


Ethical Traps: Let's Examine Some Recent, Real World Cases

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Ethical Traps: Let's Examine Some Recent, Real World Cases




- The AICPA Conceptual Framework—the Threats and Safeguards Approach to Ethical Compliance
- The 9 Threats to Independence
- Conflicts of Interest vs. Independence/Objectivity
- The AICPA Framework versus AGA's, IIA's, and ISACA's Codes of Ethics
- Let's Take a Look at Some Recent, Real-World Cases

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Please Note




The views expressed in this presentation are my views and do not represent the official views of the AGA Professional Ethics Board

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The AICPA Conceptual Framework—the Threats and Safeguards Approach to Ethical Compliance



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AICPA Conceptual Framework



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AICPA Conceptual Framework

Identify Ethical Threat



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The 7 Threats to Independence

- Adverse Interest
- Advocacy
- Familiarity
- Management Participation
- Self-Interest
- Self-Review
- Undue Influence

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Adverse Interest

The threat that a member will not act with objectivity because the member's interests are opposed to the client's interests. E.g.:

- Your audit client or a shareholder threatens to sue you unless to render a certain opinion ...
- A client or officer, director or significant shareholder sues your firm ...

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Advocacy

The threat that a member will promote a client's interests or position to the point that his or her objectivity or independence is compromised. E.g.:

- You provide forensic accounting services for a client in litigation or in a dispute with 3rd parties ...
- You endorse a client's services or products ...

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Familiarity

The threat that, due to a long or close relationship with a client, a member will become too sympathetic to the client's interests or too accepting of the client's work or product. E.g.:

- One of your close relatives or a close friend is employed by the client ...
- One of your former partners or a former professional employee takes a key position with the client ...

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Management Participation

The threat that a member will take on the role of client management or otherwise assume management responsibilities. E.g.:

- Your firm was previously retained by the client to design its accounting policies and procedures ...
- Your client lost its CFO suddenly and asked your firm to take over that role until they found a new CFO ...

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Self-interest

The threat that a member could benefit, financially or otherwise, from an interest in, or relationship with, a client or persons associated with the client. E.g.:

- You have a financial interest in a client and the outcome of your engagement with the client may affect the value of that financial interest ...
- Excessive reliance exists on revenues from a single client ...

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Self-Review

The threat that a member will not appropriately evaluate the results of a previous judgment made or service performed or supervised by the member or an individual in the member's firm and that the member will rely on that service in forming a judgment as part of another service. E.g.:

- Your firm provided bookkeeping services for a client ...
- One of your partners was formerly a key employee of the client ...

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Undue Influence

The threat that a member will subordinate his or her judgment to an individual associated with a client or any relevant third party due to that individual's reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the member. E.g.:

- Your firm is threatened with dismissal from a client engagement ...
- The client indicates that your firm will not get future work if you continue to disagree on accounting matters ...

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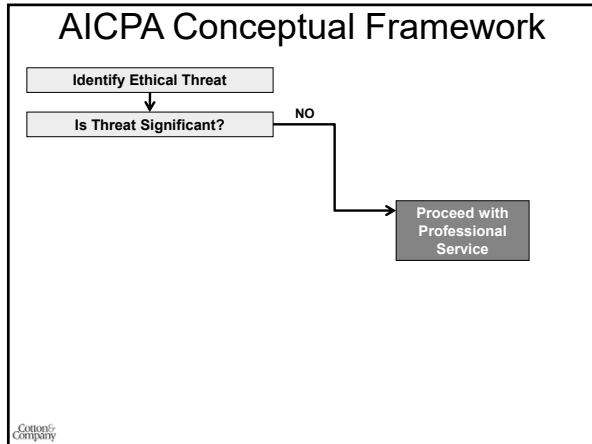
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The 6 Threats to Complying with Other Parts of the Code

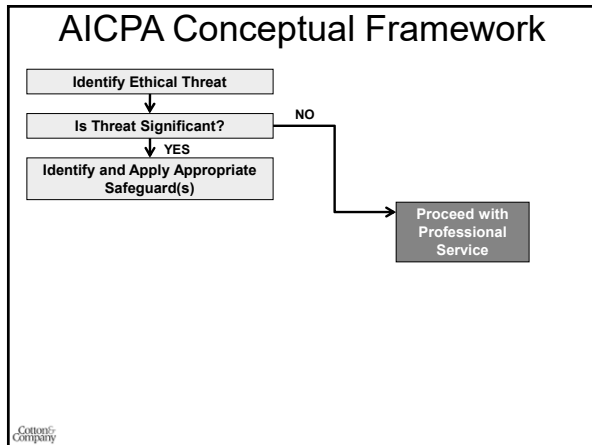
- Adverse Interest
- Advocacy
- Familiarity
- Management Participation
- Self-Interest
- Self-Review
- Undue Influence

