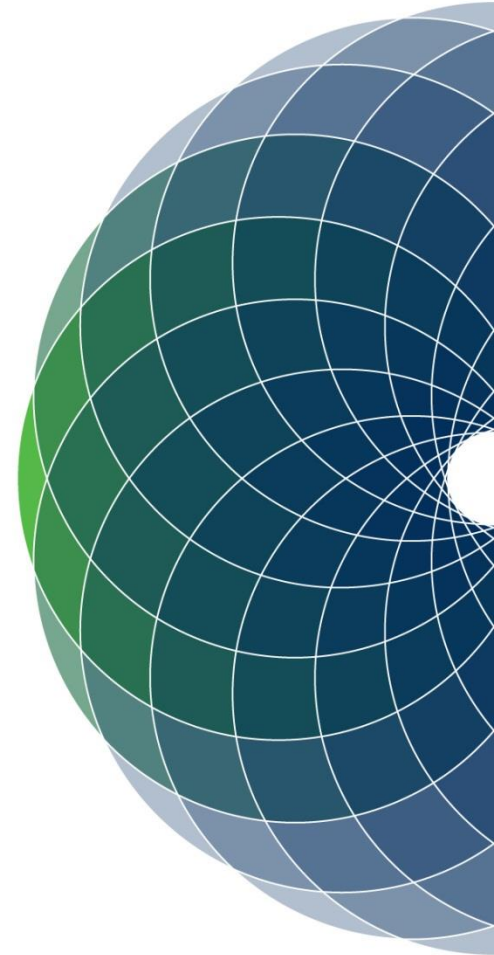


# Ethics, Principles and Professional Responsibilities

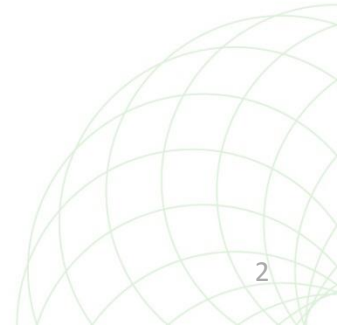
**George L. Kennedy, CPA**

Shareholder

October 13, 2014



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# Presenting Today

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**Industries/Specializations:** Government, Not-for-Profit, Manufacturing and Distribution

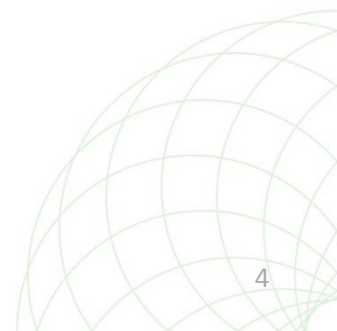
**Professional Overview:**

George focuses on providing assurance services to clients in the government, not-for-profit and manufacturing and distribution sectors. With more than 20 years in public accounting, he has extensive experience in managing and developing professional client relationships.



# Objectives

- Accounting as a Profession
- Ethics
- Ethics/Professional Conduct
- Fraud
- Ethics in Organizations
- SC Ethics Requirements



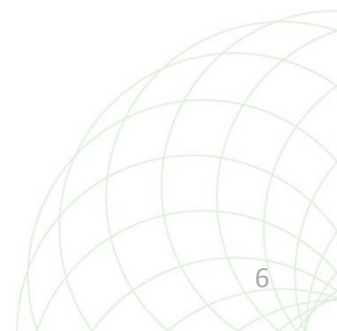
# The Accounting Profession

- A profession is defined as a vocation founded upon specialized educational training
  - The purpose is to provide objective counsel and service to others
  - Members of a profession
    - Maintain their skills thru continuing education
    - Commit to behaving ethically to protect public interests
    - Recognize they have a social obligation
  - A profession is viewed as something more than a job



# Ethics and the Accounting Profession

- Why is Ethics important to the accounting profession?
  - As a profession, accountants perform an essential role in society
  - Laws and rules are not enough
  - Truth and trust issue



