

Ethical Leadership

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Learning Objectives

- Explain important principles underlying ethical decision-making, including when in a leadership role
- Recognize ethical dilemmas and how to approach resolution of conflicts

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Moral Philosophy

- Discipline concerned with what is morally good and bad - right and wrong
- Happiness comes from the knowledge of the “good”, which comes from goodness of character and wisdom of the intellect. – Socrates

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Aristotle's Virtue Ethics

- Ethics is comprised of virtue of thought and virtue of character
- Aimed towards the intermediary while cultivating a balanced life between excess and deficiency (called the “Golden Mean”)
 - e.g., bravery is the intermediate between cowardliness and recklessness
- By aiming at what is both good and just, a sustainable and self-sufficient happiness can be achieved

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Aristotle's Virtues – In Balance

- | | |
|--|---------------------------|
| 1. Courage | 8. Concern for others |
| 2. Temperance | 9. Truthfulness |
| 3. Spending well | 10. Wit |
| 4. Living well | 11. Friendliness |
| 5. Taking pride in accomplishments | 12. Modesty |
| 6. Concern with the noble, not the petty | 13. Righteous indignation |
| 7. Diligence | 14. Justice |

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Pulse Check – Ethical Dilemmas

Have you ever lied to get out of a social engagement you did not want to attend?

- A. Yes.
- B. No.
- C. Maybe.

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Integrity

- If you have it, nothing else matters.
- If you don't have it, nothing else matters.
- Moral men would do nothing dishonest, even if his actions would be hidden forever from the knowledge of gods and men. - Cicero

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E&Y Ethics 2022 Scandal

- Ernst & Young paid \$100 million fine after auditors cheated on Ethics component of CPA exams and CPE courses
 - Occurred between 2017-2021
 - E&Y admitted to withholding evidence from the SEC Enforcement Division's investigation
 - Largest penalty ever imposed by the SEC against an auditing firm
- Texas followed on with a \$3 million fine

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PwC Australia

- A partner leaked confidential information to other partners while consulting with the Australian Tax Office on the potential effects of proposed tax legislation
 - PwC turned the confidential information into billable hours for numerous clients
- Mandated bi-annual training on conflicts of interest policies and Code of Conduct in the years 2022 and 2024

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Recent Ethics Change

- Professional Qualifications and Competencies
- Broadens the scope of “solicitation or disclosure of CPA Examination questions and answers” to all activity related to acquiring and maintaining qualification and competency
- Effective immediately upon 9/15/23

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Common Ethical Issues in Today's World

- Accounting and financial reporting
- Data privacy
- Health and safety
- Favoritism and nepotism
- Harassment and discrimination

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Ethical excuses:

- It's legal
- It happens at work
- No one finds out
- No one gets hurt
- I don't benefit personally
- Someone else asked me to do it
- It's for a good cause
- Everyone else does it
- I didn't mean to do anything wrong
- **It isn't of consequence (materiality)**

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Business Ethics

*The set of **principles and standards** that govern our **actions and decisions** as they pertain to what is **right and wrong** within the context of **business practice**.*

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LRN Ethics Study

- 94% of employees surveyed say it is "critical" or "important" that a company they work for is ethical
- 82% would prefer to be paid less and work for a company with ethical business practices than receive higher pay at a company with questionable ethics
- 30% of employed Americans have left a job for ethical reasons

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Business Ethics in Balance

1. Owners/investors/members/citizens
 - Rate of return, fulfillment of mission, abide by bylaws, transparent reporting
2. Customers/suppliers/employees
 - Well-being, rights to certain treatments, fairness
3. Society
 - Environmental, social, governance

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Example - Is This Ethical?

1. Outsourcing a significant number of jobs to overseas workers
2. Using child labor in the production of goods

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The Ethical-Legal Dilemma

- Is an action ethical if it is legal?
- Laws often change to reflect the current norms of ethical behavior.
 - Norms for ethical behavior may change faster than the laws meant to reflect them.

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Pulse Check – Ethical Dilemmas

Is it right for Google to force Advertising Companies to sign contracts saying they would not accept advertising from rival search engines?

- A. Yes.
- B. No.
- C. Maybe.