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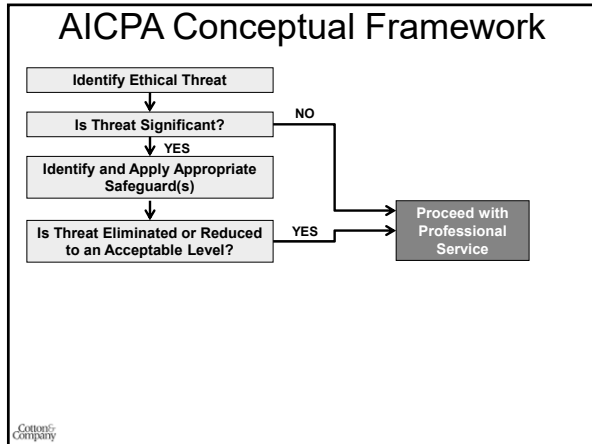
Safeguards

An action or control that will tend to mitigate a threat. There are 3 broad categories

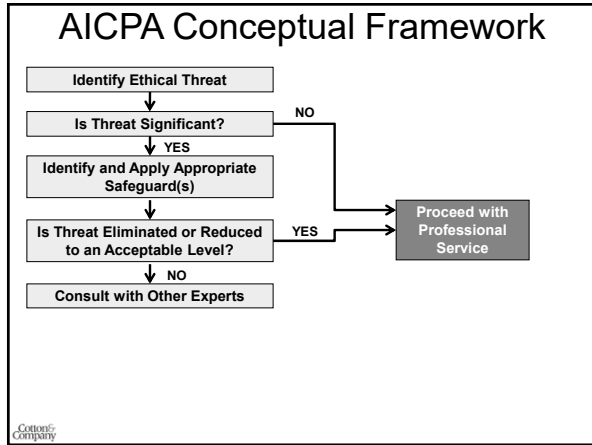
- Safeguards created by the profession, legislation, or regulation.
- Safeguards implemented by the client. (It is not possible to rely solely on safeguards implemented by the client to eliminate or reduce significant threats to an acceptable level.)
- Safeguards implemented by the firm, including policies and procedures to implement professional and regulatory requirements.

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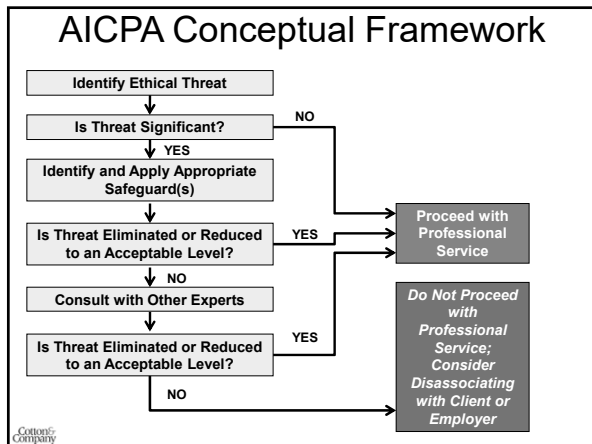
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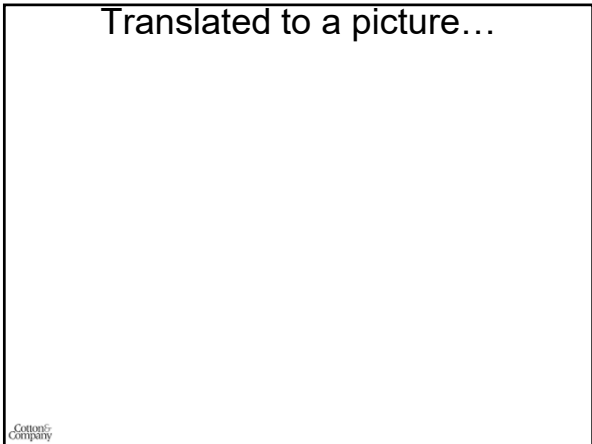


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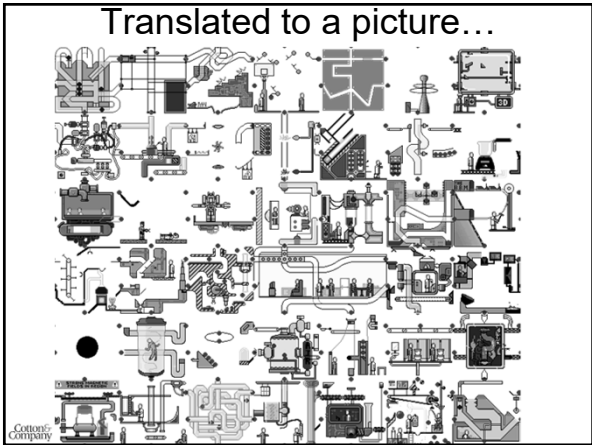
Translated to a picture...



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Translated to a picture...



