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To Tell or Not to Tell: An Auditing Case in Ethical Decision Making and Conflict Resolution

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ABSTRACT: This case requires you to resolve a fictitious yet realistic ethical dilemma as you assume the role of audit manager in a large, national CPA firm. You will be presented with a scenario whereby you learn from the CFO of Bell Manufacturing, an audit client, that the CFO entered the United States and worked a number of years under false pretenses for the audit client while he was an illegal alien. Although the CFO recently obtained U.S. citizenship, subsequent audit work revealed that Bell Manufacturing failed to obtain the documents required under federal law to certify his eligibility for employment. Before addressing specific case requirements, you will be introduced to a primer on professionalism and ethical decision making in an audit environment. Case requirements first ask you to establish a baseline position by outlining your initial reaction regarding the impact of this information on your auditor responsibilities. You will then be asked to electronically search the authoritative literature covering illegal acts by a client, as well as standards on fraud and the *Code of Professional Conduct*. After researching the issue, you will be asked to write a memo to the audit partner detailing your recommendation for resolution of this issue. Completion of this case will contribute to development of your ethical, analytical, research, and communication skills, better preparing you for practice and the new CPA exam.

CASE SCENARIO

Bell Manufacturing, Inc. is a publicly traded company that produces consumer goods for sale, primarily to wholesalers. The company hired your accounting firm, Hogue & Company, more than three years ago under both auditing and consulting engagements to assist with its initial public offering of common stock under the 1933 Securities Act. Hogue & Company is among the 12 largest accounting firms in the United States. It has developed a respectable reputation regarding its ability to help growing companies go public. You are currently an audit manager for Hogue & Company, having been promoted to this position from senior auditor in the last year, due in large part to your successful handling of the Bell Manufacturing account.

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You have just returned from lunch with Jay Hoffman, the new chief financial officer (CFO) for Bell Manufacturing, Inc. The purpose of the meeting was to congratulate Hoffman on his recent promotion. You have known Hoffman since you were assigned to this engagement, during which time he has progressed from accounting manager to chief accountant and now to his current position. When you expressed how pleased you were about his promotion, Hoffman explained how proud he was of the accomplishments he has achieved since entering the country as an illegal alien. He then told you that he entered the U.S. illegally because, at the time, that was the only way he could get into this country. He was quick to explain that he has been a U.S. citizen for almost three years and asked that you keep this in confidence.

In connection with your audit of executive payroll, you pulled Hoffman's personnel file, along with those of all senior executives of Bell. After the lunch meeting with Hoffman, you reviewed the contents of his personnel file. As required by federal law, a Form I-9, Employment Eligibility Verification, from the U.S. Immigration and Naturalization Service, was included in his personnel record. Hoffman completed and signed the form in 1992 at the commencement of his initial employment with Bell Manufacturing. He checked the box indicating he was a citizen of the United States and signed the form, attesting under the penalty of perjury that he had made no false statements or used false documents in connection with the completion of the form. Hoffman's I-9 Form, along with the official instructions for completion, is presented as Attachment 1.

Since 1986, federal law has required all newly hired employees (citizens and noncitizens) to complete and sign Section 1 of Form I-9. Federal law also establishes that "the employer is responsible for ensuring that Section 1 is timely and properly completed." Employers must then complete and sign Section 2 of the form. This process requires employers to examine evidence of employee identity and employment eligibility within three business days of the date employment begins. The employee must present specific acceptable documentation to verify identity and employment eligibility, for example, a U.S. Passport or Certificate of U.S. Citizenship. A complete list of acceptable documentation is provided on page three of Form I-9 (see Attachment 1). To your surprise, Bell Manufacturing never completed Section 2 of Hoffman's form.

AUDIT ENVIRONMENT, PROFESSIONALISM, AND ETHICS

The independent audit of financial statements is an essential part of the proper functioning of the capital markets. Recent high-profile events, however, have led to the erosion of public confidence in the accounting profession and the capital markets system. It is, seemingly, an understatement to say that accountants and accounting practices have been under fire in recent years. For example, in 1998 then-Chairman of the SEC Arthur Levitt delivered a speech, "The Numbers Game," referring to widespread abuses of financial reporting that resulted in earnings management (Levitt 1998). Levitt said, "This process has evolved over the years into what can best be characterized as a game among market participants. A game that, if not addressed soon, will have adverse consequences for America's financial reporting system." More recently, questionable financial reporting and the bankruptcies of Enron and WorldCom have forced the accounting profession under a public microscope. The AICPA (2002a) recently released the following statement: "Our profession has zero tolerance for CPAs who do not adhere to the rules." A document prepared jointly by the Big 5 accounting firms and the AICPA offers suggested actions that management, auditors, and audit committees can contribute to ensure high-quality financial reporting for the benefit of investors (AICPA 2002b).[1] Included in these suggestions for auditors are the following:

- "Understand the stresses on the company's internal control over financial reporting, and how they impact its effectiveness."

