Discovering Ethical Behavior

Where Does Ethical Behavior Begin?

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Lying For Profit

If it's legal is it ethical? Surprisingly a significant number of business owners don't see the dividing line between ethical behavior and illegal acts. If this seems ambiguous consider the following examples:

- Company A is negotiating a large contract with one customer, Company B. If Company A gets this contract total revenue from it will be approximately 40% of Company A's revenue next year. During negotiations the purchasing manager of Company B approaches the president of Company A and requests special consideration. The purchasing manager strongly suggests that a substantial donation to the purchasing manager's church would be looked upon very favorably with respect to future business. If the president of Company A makes the donation to the purchasing manager's church is the behavior of either party illegal or unethical? The president of Company A does not want to do this but realizes that if he does not meet the request of the purchasing manager that Company A may well go out of business. Company A provides employment for 1,000 people. In addition the president will risk losing his investment in Company A as well as his future pension benefits and stock options. The failure of the company would also substantially damage his career opportunities. *What is your call?*

At the very least the behavior of Company A's president and Company B's purchasing manager is unethical. In many jurisdictions the actions of the purchasing manager would be considered to be a facilitating payment or a kickback and thus would be a criminal act. The president of Company A would also be at risk because he knowingly entered into the agreement with the purchasing manager. Good intentions don't count when it comes to a court of law. Company A's president could be looking at prison if a third party gained knowledge of the arrangement or federal or state regulators discovered its existence.

When most people weigh the possible loss of their job, current and future benefits, significant damage to a financial investment, or possible career damage they will get the checkbook out in a minute regardless of the ethical or legal ramifications; in particular when the checkbook belongs to their employer. The rationalization that is used is often schizophrenic because it entails engaging in behavior working in a corporate shell that would not be palatable for most people as an individual. In our example the fact that Company A is incorporated, and that it is separate from the president makes risky behavior for self-gain or self-preservation more likely.

Charlie Chaplin summed it up when he said:

"Man is an animal with primary instincts of survival. Consequently, his ingenuity has developed first and his soul afterwards. Thus the progress of science is far ahead of man's ethical behavior."

- The president of a small company incurs significant travel and entertainment expense. He represents to the board of directors and the outside auditors that all expenses were ordinary and necessary in the scope of his duties. In actuality the majority of expenses are personal in nature. When inquiry is made by the CPA preparing the company's corporate tax return the president responds that the IRS audits returns based on percentages and that his travel and entertainment expense is within allowable percentages regardless of the origin of the expenses. The president further adds that it is easy to get a professional opinion from another public accounting firm. The CPA preparing the return is new to the client and has been with the public accounting firm only a short period of time. He feels intimidated and is afraid that if he doesn't comply with the president's wishes that the client will be lost and his job will be placed in jeopardy. Is the behavior of either party illegal or unethical? *How would you handle this dilema?*

Plato described this situation long before the IRS was a glimmer in the eye of Congress:

"When there is an income tax, the just man will pay more and the unjust less on the same amount of income."

Opinion Shopping

In our previous example it is fairly obvious that the president of the company in question is guilty of tax fraud. Dependent upon the extent of knowledge of this crime other parties could be culpable including the CPA who prepared the return, the company's board of directors, and other employees of the company who assisted. Unfortunately, this type of activity is often not reported because the practice of "opinion shopping" is not illegal. While it is highly unethical chief executive officers may shop a company's auditing and tax work around in an attempt to obtain more favorable tax treatment, a preferred accounting treatment for reporting purposes, or more leverage with respect to professional fees. The later point may come into play when a client makes up a material portion of a public accounting firm's revenue. In instances in which opinion shopping has occurred and a change in auditing firm must be reported to outside governmental agencies such as the SEC or the DOL disputes over tax and financial reporting are seldom disclosed unless the auditing firm voluntarily resigned. However, the practice is not uncommon and public records are litered with financial accounting scandals, such as Enron, Tyco and WorldCom, where substantial financial leverage was exerted over a public accounting firm and the firm in turn "bent the rules" to accommodate the client.

Ignorance Is Not A Defense

Employee benefit plans are particularly vulnerable to unethical or illegal acts. Because of the multitude of confusing regulations, the magnitude of plan assets that can be invested and the knowledge level of some plan administrators it is easy for errors in plan recordkeeping activities to be magnified and to turn into significant acts of noncompliance. Because of the complexity of ERISA and IRS regulations an adequate safety net may not be provided internally and this results in a greater need for knowledgeable outside professionals. "Soft money" is a thorny problem also because investment commissions can be significant on invested benefit plan assets.

Brokers as a rule are not independent with respect to the investment products that they sell. This can make issues of independence and integrity difficult because motives are sometimes not clearcut until after the fact.

> **Ernest Hemingway could have been describing the complexity of this situation and the plight of plan administrators when he wrote in *A Farewell to Arms*:**
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> **"You never had time to learn. They threw you in and told you the rules and the first time they caught you off base they killed you."**

Plan participants are in an even more precarious situation because they have little or no control over commissions paid, investment managers and brokers selected, load fees paid, administrative fees paid, and investment instruments. Ethical treatment of plan participants is paramount in establishing and maintaining employee benefit plans that are both cost efficient and in compliance.

Audit committees

An independent audit committee that reports directly to the board of directors can be an effective internal control to help prevent illegal acts and to encourage ethical behavior within a company. If the company maintains an internal audit department it should report directly to the audit committee rather than the chief executive officer or the chief financial officer. If the company or its employee benefit plans are audited the public accounting firm(s) should also report directly to the audit committee. In instances in which a company is too small to have an internal auditor and an audit committee management should be encouraged to appoint outside directors. Trust committees for employee benefit plans should also include non-management participants.

Is It Ethical If It's Legal?

When asked by researchers *"if it is legal, is it also ethical?"* an alarming number of recent college graduates responded that as long as it was legal it was ethical. This may be symptomatic of generational trends, job opportunity pressures or changing perceptions within our culture as a whole.

Recognizing this many undergraduate and graduate business programs have rushed in recent years to add mandatory ethics courses to their required curriculums. Many state boards of public accountancy have also added ethics courses to annual CPE requirements. This of course begs the question of "why do adults have to be trained to do the right thing?"

A Checklist For Ethical Behavior

Provided below is a checklist to monitor ethical behavior. It is designed to monitor corporate and individual behavior in decision making. It is intended to be fluid and will continue to be expanded. Ethical behavior as defined through this checklist is based upon personal honor, in a manner similar to the honor code central to the service academies and some private schools. It places emphasis on the greater good and the collective interest of society as opposed to individual advancement by any means possible. It is not intended to be an expression of moral, religious or political beliefs, but rather a practical point of reference. It should be noted that based upon circumstances answers may not be simple "YES" or "NO" responses.

Will my actions cause harm to another person?

Are my actions strictly for my own self-interest?

Do my actions or activities constitute a conflict of interest?

Am I using other people as instruments for illegal or unethical behavior?

Would my actions be considered to be illegal by the average person?

Do I expect material gain by manipulating events, actions, or responses of others?

Do I place a dollar value on integrity?

Would I be angry if someone treated me the same way I treat them?