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AICPA Threats vs. Yellow Book Threats

AICPA	Yellow Book
• Adverse Interest	• Adverse Interest
• Advocacy	• Advocacy
• Familiarity	• Familiarity
• Management Participation	• Management Participation
• Self-Interest	• Self-Interest
• Self-Review	• Self-Review
• Undue Influence	• Undue Influence
	• Bias
	• Structural

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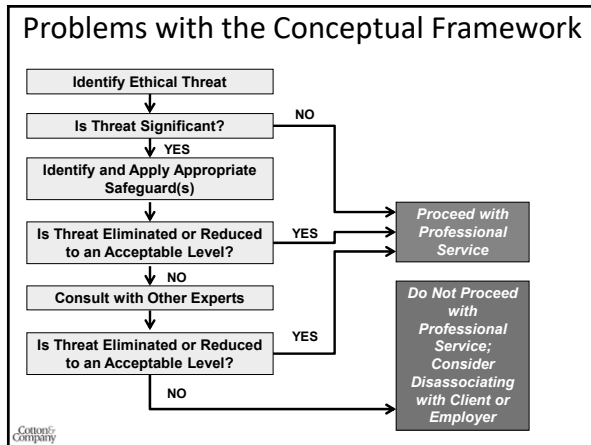
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Yellow Book Threats

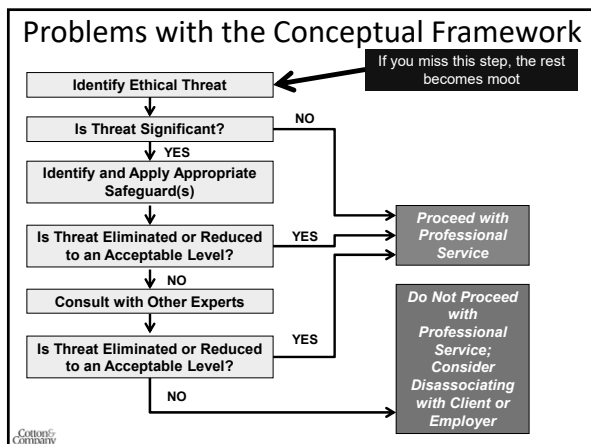
- **Bias threat** – the threat that an auditor will, as a result of political, ideological, social, or other convictions, take a position that is not objective.
- **Structural threat** – the threat that an audit organization's placement within a government entity, in combination with the structure of the government entity being audited, will affect the audit organization's ability to perform work and report results objectively.

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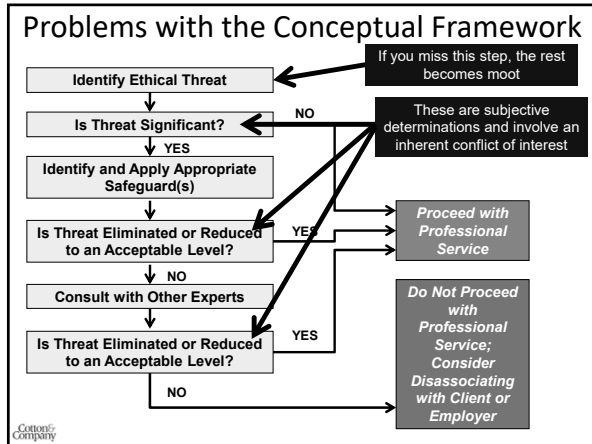
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Conflicts of Interest vs. Independence/Objectivity

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- ### The 7 Threats to Independence
- Adverse Interest
 - Advocacy
 - Familiarity
 - Management Participation
 - Self-Interest
 - Self-Review
 - Undue Influence
- ALL of these are simply conflicts of interest ...**
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The 7 Threats to Independence

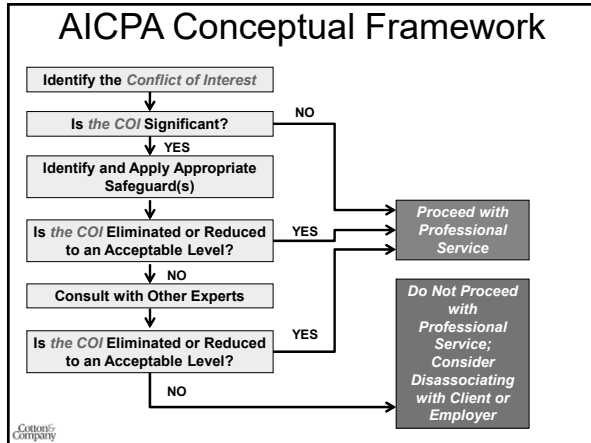
- Adverse Interest
- Advocacy
- Familiarity
- Management Participation
- Self-Interest
- Self-Review
- Undue Influence

ALL of these are simply conflicts of interest ...

While there is some benefit to identifying the 7 categories of conflicts of interest, should there be a Code rule that simply deals with conflicts of interest?

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There are Actually Separate Code Sections that Cover COIs

1.110 Conflicts of Interest
1.110.010 Conflicts of Interest for Members in Public Practice

.12 When a conflict of interest exists, the member should disclose the nature of the conflict of interest to clients and other appropriate parties affected by the conflict and obtain their consent to perform the professional services. *The member should disclose the conflict of interest and obtain consent even if the member concludes that threats are at an acceptable level.*

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There are Actually Separate Code Sections that Cover COIs

- 2.110 Conflicts of Interest
- 2.110.010 Conflicts of Interest for Members in Business

.11 When a conflict of interest exists, the member should disclose the nature of the conflict to the relevant parties, including to the appropriate levels within the employing organization and obtain their consent to undertake the professional service. *The member should disclose the conflict of interest and obtain consent even if the member concludes that threats are at an acceptable level.*

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Oddly, however, the Code does not define a COI



1. A situation that has the potential to undermine the impartiality of a person because of the possibility of a clash between the person's self-interest and professional interest or public interest.
2. A situation in which a party's responsibility to a second-party limits its ability to discharge its responsibility to a third-party.

