditor is prohibited from having any direct interest such as stock ownership in the client or significant indirect interest such as ownership of stocks in the client by the CPA's close relatives.

Critics argue that independence rules must also be addressed in cases of providing conflicting services to the client. For example, how can an auditor be independent of his or her client in conducting a financial audit if the auditor is also the one who had provided advice in the development or purchase of the client's accounting system? Similarly, the profession has been criticized for taking inadequate responsibility for detecting fraudulent financial reporting by clients in situations where auditor's self interest has been on the line. These allegations have resulted in Congressional investigations of the profession. For example, Senator Metcalf investigated the profession in 1976 (US Senate, 1976), while Senators Moss did the same in 1978 (US Senate, 1978)[2].

The profession's response has been to set up commissions to investigate these issues, and to provide recommendations, based on which new pronouncements could be issued. For example, in response to Senators Metcalf and Moss investigations, the AICPA established the Commission on Auditors' Responsibilities in the mid-1970s (The Cohen Commission, 1978). The recommendations from this commission led to the establishment of another commission to investigate fraudulent financial reporting (The Treadway Commission, 1987), and later to another commission (COSO, 1992) that made a long list of recommendations. As a result of the recommendations of these commissions, the profession has taken significant steps to enhance its guidance for practitioners by issuing new pronouncements. The revised Code of Conduct issued in 1988 (AICPA, 1988) tightened the Code requirements by eliminating some ambiguous and controversial sections. Specifically, the new Code allows for advertising by CPAs that was prohibited by the earlier code. In the same year, the Auditing Standards Board issued a package of nine

new *Statements on Auditing Standards* (dubbed expectation gap standards) to provide better guidance to the auditors in their conduct of the financial audit. More recently, the Auditing Standards Board responded to the Treadway Commission (1987) and COSO (1992) reports by issuing a new *Statement on Auditing Standards No. 82*, that requires auditors to plan the audit so that if fraud exists, it can be detected (Auditing Standards Board, 1997). In the past, the profession steadfastly denied responsibility to plan the audit for the purpose of detecting fraud, although it maintained that if fraud was indicated in the course of the normal audit, it would be investigated.

Other contemporary ethical issues confronting the profession include confidentiality, public confidence, and serving the public interest.

Confidentiality

The CPA is entrusted with a large amount of information from the client. The auditor is prohibited to share this information with others, except in response to court order and other exceptional situations. For example, the auditor can provide financial ratios to industry trade groups so long as specific client information is not revealed. However, the auditor cannot use confidential information for self or other financial interests such as trading stocks based on the insider information gathered in the course of the audit.

Public confidence

The profession allows CPAs to advertise, but through its ethic rulings, it limits the type of advertising to those that enhance public confidence. For example, contingent fees and commissions are not allowed for referral of attest function services (i.e., audits, compilation and reviews), but allowed for management advisory services. Contingent fees and referral commissions were prohibited altogether until 1988, when the AICPA council voted to change the rule, under pressure from the Federal Trade Commission (Mintz, 1990: 3). Nevertheless, critics argue that advertising has helped change public accounting from a profession to a business (Mason, 1994).

Serving the public interest

As stated earlier, the profession has only recently begun to accept responsibility for planning the audit for detection of fraud and other illegal acts (Auditing Standards Board, 1997). More needs to be done to clarify the CPA's responsibility to the public. For example, should the CPA engage in whistle-blowing when an illegal act or fraud is detected to have been committed by a client? As critics argue, at the present time, "the resolution of conflicts between an accountant's client, on the one hand, and the general public, on the other, is usually balanced in favor of the client. The legal system supports this outcome, at least for the time being" (Epstein and Spalding, 1993: 271). Others argue that the source of this problem is the weight that is placed on confidentiality at the expense of public interest (Collins and Schulz, 1995).