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Environmental Component

- Addresses how an entity is exposed to and manages risks and opportunities related to the environment
 - For example, climate-related matters, greenhouse gas emissions, renewable energy, natural resource scarcity, pollution, waste, and an entity's impact on the environment
- Litigation risk due to environmental contamination and other matters would also be placed in the environmental category

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Social Component

- Encompasses information about an entity's values and business relationships
 - For example, fair labor practices, the use of ethically sourced material in the production of products, product quality and safety, human capital such as employee health and safety, privacy and data security, community relations, and diversity and inclusion policies and efforts

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Governance Component

- Encompasses information about the system of rules, practices, and processes by which an entity is directed and controlled
 - For example, the structure and diversity of the board of directors, executive compensation, tax transparency, business ethics, critical event responsiveness, entity resiliency, and policies and practices related to lobbying, political contributions, bribery, and corruption

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Why Growing Interest

- Interested parties seek to understand the effects of relevant ESG matters on an entity's business strategy, cash flows, financial position, and financial performance
 - For both public and private companies
- In other cases, parties seek ESG information from a public policy perspective or to influence corporate behavior

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Accounting Ethics

- Accounting is the “language” of business.
 - Luca Paciolo, the “father of accounting”, included a discussion of accounting ethics in his 1494 textbook.
- Apply the highest standards of ethical behavior and transparency to information conveyed.
 - The interests of the public must be in the forefront of any professional judgement.
 - Lack of ethical behavior leads to financial malfeasance, data manipulation, and fraudulent financial reporting.

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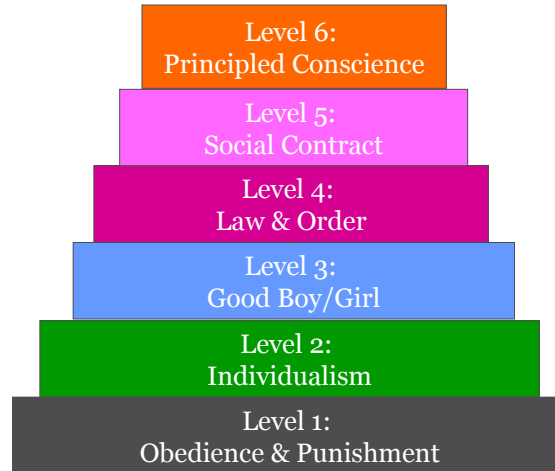
Pulse Check – Ethical Dilemmas

Is it okay to consistently round up when billing customers for hourly work?

- A. Yes.
- B. No.
- C. Maybe.

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Theory of Moral Development



Source: Lawrence Kohlberg, Harvard University Professor (1958)

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Case Study – Booking Quarterly Sales

- Your company has a minimum current ratio debt covenant on \$1 million loan.
- Normally, your company ships large amounts of inventory on the last day of each quarter.
- This quarter there was a software glitch, and shipments could not be processed until the first day of the next quarter.
- Would it be ethical to book the one day of shipments to avoid default?

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Case Study Possible Responses

1. No – you do not lie.
2. No – you will lose your job if you get caught.
3. No – you are not to blame for the software glitch.
4. No – intentionally misreporting financial information is against the AICPA's *Code of Professional Conduct*.
5. No – the bank has a right to transparency to make good credit risk decisions.
6. No – others may need access to the same funding and are better credit risks.

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Getting Stuck in Level 4

- Accountants often tend to fall back on a Level 4 mentality – what does the rule say?

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Pulse Check – Ethical Dilemmas

You are a software developer assigned to modify a client's application. The project is bid at 4 weeks at a cost of \$250K. You quickly realize that the same goals can be accomplished for half the cost.

Do you offer the simpler solution?

- A. Yes.
- B. No.
- C. Maybe.

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What is Your Ethical Backbone?

- We are what we repeatedly do. – Aristotle
- Every dishonest act has an inevitable consequence on our character

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Key Character Principle

- Past behavior is the best predictor of future behavior
- Our actions become habits, and well-ingrained habits may be difficult to change
 - Even if we have an intention to change
 - We tend to do what is rewarding and pleasant

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The Importance of Clarity in Intentions

1. I intend to report the income I overlooked last year to the IRS.
2. I intend to obtain the necessary tax forms and meet with my tax accountant today to submit an amended return by the end of the week.

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Behavioral Justification

- When our behavior is inconsistent with our attitudes and values, we rationalize our behavior by making excuses and justifications that we eventually perceive to be absolutely true.
- Behavior may change our values.
 - Especially if we need to justify our behavior.
- Place a higher value on what is right, versus what is self-satisfying.
- Don't lie to yourself with self-justification.

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Psychological Justifications

- Claiming it is a grey area with room for interpretation
- Altruism over self-interest
 - College admissions scandal wanting best for child
- “Moral licensing” for a recent good deed
 - More likely to cheat on a computer game if recently purchased an environmentally friendly product
- Partially “come clean”

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Pulse Check – Ethical Dilemmas

Is it okay for a company to consistently run a “limited-time” deal to encourage immediate spending?

- A. Yes.
- B. No.
- C. Maybe.