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The AICPA Framework versus AGA's, IIA's, and ISACA's Codes of Ethics

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The AICPA Framework versus AGA's Code of Ethics

- Can AGA, IIA, and ISACA members use the AICPA Conceptual Framework to stay in compliance with the AGA's Code of Ethics?

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The AICPA Framework versus AGA's Code of Ethics

AGA's Code of Ethics has 4 Overarching Principles:

1. *AGA Members and CGFMs Shall Serve and Support the Public Interest.*
2. *AGA Members and CGFMs Shall Maintain the Highest Standards of Professionalism and Integrity.*
3. *AGA Members and CGFMs Shall Remain Objective in Carrying Out their Duties and Responsibilities.*
4. *AGA Members and CGFMs Shall Carefully Maintain and Protect Confidential Information.*

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The AICPA Framework versus IIA's Code of Ethics

IIA's Code of Ethics has 4 Overarching Principles:

1. *Integrity*
2. *Objectivity*
3. *Confidentiality*
4. *Competency*

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The AICPA Framework versus ISACA’s Code of Ethics

AGA’s Code of Professional Ethics has 7 Overarching Principles, Including:

- 2. Objectivity, due diligence, and professional care
- 3. Serve in the interest of stakeholders in a lawful manner, maintaining high standards of conduct and character
- 4. Maintain privacy and confidentiality
- 5. Maintain competency

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The AICPA Framework versus AGA’s Code of Ethics

AGA’s principles align quite closely with the AICPA’s Code of Professional Conduct:

AGA Principle	AICPA Principle
Serve/support 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 a commitment to professionalism. [0.300.030]
Maintain high standards of professionalism and integrity	Members should perform all professional responsibilities with the highest sense of integrity. [0.300.040]
Remain objective in carrying out duties and responsibilities	A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. [0.300.050]
Carefully maintain and protect confidential information	A member ... shall not disclose any confidential client information without the specific consent of the client. [1.700-001]

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The AICPA Framework versus AGA’s, IIA’s, and ISACA’s Codes of Ethics

- If you find yourself facing a potential ethical dilemma as it relates to the AGA, IIA, or ISACA Codes of Ethics, the AICPA Conceptual Framework might help you maneuver through it successfully.

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Let's Take a Look at Some Recent, Real-World Cases

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Other Professionals' Ethical Lapses

- Engineers
- Journalists
- Medical Researchers
- Prosecutors

- The Sad, Sad Case of Arthur Andersen

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Engineers and the "Diesel Dupe"

BBC

Volkswagen: The scandal explained

By Russell Hotten
Business reporter, BBC News

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Engineers and the “Diesel Dupe”

BBC

It's been dubbed the "diesel dupe". In September, the **Environmental Protection Agency (EPA)** found that many VW cars being sold in America had a "defeat device" - or software - in diesel engines that could detect when they were being tested, changing the performance accordingly to improve results. The German car giant has since admitted cheating emissions tests in the US.

When the cars were operating under controlled laboratory conditions - which typically involve putting them on a stationary test rig - the device appears to have put the vehicle into a sort of safety mode in which the engine ran below normal power and performance. Once on the road, the engines switched out of this test mode.

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An Ethical Breach, Per the NSPE NATIONAL SOCIETY OF PROFESSIONAL ENGINEERS

Fundamental Canons
Engineers, in the fulfillment of their professional duties, shall:

1. Hold paramount the safety, health, and welfare of the public.
2. Perform services only in areas of their competence.
3. Issue public statements only in an objective and truthful manner.
4. Act for each employer or client as faithful agents or trustees.
5. Avoid deceptive acts.
6. Conduct themselves honorably, responsibly, ethically, and lawfully so as to enhance the honor, reputation, and usefulness of the profession.

Content Company Source: NSPE Code of Ethics for Engineers, <https://www.nspe.org/resources/ethics/code-ethics>

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An Ethical Breach, Per the NSPE NATIONAL SOCIETY OF PROFESSIONAL ENGINEERS

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4. Act for each employer or client as faithful agents or trustees.
5. **Avoid deceptive acts.**
6. **Conduct themselves honorably, responsibly, ethically, and lawfully so as to enhance the honor, reputation, and usefulness of the profession.**

Content Company Source: NSPE Code of Ethics for Engineers, <https://www.nspe.org/resources/ethics/code-ethics>

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Which threats should these engineers have been concerned about?


AICPA	Yellow Book
A. Adverse Interest	H. Bias
B. Advocacy	I. Structural
C. Familiarity	
D. Management Participation	
E. Self-Interest	
F. Self-Review	
G. Undue Influence	

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Which threats should these engineers been concerned about?

AICPA	Yellow Book
A. Adverse Interest	H. Bias
B. Advocacy	I. Structural
C. Familiarity	
D. Management Participation	
E. Self-Interest	
F. Self-Review	
G. Undue Influence	



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How would the VW engineers measure up against the AGA/IIA/ISACA Codes of Ethics?