II. Conclusion

The accounting profession has developed an elaborate Code of Conduct complete with a continuing education and an effective enforcement program. However, more needs to be done to make accountants more responsive to public expectations to enhance public trust. While the profession has been forthcoming in its responses to Congressional hearings and private commission recommendations in the past two decades, more is needed to continue building a more trustworthy profession. This is especially urgent in light of the speedy change that is fostered by the age of information technology.

References

Abbott, A. (1988). *The System of Professions: An Essay on the Division of Expert Labor.* Chicago, IL, University of Chicago Press.

AICPA (1988). *Code of Professional Conduct.* AICPA, New York.

(1997). *Joint Ethics Enforcement Program (JEEP). Manual of Procedures.* New York.

AICPA Auditing Standards Board (1997). *Statement on Auditing Standards No. 82: Consideration of Frau in a Financial Statement Audit.* New York.

AICPA. CPA Vision Project (1998) "CPA vision project identifies top five core values". *The CPA Letter* l, June, 9.

Cohen, R., Pant, L.W. (1991). "Beyond bean counting: Establishing high ethical standards in the public accounting profession". *Journal of Business Ethics,* 10, 45-56.

Collins, A., Schulz, N. (1995). "A critical examination of the AICPA Code of Professional Conduct". *Journal of Business Ethics*, 14, 31-41.

COSO (1992). *Internal Control: Integrated Framework*. Harborside, NJ.

Elliott, R. K., Pallais, D. M. (1997) "First: Know your market". *Journal of Accountancy,* July, 56-63.

Epstein, M. J. and Spalding, A. D. (1993) *The Accountant's Guide to Legal Liability and Ethics*. MA, Irwin, Boston.

Finn, D. W., Chenko, L. B., Hunt, S. D. (1988). "Ethical problems in public accounting: The view from the top." *Journal of Business Ethics*, 7, 605-15.

Haberman, L. D. (1998). "Regulatory reform at NASBA." *Journal of Accountancy*. February, 16-17.

KPMG (1996) *Innovating Best Ethical Practices*. Montvalle, NJ.

KPMG, Marwick, Peat (1997). "Creating the moral organization." *KPMG Internet Web Site*. Montvalle, NJ.

KPMG, Marwick, Peat, LLP. MacDonald, E. (1997) "Trustee files $4 billion lawsuit against Ernst & Young." *The Wall Street Journal,* December 2, 240, B12.

Mason, E. (1994). "Public accounting: No longer a profession?" *The CPA Journal*, 64(6) July, 34-7.

Mintz, S. (1990) *Cases in Accounting Ethics and Professionalism*. McGraw-Hill, New York.

Neale, A. (1996) "Conduct, misconduct and accounting." *Journal of Business Ethics*, 15, 219-26.

News Report (1995) "New era in ethics enforcement." *Journal of Accountancy*, August, 13.

Pallais, D. (1996) "Assurance services: Where we are; where we're going." *Journal of Accountancy*, 182(3) September, 16-17.

Preston, A. M., Cooper, D. J., Scarbrough, D. P. (1995)" Changes in the code of ethics of the US accounting profession, 1917 and 1988: The continual quest for legitimization." *Accounting, Organizations and Society*, August, 507-46.

Ruble, M. R. (1997) "Letter from the state board: What should you do next?" *Journal of Accountancy*, 183(5) May, 75.

The Cohen Commission (1978). "Report, Conclusions, and Recommendations." AICPA, New York, .

The New York Times, December 27, 1997: 147, B147.

The Treadway Commission (1987) *Report of the National Commission on Fraudulent Financial Reporting*. AICPA, New York.

US Senate Subcommittee on Reports, Accounting and Management of the Committee on Governmental Affairs; the Metcalf Committee (1976). *The Accounting Establishment*. US Government Printing Office, Washington DC.

US Senate; the Moss Committee (1978) *Report of the Committee on Auditors' Responsibilities*. US Government Printing Office, Washington DC.

---

[1] Source: AICPA (1988)

[2] A detailed discussion of these investigations and the profession's response to them is beyond the scope of this chapter; they are stated here to show the significance of the issues.