# Ethics in the Workplace

- 2013 National Business Ethics Survey
  - *The Good News*
    - 41% of American workers observed misconduct on the job
      - *Down from 45% in 2011 and 55% in 2009*
    - 9% of American workers felt pressure to compromise standards, often a leading indicator of misconduct
      - *Down from 13% in 2011 and 11% in 2009*



# Ethics in the Workplace

- 2013 National Business Ethics Survey
  - *The Not So Good News*
    - Of those who observed misconduct on the job, only 63% reported what they saw
      - *Down from 65% in 2011 and 63% in 2009*
    - 21% of those who reported misconduct said they experienced retaliation
      - *Virtually unchanged from 2011*

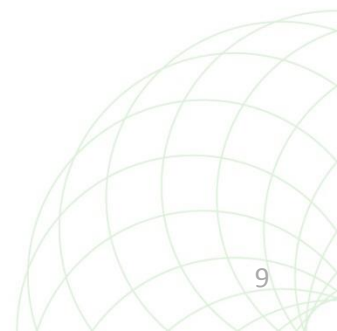




# Ethics and the Accounting Profession

*It takes twenty years to build a reputation and five minutes to lose it. If you think about that, you will do things differently.*

Warren Buffett



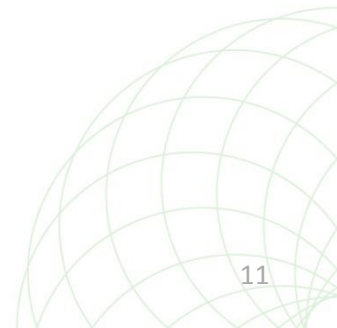
# What is Ethics?

- Ethics:
  - Rules of behavior based on ideas about what is morally good and bad
  - Basically means the ability to distinguish between what is right from what is wrong and the commitment to do what is right



# What is Ethics?

- Ethics is NOT the same as:
  - Feelings
  - Law
  - Religion
  - Cultural norms
  - Science
- But all of these things influence ethics