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AGA's Code of Ethics 4 Overarching Principles:

1. *Serve and Support the Public Interest.* ←
2. *Maintain the Highest Standards of Professionalism and Integrity.* ←
3. *Remain Objective in Carrying Out their Duties and Responsibilities.*
4. *Carefully Maintain and Protect Confidential Information.*

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IIA's Overarching Principles

1. *Integrity* ←
2. *Objectivity*
3. *Confidentiality*
4. *Competency*

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ISACA's Overarching Principles

2. *Objectivity, due diligence, and professional care*
3. *Serve in the interest of stakeholders in a lawful manner, maintaining high standards of conduct and character* ←
4. *Maintain privacy and confidentiality*
5. *Maintain competency*

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Journalists and Political Activism



Political activism. A commendable MSNBC.com investigation revealed that at least 140 journalists contributed to political parties, movements or candidates. Many journalists explained why they felt they had done nothing wrong and nothing contrary to their news organization's policies.

Ten Florida journalists accepted payment from the federal government in exchange for their contributions to television and radio stations that work to undermine Cuban President Fidel Castro's regime.

SPJ's ethics code states that journalists should "remain free of associations and activities that may compromise integrity or damage credibility." The code also encourages journalists to shun "... political involvement, public office and service in community organizations if they compromise journalistic integrity."

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Which threats should these journalists have been concerned about?

- | | |
|---|--|
| <p>AICPA</p> <ul style="list-style-type: none"> A. Adverse Interest B. Advocacy C. Familiarity D. Management Participation E. Self-Interest F. Self-Review G. Undue Influence | <p>Yellow Book</p> <ul style="list-style-type: none"> H. Bias I. Structural |
|---|--|

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Which threats should these journalists been concerned about?

- | | |
|---|--|
| <p>AICPA</p> <ul style="list-style-type: none"> A. Adverse Interest B. Advocacy C. Familiarity D. Management Participation E. Self-Interest F. Self-Review G. Undue Influence | <p>Yellow Book</p> <ul style="list-style-type: none"> H. Bias I. Structural |
|---|--|

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How would these journalists measure up against the AGA/IIA/ISACA Codes of Ethics?

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AGA's Code of Ethics 4 Overarching Principles:

1. *Serve and Support the Public Interest.* ←
2. *Maintain the Highest Standards of Professionalism and Integrity.*
3. *Remain Objective in Carrying Out their Duties and Responsibilities.* ←
4. *Carefully Maintain and Protect Confidential Information.*

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IIA's Overarching Principles

1. *Integrity* ←
2. *Objectivity* ←
3. *Confidentiality*
4. *Competency*

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ISACA's Overarching Principles

2. Objectivity, due diligence, and professional care
3. Serve in the interest of stakeholders in a lawful manner, maintaining high standards of conduct and character
4. Maintain privacy and confidentiality
5. Maintain competency

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Journalist/Source Relationships

 **Society of Professional Journalists**
Empowering and protecting journalism since 1909

Journalist/Source relationships. Journalists must maintain a healthy distance from people they cover.

A former Telemundo anchorwoman reported about Los Angeles Mayor Antonio Villaraigosa's marital difficulties without mentioning that she was dating him. The station suspended and reassigned the anchor. When the anchor didn't show up for her new assignment, the station announced that she had quit her job.

Getting too close to sources sorely compromises a journalist's ability to "act independently," as SPJ's code instructs.

"Avoid conflicts of interest, real or perceived," the code states. And "remain free of associations and activities that may compromise integrity or damage credibility," the code instructs."

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Which threats should this journalist have been concerned about?

<p style="text-align: center;">AICPA</p> <p>A. Adverse Interest</p> <p>B. Advocacy</p> <p>C. Familiarity</p> <p>D. Management Participation</p> <p>E. Self-Interest</p> <p>F. Self-Review</p> <p>G. Undue Influence</p>	<p style="text-align: center;">Yellow Book</p> <p>H. Bias</p> <p>I. Structural</p>
--	---

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Which threats should this journalist have been concerned about?

AICPA	Yellow Book
A. Adverse Interest	H. Bias
B. Advocacy	I. Structural
C. Familiarity	
D. Management Participation	
E. Self-Interest	
F. Self-Review	
G. Undue Influence	

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How would this journalist measure up against the AGA/IIA/ISACA Codes of Ethics?

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AGA's Code of Ethics 4 Overarching Principles:

1. *Serve and Support the Public Interest.*
2. *Maintain the Highest Standards of Professionalism and Integrity.*
3. *Remain Objective in Carrying Out their Duties and Responsibilities.*
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IIA's Overarching Principles

1. *Integrity* 
2. *Objectivity* 
3. *Confidentiality*
4. *Competency*

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ISACA's Overarching Principles

2. Objectivity, due diligence, and professional care 
3. Serve in the interest of stakeholders in a lawful manner, maintaining high standards of conduct and character 
4. Maintain privacy and confidentiality
5. Maintain competency

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Feds Fault Premie Researchers For Ethical Lapses

npr

- Study involved 1,300 premature infants at nearly 2 dozen medical institutions between 2004 and 2009
- Infants were randomly assigned to receive 2 different levels of oxygen to see which was better at preventing blindness without increasing the risk of neurological damage or death
- Parents were not told in advance about the "reasonably foreseeable risks."