[1] At the time the white paper was written, the "Big 5" referenced the five largest accounting firms in the profession. Currently, after the demise of Arthur Andersen, these firms are referenced as the "Big 4."

ATTACHMENT 1

U.S. Department of Justice
Immigration and Naturalization Service

OMB No. 1115-0136

Employment Eligibility Verification

INSTRUCTIONS

PLEASE READ ALL INSTRUCTIONS CAREFULLY BEFORE COMPLETING THIS FORM.

Anti-Discrimination Notice. It is illegal to discriminate against any individual (other than an alien not authorized to work in the U.S.) in hiring, discharging, or recruiting or referring for a fee because of that individual's national origin or citizenship status. It is illegal to discriminate against work eligible individuals. Employers **CANNOT** specify which document(s) they will accept from an employee. The refusal to hire an individual because of a future expiration date may also constitute illegal discrimination.

Section 1 - Employee. All employees, citizens and noncitizens, hired after November 6, 1986, must complete Section 1 of this form at the time of hire, which is the actual beginning of employment. **The employer is responsible for ensuring that Section 1 is timely and properly completed.**

Preparer/Translator Certification. The Preparer/Translator Certification must be completed if Section 1 is prepared by a person other than the employee. A preparer/translator may be used only when the employee is unable to complete Section 1 on his/her own. However, the employee must still sign Section 1.

Section 2 - Employer. For the purpose of completing this form, the term "employer" includes those recruiters and referrers for a fee who are agricultural associations, agricultural employers or farm labor contractors.

Employers must complete Section 2 by examining evidence of identity and employment eligibility within three (3) business days of the date employment begins. If employees are authorized to work, but are unable to present the required document(s) within three business days, they must present a receipt for the application of the document(s) within three business days and the actual document(s) within ninety (90) days. However, if employers hire individuals for a duration of less than three business days, Section 2 must be completed at the time employment begins. **Employers must record: 1)** document title; **2)** issuing authority; **3)** document number; **4)** expiration date, if any; and **5)** the date employment begins. Employers must sign and date the certification. Employees must present original documents. Employers may, but are not required to, photocopy the document(s) presented. These photocopies may only be used for the verification process and must be retained with the I-9. **However, employers are still responsible for completing the I-9.**

Section 3 - Updating and Reverification. Employers must complete Section 3 when updating and/or reverifying the I-9. Employers must reverify employment eligibility of their employees on or before the expiration date recorded in Section 1. Employers **CANNOT** specify which document(s) they will accept from an employee.

- If an employee's name has changed at the time this form is being updated/ reverified, complete Block A.
- If an employee is rehired within three (3) years of the date this form was originally completed and the employee is still eligible to be employed on the same basis as previously indicated on this form (updating), complete Block B and the signature block.
- If an employee is rehired within three (3) years of the date this form was originally completed and the employee's work authorization has expired **or** if a current employee's work authorization is about to expire (reverification), complete Block B and:
  - examine any document that reflects that the employee is authorized to work in the U.S. (see List A **or** C),
  - record the document title, document number and expiration date (if any) in Block C, and
  - complete the signature block.

Photocopying and Retaining Form I-9. A blank I-9 may be reproduced, provided both sides are copied. The Instructions must be available to all employees completing this form. Employers must retain completed I-9s for three (3) years after the date of hire or one (1) year after the date employment ends, whichever is later.

For more detailed information, you may refer to the INS Handbook for Employers, (Form M-274). You may obtain the handbook at your local INS office.

Privacy Act Notice. The authority for collecting this information is the Immigration Reform and Control Act of 1986, Pub. L. 99-603 (8 USC 1324a).

This information is for employers to verify the eligibility of individuals for employment to preclude the unlawful hiring, or recruiting or referring for a fee, of aliens who are not authorized to work in the United States.

This information will be used by employers as a record of their basis for determining eligibility of an employee to work in the United States. The form will be kept by the employer and made available for inspection by officials of the U.S. Immigration and Naturalization Service, the Department of Labor and the Office of Special Counsel for Immigration Related Unfair Employment Practices.

Submission of the information required in this form is voluntary. However, an individual may not begin employment unless this form is completed, since employers are subject to civil or criminal penalties if they do not comply with the Immigration Reform and Control Act of 1986.