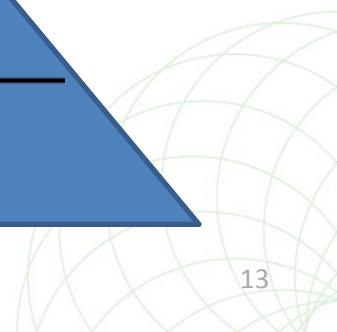
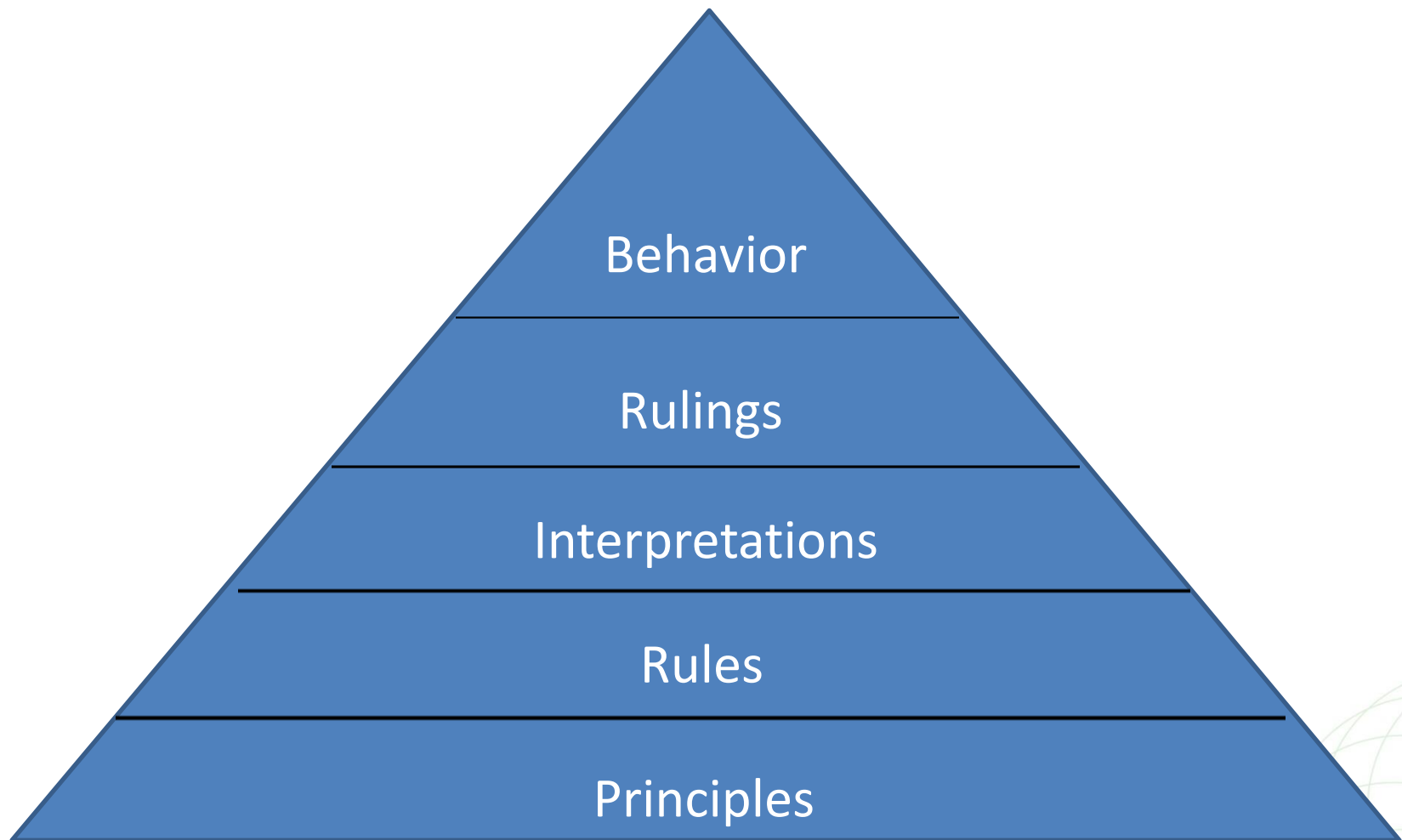


# Who Establishes Ethical Standards?

- State licensing boards
- State CPA associations
- American Institute of CPAs (AICPA)
- Other professional societies (CIMA, IFAC)
- Securities Exchange Commission (SEC)
- Department of Labor (DOL)
- Public Company Accounting Oversight Board (PCAOB)
- Government Accountability Office (GAO)



# AICPA Code of Professional Conduct



# Rules or Ethics or Virtue

- Accounting has long been held as a profession which focuses on rules
- Ethics focuses on doing the right thing
- Virtue focuses on what we should be:
  - What kind of person
  - What ideals we should embrace
  - Attitudes, dispositions or character traits that enable us to be and act in ethical ways



# Common Virtues

- Honesty
- Courage
- Compassion
- Generosity
- Fidelity
- Integrity
- Fairness
- Self-control



# Philosophy 101

- Virtues and Ethics are Interrelated
  - Virtues are developed through learning and practice
  - Aristotle believed that character can be improved by practicing self-discipline or corrupted by self-indulgence
  - Virtues are habits
  - A virtuous person is an ethical person





# Ethical Framework for Accounting Profession

- No matter if you practice public or private accounting, reliance of the public and the business community on sound financial reporting imposes an obligation to maintain high standards of
  - Integrity
  - Objectivity
  - Technical competence and due care
  - Confidentiality



# Integrity

- The practice of a profession is marked by integrity
  - **Integrity** – adherence to moral and ethical principles; soundness of moral character; honesty
- Often regarded as a core principle of the accounting profession



# Integrity

- Quick Exercise
  - Do you know someone who has integrity?
  - Write-down two characteristics they display which represent integrity.