Source: <https://www.npr.org/sections/health-shots/2013/04/10/176811809/feds-fault-preemie-researchers-for-ethical-lapses>

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Feds Fault Premie Researchers For Ethical Lapses



- In fact, the consent form “did not identify any risks” from subjecting the infants to either the high or low oxygen levels.
- The published study showed that the infants who got the higher oxygen level had more than twice the incidence of severe blindness; while infants who got the lower level were slightly more likely to die.

Source: <https://www.npr.org/sections/health-shots/2013/04/10/176811809/feds-fault-preemie-researchers-for-ethical-lapses>



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Feds Fault Premie Researchers For Ethical Lapses



- Among the 654 babies in the low-oxygen cohort, 130 died—3.2% more than in the high oxygen cohort.
- In the high-oxygen cohort, 91 of 509 developed blindness—a rate of nearly 18%, compared to 9% in the low-oxygen cohort.
- The flawed consent forms were approved by ethics committees at all 23 medical institutions involved in the study.

Source: <https://www.npr.org/sections/health-shots/2013/04/10/176811809/feds-fault-preemie-researchers-for-ethical-lapses>



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Feds Fault Premie Researchers For Ethical Lapses



- The ethical problem came to light when Public Citizen called on the HHS secretary to apologize to the parents of the 1,316 infants involved in the study.
- *The word 'unethical' doesn't even begin to describe the egregious and shocking deficiencies in the informed-consent process for this study," Dr. Michael Carome of Public Citizen's Health Research Group says in a press release. He says it's likely that many parents would not have agreed to enroll their infants in the study if they had known about the risks.*

Source: <https://www.npr.org/sections/health-shots/2013/04/10/176811809/feds-fault-preemie-researchers-for-ethical-lapses>



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NIH Clinical Center
America's Research Hospital

Patient Recruitment
Ethics in Clinical Research
Ethical Guidelines

Informed Consent
For research to be ethical ... individuals should make their own decision about whether they want to participate This is done through a process called informed consent in which individuals (1) are accurately informed of the purpose, methods, risks, benefits, and alternatives to the research, (2) understand this information and how it relates to their own clinical situation or interests, and (3) make a voluntary decision about whether to participate.

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Which threats should these researchers have been concerned about?

AICPA	Yellow Book
A. Adverse Interest	H. Bias
B. Advocacy	I. Structural
C. Familiarity	
D. Management Participation	
E. Self-Interest	
F. Self-Review	
G. Undue Influence	

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Which threats should these researchers have been concerned about?

AICPA	Yellow Book
A. Adverse Interest	H. Bias
B. Advocacy	I. Structural
C. Familiarity	
D. Management Participation	
E. Self-Interest 	
F. Self-Review	
G. Undue Influence	

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How would these researchers measure up against the AGA/IIA/ISACA Codes of Ethics?



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AGA's Code of Ethics 4 Overarching Principles:


1. *Serve and Support the Public Interest.* ←
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IIA's Overarching Principles

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ISACA's Overarching Principles

- 2. Objectivity, due diligence, and professional care
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- 4. Maintain privacy and confidentiality
- 5. Maintain competency

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Prosecutors



Mike Nifong

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<https://www.wral.com/news/local/video/1767541/>

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Mike Nifong

- In 2006, prosecuted 3 Duke University lacrosse players for rape, sexual assault, and kidnapping
- Gave 50-70 media interviews in 1st weeks of the case; 48 statements to the press
- Nifong withheld DNA evidence from defense attorneys
- Many inconsistencies in the alleged victim's story surfaced
- NC Attorney General took over the case; dropped all charges against the 3 athletes.

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Mike Nifong

- NC State Bar filed ethics charges against Nifong
- Nifong disbarred based on guilty findings on 27 of 32 ethics charges
- Served 1 day in jail for contempt of court
- Civil suit by the 3 players revealed that Nifong thought the case would further his re-election efforts (Nifong told his campaign manager that the case would provide "millions of dollars in free advertising.")
- Nifong declared bankruptcy in 2008 (\$244,000 in assets and \$180.3 million in liabilities)

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CRIMINAL JUSTICE STANDARDS
for the
PROSECUTION FUNCTION

- Nifong likely violated (at least) standards:
- 3-1.4 The Prosecutor's Heightened Duty of Candor
 - 3-1.5 Preserving the Record
 - 3-1.6 Improper Bias Prohibited
 - 3-1.7 Conflicts of Interest
 - 3-1.10 Relationship with the Media
 - 3-3.3 Relationship with Courts, Defense Counsel and Others
 - 3-5.4 Identification and Disclosure of Information and Evidence

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Which threats should Nifong have been concerned about?

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How would Nifong measure up against the AGA/IIA/ISACA Codes of Ethics?