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Reversing Downward Spirals in Behavior

1. Recognize what is wrong – and why.
2. Feel remorse- for the act itself, not just being caught.
3. Resolve to change – with sincerity.
4. Plan future behavioral intentions.
5. Demonstrate improved moral behavior – recognizing that change takes time.

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3 Stages of the Character Continuum

1. Unethical - What is in it for me (WIIFM)?
2. Ethical - What is fair and equitable?
3. Virtuous - How can I serve others and contribute to society?

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Steps in Making Ethical Decisions

1. Recognize that you are in an ethical dilemma
2. Identify and analyze the key elements in the situation
 - Who may be harmed?
 - Who may benefit?
 - What are my responsibilities and obligations?

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Steps in Making Ethical Decisions

3. Identify the alternatives and weigh the impact of each choice
4. Select the best and most ethical alternative
 - Consider all the circumstances and the consequences
 - Follow your moral compass

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Possible Approaches to Resolving an Ethical Dilemma

1. Refute the Dilemma - Challenge whether the existence of the dilemma can be logically refuted.
2. Apply Value Theory - Choose the alternative that offers the greater good and the lesser evil.
3. Find Alternative Solutions - Reconsider the problem to see if a new alternative solution may arise.

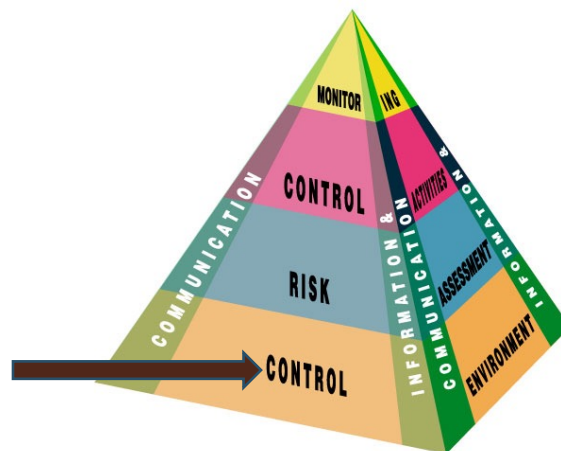
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Three Easy "Ethics Check" Questions

1. Is it legal and consistent with policies?
2. Is it fair and balanced?
3. How will it make me feel about myself?
4. Would I want my parents to know?
5. The Washington Post test.

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5 Internal Control Components



Source: Based on the 2013 COSO Integrated Framework

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1. Commitment to Integrity and Ethical Values

- Governance and management demonstrates importance by tone at top
 - Through directives, attitudes, and behavior
- Uses ethical values to balance needs and concerns of different stakeholders
- Establishes processes to evaluate performance against expected standards of conduct

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5. Holds Individuals Accountable

- Enforces accountability for individual performance
 - Supports day-to-day decision making, attitudes, and behaviors
 - Incentives, performance appraisals and disciplinary actions
- Adjusts excessive pressures on personnel
 - Goals, unrealistic workloads, few resources

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AICPA Code of Professional Conduct

- Represents the high degree of responsibility to the public interest, clients, and colleagues
- Comprised of principles, rules, and interpretations
- Honor the public trust, not personal gain

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Organization of Code of Conduct

- Part 1 – Members in Public Practice
- Part 2 – Members in Business
- Part 3 – All Other Members
 - Including those retired or between jobs

Note: If the member has multiple roles, apply the most restrictive provisions from all applicable parts of the Code.

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Responsibility for Actions of Others

- *A member* may be held responsible for the acts of all persons associated with the *member* whom the *member* has the authority or capacity to control

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Pulse Check

- Your co-worker is engaging in “Coffee Badging”
- Do you have a responsibility to tell his/her supervisor?
 - A. Yes.
 - B. No.
 - C. Maybe.

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Knowing Misrepresentations- Members in Business

- Makes, or permits or directs another to make, materially false and misleading entries in an entity's financial statements or records;
- Fails to correct an entity's financial statements or records that are materially false and misleading when the member has the authority to record the entries; or
- Signs, or permits or directs another to sign, a document containing materially false and misleading information

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Obligation to the External Accountant- Members in Business

- When dealing with an employer's external accountant, a *member* must be candid and not knowingly misrepresent facts or knowingly fail to disclose material facts

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Pulse Check – Ethical Dilemmas

You are the Controller for a company. The CEO wants to do something nice for the CFO and the CFO of the largest customer, who are old friends. The CEO wants to send them and their spouses to a week at a 5-Star Resort in the Caribbean. Is it okay to authorize the disbursement?

- A. Yes.
- B. No.
- C. Maybe.

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Thank you!  **EMERGENT**
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