# Integrity

***Being straightforward and honest in professional and business relationships; fair dealing and truthfulness; not being associated with information that contains materially false or misleading statements or information furnished recklessly.***

**Federation of European Accountants**



# Integrity

- An accounting professional showing integrity should:
  - Be straightforward, honest and truthful.
  - Deal fairly by behaving in a manner expected by the profession, including treating people on the same basis without bias.
  - Comply with the spirit and letter of laws and regulations.
  - Take public interest into consideration.
  - Show consistency.
  - Be open-minded, considering new information and ideas.
  - Take corrective action.



# Objectivity

- The practice of a profession is marked by objectivity
  - *Objectivity – based on facts rather than feelings or opinions; not influenced by feelings*



# Objectivity

- Objectivity is
  - A state of mind.
  - Impartial, intellectually honest; free of conflicts of interest.
  - Professional accountants have a responsibility to maintain objectivity in rendering services.



# Objectivity

- Objectivity in thought and expression
  - *Transparency* – a trait of communication whereby what is being communicated is naturally understood as being a fair representation of what the communication is about.
    - Objectivity in thought – an impartial, honest and fair state of mind.
    - Objectivity in expression – transparency in communication; not intentionally misleading.





# Technical Competence and Due Care

- ***Technical Competence*** – a combination of education and experience, competence requires a commitment to learning and improvement and evaluating whether education and experience are adequate for the responsibilities to be assumed.
- ***Due Care*** – performing to the best of one’s ability with concern for the best interest of those for whom services are being performed.



# Technical Competence and Due Care

- Accounting professionals have a responsibility to
  - Maintain an appropriate level of professional competence by ongoing development of their knowledge and skills.
  - Perform their professional duties in accordance with relevant laws, regulations, technical and ethical standards.
  - Prepare complete and clear reports and recommendations after appropriate analysis of relevant and reliable information.



# Confidentiality

- The practice of a profession is marked by confidentiality
  - To maintain confidentiality, professional accountants should refrain from:
    - Disclosing information about their organization to those outside of the organization
    - Disclosing information to those within the organization without a need to know
    - Using information obtained to their personal advantage



# Confidentiality

- Accounting professionals have a responsibility to
  - Refrain from disclosing confidential information acquired in the course of their work except when authorized, or unless legally required to do so.
  - Inform subordinates as appropriate regarding the confidentiality of information acquired in the course of their work and monitor their activities to assure the maintenance of that confidentiality.
  - Refrain from using or appearing to use confidential information acquired in the course of their work for unethical or illegal advantage either personally or through third parties.



# Confidentiality

- There may be instances when disclosure of confidential information is appropriate, necessary or required:
  - Permitted or authorized by the employer
  - Required by law
  - To respond to regulatory inquiry



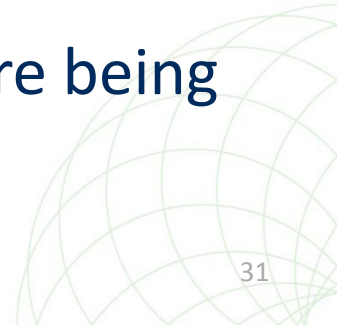
# Fraud

- Fraud is defined as wrongful or criminal deception intended to result in financial or personal gain.
- Ethics has a role in reducing the risk of fraud in organizations
  - Companies with a strong ethics culture tend to thrive over time
  - Organizations with a weak ethics culture tend to struggle or even fail over time



# Fraud

- Association of Certified Fraud Examiners (ACFE) survey participants estimated that the typical organization loses 5% of its annual revenue to fraud. Applied to the 2011 Gross World Product, this figure translates to a potential projected annual fraud loss of more than \$3.5 trillion.
  - The median loss caused by the occupational fraud cases in the study was \$140,000. More than one-fifth of these cases caused losses of at least \$1 million.
  - The frauds lasted a median of 18 months before being detected.