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AGA's Code of Ethics 4 Overarching Principles:

1. *Serve and Support the Public Interest.* ←
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3. *Remain Objective in Carrying Out their Duties and Responsibilities.* ←
4. *Carefully Maintain and Protect Confidential Information.*

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IIA's Overarching Principles

1. *Integrity* ←
2. *Objectivity* ←
3. *Confidentiality*
4. *Competency* ←

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ISACA's Overarching Principles

2. *Objectivity, due diligence, and professional care* ←
3. *Serve in the interest of stakeholders in a lawful manner, maintaining high standards of conduct and character* ←
4. *Maintain privacy and confidentiality*
5. *Maintain competency* ←

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***The Sad, Sad Case of
Arthur Andersen***

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**The AICPA PEEC Issued the
Conceptual Framework in 2006**

- Arthur Andersen (the firm) “died” in 2002
- Could the Conceptual Framework have saved the firm?
- Could the AGA Code of Ethics have saved the firm?

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Andersen: The Best of the Best

- Founded in 1914
- Motto: “Think Straight, Talk Straight”
- Changed the way auditing was done:
 - “[Andersen] made a name for himself by providing auditing that was answerable to companies’ shareholders, not their executives”

Source: Power Failure, The Inside Story of the Collapse of Enron, Mimi Swartz and Sherron Watkins, Doubleday, 2003, page 94.

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Andersen: The Best of the Best

My own mother told me in Norwegian, "Think straight—talk straight." No finer heritage could possibly be passed from one generation to another. It has been as a firm rock to which I could anchor in a storm. Never has it failed me.... This challenge will never fail anyone in a time of trial and temptation.

--Arthur E. Andersen

Source: Final Accounting: Ambition, Greed, and the Fall of Arthur Andersen, Barbara Ley Toffler, Broadway Books, 2003, page 9.

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Andersen: The Best of the Best

- At age 28, Arthur Andersen confronted the president of his fledgling firm's most lucrative client
- The company had not properly accounted for operating expenses, thereby inflating profits
- The president insisted that Andersen change his report
- Andersen said, "There's not enough money in the city of Chicago to induce me to change that report!"
- The client fired Andersen, "but, months later ... the [client] filed for bankruptcy. [Andersen] had been right."

Source: Final Accounting: Ambition, Greed, and the Fall of Arthur Andersen, Barbara Ley Toffler, Broadway Books, 2003, page 12.

Corporation's Company

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Andersen: The Best of the Best

- Arthur Andersen died in 1947
- His successor was Leonard Spacek
- "It was under Spacek's leadership that the firm grew into the most respected—and feared—accounting firm in the world"
- "Leonard believed that you could be outspoken within the profession and develop a firm on integrity, and you would be respected by your clients for trying to move the profession forward" (according to Harvey Kapnick)

Source: Final Accounting: Ambition, Greed, and the Fall of Arthur Andersen, Barbara Ley Toffler, Broadway Books, 2003, page 17-18.

Corporation's Company

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Andersen: The Best of the Best

- By the 1970s and 1980s, there were 8 major CPA firms, known as “The Big 8”
- In reality, however, there was Arthur Andersen, and then the other 7 firms
- How did things go so terribly wrong for Andersen?

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How did things go so terribly wrong for Andersen?

- The auditing profession changed drastically in the 1990s
- “In the old days, the client didn’t tell us what to do. We told the client what was right. And if they didn’t listen to us, we dropped them. In those days, being dropped by your auditor was a scary business; it usually meant that your stock price would drop as well. Not anymore. Now if the auditor tells the client something it doesn’t like, the client drops the auditor—and that can mean a few million dollars a year right down the drain.” [Retired Andersen partner]

©Cotten's Company Source: Final Accounting: Ambition, Greed, and the Fall of Arthur Andersen, Barbara Ley Toffler, Broadway Books, 2003, page 49.

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How did things go so terribly wrong for Andersen?

- The auditing profession changed drastically in the 1990s in another significant way—consulting
- The major CPA firms discovered that consulting services were higher profit and lower risk
- This relegated the audit to a commodity—an avenue to get access to lucrative consulting work—sometimes as a loss leader

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How did things go so terribly wrong for Andersen?

- In the late 1970s, Andersen’s CEO, Harvey Kapnick, foresaw the inherent conflict of interest in auditing and consulting at the same client and proposed splitting the two practices while remaining under the Andersen Worldwide (AW) organization
- This led to a two-decades-long struggle within the firm between AA (Arthur Andersen) and AC (Andersen Consulting)
- On 17 December 1997, the AC partners voted to break completely from AA

Source: Final Accounting: Ambition, Greed, and the Fall of Arthur Andersen, Barbara Ley Toffler, Broadway Books, 2003, pages 77; 93.

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How did things go so terribly wrong for Andersen?

- Arbitration ensued to determine how much AC would pay AA; AA partners expected about \$15 billion
- In the meantime, to maintain profitability, AA immediately began ... selling consulting services
- AC offered AA \$2 billion; AA turned that down
- On 7 August 2000, the arbitrator ruled: AC had to pay AA \$1 billion; and AC could no longer use the Andersen name

Source: Final Accounting: Ambition, Greed, and the Fall of Arthur Andersen, Barbara Ley Toffler, Broadway Books, 2003, pages 96-97.

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How did things go so terribly wrong for Andersen?