# Fraud

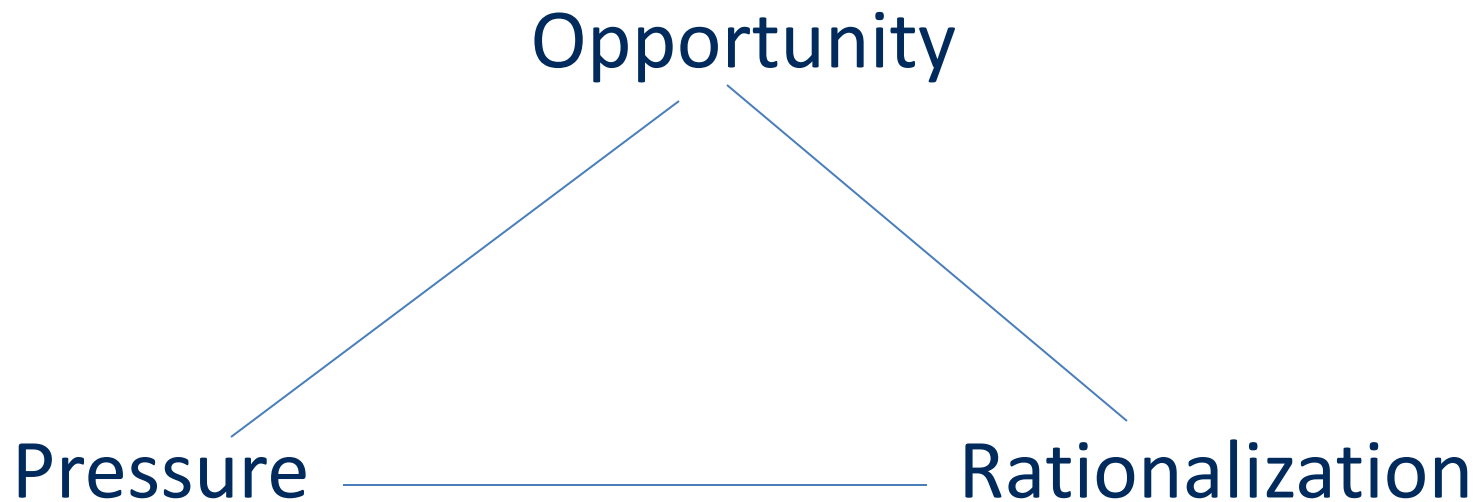
- Other costs of fraud:
  - Reputation of the organization
  - Low employee morale
  - Cost of human resources diverted to investigation
  - Fraud undermines the organization's mission





# Fraud

## The Fraud Triangle



# Fraud - Who Commits Fraud?

- Incentive/Pressure
  - Habitual criminal who steals for the sake of stealing
  - Personal prestige, goal achievement
  - Morally superior, justified in making others victims
  - Desperate need for money
  - Vices such as gambling/drugs



# Fraud - Who Commits Fraud?

- Perceived Opportunity
  - Weak internal controls
  - Circumvention of internal controls
  - The greater the position, the greater the trust and exposure to unprotected assets
  - “Most Trusted Employee”



# Fraud - Who Commits Fraud?

- Attitude/Rationalization
  - I need it more than the other person.
  - I'm borrowing and will pay it back later.
  - Everybody does it.
  - The organization is so big that it won't even be missed.
  - Nobody will get hurt
  - I deserve it.
  - I'm not paid enough.
  - It's just part of the job.
  - I'm not gaining personally.



# Fraud - Who Commits Fraud?

## Organizational Red Flags

- Bad Tone at the Top
- No Communication of Expectations
- Too Much Trust in Key Employees
- Lack of Proper Authorization Procedures
- Lack of Attention to Detail
- Poor Segregation of Duties
- Tendency Toward Crisis Management



# Ethics in Organizations

- The culture of an organization has an impact on the way individuals within it behave.
  - Tone at the top.
  - Ethical behavior within an organization is not the result of a single decision or single employee, rather it is built over time.
  - Individual professional integrity and organizational integrity are linked.