- AC had been generating the majority of AW profits
- Loss of those profits when AC split in 1997 “meant an instant \$100,000 haircut per year for all AA partners”
- AA partners began selling ... consulting services
- The AA “one firm” culture changed drastically
- “In the end, it was all about the bucks”

Source: Final Accounting: Ambition, Greed, and the Fall of Arthur Andersen, Barbara Ley Toffler, Broadway Books, 2003, pages 98.

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How did things go so terribly wrong for Andersen?

- “The four cornerstones of success at [AA]—People Management, Quality, Thought Leadership, and Financial Performance—were referred to as ‘three pebbles and a boulder.’ The boulder was financial performance. The rest, it seemed was a joke.”

Source: Final Accounting: Ambition, Greed, and the Fall of Arthur Andersen, Barbara Ley Toffler, Broadway Books, 2003, pages 105.

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How did things go so terribly wrong for Andersen?

- In the late 1990s, Enron became the 7th largest corporation in the world
- Enron’s accounting involved “aggressive” creation and use of special purpose entities (SPEs) to hide liabilities and losses
- The AA partner in charge of the Enron engagement, David Duncan, was asked to approve each SPE
- Carl Bass, a member of AA’s Professional Standards Group pushed back on the SPE accounting

Source: Final Accounting: Ambition, Greed, and the Fall of Arthur Andersen, Barbara Ley Toffler, Broadway Books, 2003, pages 210-213.

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How did things go so terribly wrong for Andersen?

- Duncan and other senior partners overruled Bass and Enron demanded that Bass no longer be involved in the engagement
- In 2000, AA was earning \$52 million per year from the Enron—roughly half audit fees and half consulting fees
- On 16 October 2001, Enron reported 3rd quarter losses of \$638 million

Source: Final Accounting: Ambition, Greed, and the Fall of Arthur Andersen, Barbara Ley Toffler, Broadway Books, 2003, pages 210-213.

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How did things go so terribly wrong for Andersen?

- AA in-house lawyer sent Duncan’s team an email on 12 October 2001: “It might be useful to consider reminding the engagement team of our documentation and retention policy”
- Duncan interpreted that as a recommendation to begin shredding documents
- Enron filed for bankruptcy protection on 2 December 2001
- AA was indicted on one felony count of obstruction of justice on 14 March 2002

Source: Final Accounting: Ambition, Greed, and the Fall of Arthur Andersen, Barbara Ley Toffler, Broadway Books, 2003, pages 219.

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How did things go so terribly wrong for Andersen?

- On 15 June 2002, the jury returned a guilty verdict
- “For all intents and purposes, Andersen was dead”

Source: Final Accounting: Ambition, Greed, and the Fall of Arthur Andersen, Barbara Ley Toffler, Broadway Books, 2003, pages 219-220.

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The New York Times

Justices Unanimously Overturn Conviction of Arthur Andersen

By LINDA GREENHOUSE MAY 21, 2005

WASHINGTON, May 31 - With a brief, pointed and unanimous opinion, the Supreme Court on Tuesday overturned Arthur Andersen’s conviction for shredding Enron accounting documents as that company was collapsing in one of the nation’s biggest corporate scandals.

The court held that the trial judge’s instructions to the jury failed to require the necessary proof that Andersen knew its actions were wrong.

But the decision represents little more than a Pyrrhic victory for Andersen, which lost its clients after being indicted on obstruction of justice charges and has no chance of returning as a viable enterprise. The accounting firm has shrunk from 28,000 employees in the United States to a skeleton crew of 200, who are attending to the final details of closing down the partnership. [Page C1.] In its ruling, legal experts said, the Supreme Court did not ultimately settle the issue of whether Andersen acted with criminal intent when it allowed many of Enron’s accounting papers to be destroyed. But it made clear that prosecutors went too far by pressing District Judge Melinda Harmon in Houston to set such a low hurdle for the jury to reach a guilty verdict in the case in 2002.

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Could the Conceptual Framework have saved Arthur Andersen?

- Adverse Interest
- Advocacy
- Familiarity
- Management Participation
- Self-Interest
- Self-Review
- Undue Influence

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End Thoughts

- Our ethics rules are complex (182 pages)
- It is difficult (if not impossible) to have a complete understanding of all of them
- *MOST* of the ethical problems we may encounter simply boil down to ***conflicts of interest*** (actual or in appearance)
- Remain alert for COIs
- Then, follow the Threats & Safeguards process
- Given the nature of COI situations, it's always helpful to seek advice from someone outside the COI situation—i.e., someone objective

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Recommended Reading

- Final Accounting: Ambition, Greed, and the Fall of Arthur Andersen, by Barbara Ley Toffler, Broadway Books, 2003
- Power Failure: The Inside Story of the Collapse of Enron, by Mimi Swartz and Sherron Watkins, Doubleday, 2003.
- Unaccountable: How the Accounting Profession Forfeited a Public Trust, by Mike Brewster, John Wiley & Sons, 2003.
- Enron: The Rise and Fall, by Loren Fox, John Wiley & Sons, 2003.
- CPAs (and I'm One) Can Reverse Their Losses, by Dave Cotton, The Washington Post, January 27, 2002.
- Fixing CPA Ethics Can Be an Inside Job, by Dave Cotton, The Washington Post, October 20, 2002.

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Ethical Traps: Let's Examine Some Recent, Real World Cases

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