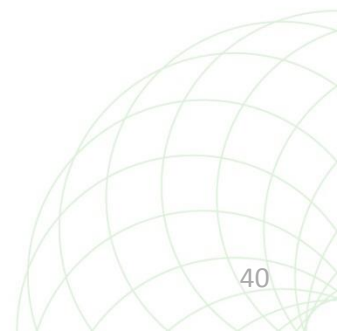
# Ethics in Organizations

- Organizations with strong ethics
  - Recognize ethical dilemmas and deals with them.
  - Apply ethical values in a clear and consistent manner.
  - Are transparent.



# Ethics in Organizations

- **Tone at the top**
  - Expectations are clearly communicated.
  - Lead by example.
  - Model behavior expected from the organization.
  - Provide a safe mechanism for reporting violations.
  - Reward integrity and ethical behavior in addition to meeting financial goals.
  - Continuously communicate the message.





# Ethics in Organizations

- Encourage Whistleblowing
  - A supportive environment for whistleblowing should include:
    - Developing rewards
    - Non-retaliation policy and training
    - Monitoring whistleblowers' career, pay and proposed discipline
    - Investigating alleged retribution
    - Implementing a records retention policy for whistleblower reports, complaints and investigations



# Ethical Decision Making

- Case studies
  - Robin Hood Councilman
  - Bank Error in Your Favor
  - All Show Treasurer



# Ethical Decision Making

- Thomas Dernoga - Robin Hood Councilman
  - With thanks to *The Washington Post*
    - Dernoga served as a Council member of Prince George's County, MD for eight years
    - During his time in office he was able to raise and contribute about \$1 million to various projects
      - \$125,000 for track resurfacing at a local high school
      - \$20,000 for books for a local elementary school



# Ethical Decision Making

- **Robin Hood Councilman, continued**
  - As a member of the County’s planning committee, Dernoga sought contributions for special projects from developers who were seeking approval of projects in this rapidly growing suburban county
  - Dernoga maintained that it was his way of getting the developers to help the communities where they do business
  - Dernoga regularly presented the funds to programs in his district, and community and school leaders began referring to the money as “Dernoga money”



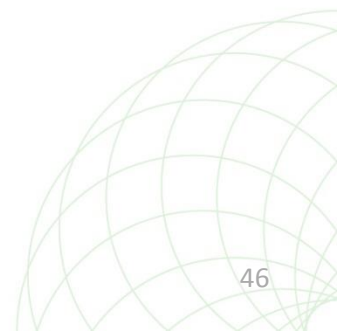
# Ethical Decision Making

- **Robin Hood Councilman, continued**
  - Dernoga says he never held up a request because a developer declined his request for a contribution
  - Dernoga maintains he did not cross any ethical or legal boundaries and never used the money for himself



# Ethical Decision Making

- Robin Hood Councilman, continued
  - From a donor's perspective:
    - Developers said they felt it was inappropriate to be asked for money while seeking approval for a project
    - Developers claim their projects were delayed until they agreed to contribute
    - "By not playing the game, we were suffering" said one developer



# Ethical Decision Making

- Robin Hood Councilman, continued
  - Dernoga claimed he would treat non-contributing developers fairly, but said *he would not do them any favors*
  - Dernoga believed the amount he was asking for was “a drop in the bucket” for a multi-million dollar development project



# Ethical Decision Making

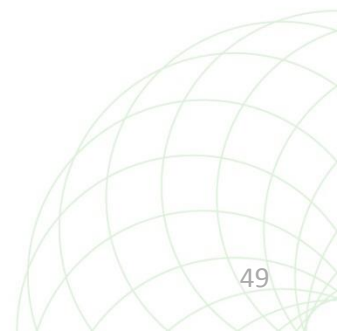
- Robin Hood Councilman, continued
  - What do you think?





# Ethical Decision Making

- **Bank Error in Your Favor**
  - In 1997, the City of Cleveland wired \$617,597 to an EFT number which was intended for Cinergy Services, Inc., one of the City's utility providers
  - The money was actually wired to a Black on Black Crime, Inc. (BBCI), a local not-for-profit, due to a clerical transposition of the EFT number



# Ethical Decision Making

- Bank Error in Your Favor, continued
  - The City was behind in performing monthly bank reconciliations, so it took nearly 5 months for the error to be discovered and 5 more weeks to figure out where the money was actually wired
  - The City asked BBCI for its money back



# Ethical Decision Making

- Bank Error in Your Favor, continued
  - When BBCI received the wire transfer, it was somewhat of a surprise
  - The organization inquired of the bank, which confirmed the wire came from the City
  - BBCI has received other payments from the City – approximately \$7,000 in the prior year
  - 6 months after the wire cleared the BBCI account, the money was gone



# Ethical Decision Making

- Bank Error in Your Favor, continued
  - In late 1997, BBCI president and 3 board members were indicted on one count of grand theft felony each
  - One board member pled guilty; the remaining went to trial
  - AT trial, the organization's president said he thought the money had come from a guardian angel, and noted that a couple of big name celebrities had expressed an interest in BBCI



# Ethical Decision Making

- Bank Error in Your Favor, continued
  - The president claimed the board chairman said it would be OK to keep and spend the money
  - The jury concluded that BBCI officials knew the money belonged to the City, but used deception to keep control of it
  - All involved served prison time
  - Thoughts/comments?



# Ethical Decision Making

- Rita Crundwell - All Show Treasurer
  - Crundwell, a life-long resident of Dixon, IL, was appointed treasurer/comptroller of the city in 1983
  - Between 1990 and 2012, she embezzled approximately \$53 million
    - 1991 - \$181,000
    - 2008 - \$5.8 million



# Ethical Decision Making

- Rita Crundwell - All Show Treasurer, continued
  - Crundwell was arrested in 2012
  - She pled guilty and was sentenced to nearly 20 years in prison



# Ethical Decision Making

- Rita Crundwell - All Show Treasurer, continued
  - How did she do it?
    - Opened a bank account called the Reserve Sewer Capital Development Account (RSCDA), with only herself as signor
    - Moved City funds into a legitimate City account – Capital Development Account (CDA)
    - Created phony invoices that she paid with CDA checks payable to “Treasurer”
    - Checks were deposited into the RSCDA





# Ethical Decision Making

- Rita Crundwell - All Show Treasurer, continued
  - Funds were used to run her thoroughbred horse farm and business and on prize-winning show horses, luxury cars and lavish entertainment
  - She was caught when another city employee stumbled on the RSCDA account while Crundwell was on vacation
  - What do you think?



# Ethical Decision Making

- When faced with an ethical dilemma, consider:
  - Are there legal concerns?
  - Is it right? (If you know it's wrong, don't do it!)
  - Does it comply with organizational values?
  - Does it comply with the principles of your profession (for accountants, GAAP)?
  - Would you be embarrassed by your decision if others knew about it?
  - Who else is affected by this (others in the organization, customers, etc.)?



# Ethical Decision Making

- Ethical dilemma, continued
  - Are you willing to take sole responsibility for this decision?
  - Is there another course of action that does not create an ethical dilemma?
  - How will it look in the newspaper?
  - Do you think a reasonable person would agree with your decision? (Ask an appropriate person.)



# SC Ethics Requirements

- Of the required CPE hours over a 3-year period, 6 of the hours must be in ethics.
- At least 2 of these hours must be in South Carolina Rules and Regulations
- Board must pre-approve all South Carolina Rules and Regulation courses
- First 3-year period will be from 1/1/2013 – 12/31/2015
- During that time, make sure you have
  - 6 total hours in ethics (behavioral or regulatory)
  - 2 of the 6 hours in SC Rules and Regulations
- For the initial 3-year period only, ethics courses 5/25/12 – 12/31/12 count



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