Reporting Burden. We try to create forms and instructions that are accurate, can be easily understood and which impose the least possible burden on you to provide us with information. Often this is difficult because some immigration laws are very complex. Accordingly, the reporting burden for this collection of information is computed as follows: **1)** learning about this form, 5 minutes; **2)** completing the form, 5 minutes; and **3)** assembling and filing (recordkeeping) the form, 5 minutes, for an average of 15 minutes per response. If you have comments regarding the accuracy of this burden estimate, or suggestions for making this form simpler, you can write to the Immigration and Naturalization Service, HQPDI, 425 I Street, N.W., Room 4034, Washington, DC 20536. OMB No. 1115-0136.

EMPLOYERS MUST RETAIN COMPLETED FORM I-9
PLEASE DO NOT MAIL COMPLETED FORM I-9 TO INS

Form I-9 (Rev. 11-21-91)N

ATTACHMENT 1

U.S. Department of Justice
Immigration and Naturalization Service

OMB No. 1115-0136

Employment Eligibility Verification

Please read instructions carefully before completing this form. The instructions must be available during completion of this form. ANTI-DISCRIMINATION NOTICE: It is illegal to discriminate against work eligible individuals. Employers CANNOT specify which document(s) they will accept from an employee. The refusal to hire an individual because of a future expiration date may also constitute illegal discrimination.

Section 1. Employee Information and Verification. To be completed and signed by employee at the time employment begins.

Print Name: Last	First	Middle Initial	Maiden Name
Hoffman	Jay	G.	
Address (Street Name and Number)		Apt. #	Date of Birth (month/day/year)
300 W. Main Street		2C	02/12/63
City	State	Zip Code	Social Security #
San Jose,	CA	92111	123-45-6789

I am aware that federal law provides for imprisonment and/or fines for false statements or use of false documents in connection with the completion of this form.

I attest, under penalty of perjury, that I am (check one of the following):
- [x] A citizen or national of the United States
- [ ] A Lawful Permanent Resident (Alien # A__________)
- [ ] An alien authorized to work until __/__/__ (Alien # or Admission #)__________

Employee's Signature: Jay Hoffman

Date (month/day/year): 06/17/1992

Preparer and/or Translator Certification. *(To be completed and signed if Section 1 is prepared by a person other than the employee.) I attest, under penalty of perjury, that I have assisted in the completion of this form and that to the best of my knowledge the information is true and correct.*

Preparer's/Translator's Signature	Print Name
Address (Street Name and Number, City, State, Zip Code)	Date (month/day/year)

Section 2. Employer Review and Verification. **To be completed and signed by employer. Examine one document from List A OR examine one document from List B and one from List C, as listed on the reverse of this form, and record the title, number and expiration date, if any, of the document(s)**

	List A	OR	List B	AND	List C
Document title:					
Issuing authority:					
Document #:					
Expiration Date (if any):	__/__/__		__/__/__		__/__/__
Document #:					
Expiration Date (if any):	__/__/__				

CERTIFICATION - I attest, under penalty of perjury, that I have examined the document(s) presented by the above-named employee, that the above-listed document(s) appear to be genuine and to relate to the employee named, that the employee began employment on *(month/day/year)* __/__/__ and that to the best of my knowledge the employee is eligible to work in the United States. (State employment agencies may omit the date the employee began employment.)

Signature of Employer or Authorized Representative	Print Name	Title
Business or Organization Name	Address (Street Name and Number, City, State, Zip Code)	Date (month/day/year)

Section 3. Updating and Reverification. To be completed and signed by employer.

A. New Name (if applicable)	B. Date of rehire (month/day/year) (if applicable)

C. If employee's previous grant of work authorization has expired, provide the information below for the document that establishes current employment eligibility.

Document Title: ________ Document #: ________ Expiration Date (if any): __/__/__

I attest, under penalty of perjury, that to the best of my knowledge, this employee is eligible to work in the United States, and if the employee presented document(s), the document(s) I have examined appear to be genuine and to relate to the individual.

Signature of Employer or Authorized Representative	Date (month/day/year)

ATTACHMENT 1

LISTS OF ACCEPTABLE DOCUMENTS

LIST A

Documents that Establish Both Identity and Employment Eligibility

1. U.S. Passport (unexpired or expired)
2. Certificate of U.S. Citizenship *(INS Form N-560 or N-561)*
3. Certificate of Naturalization *(INS Form N-550 or N-570)*
4. Unexpired foreign passport, with *I-551 stamp or* attached *INS Form I-94* indicating unexpired employment authorization
5. Alien Registration Receipt Card with photograph *(INS Form I-151 or I-551)*
6. Unexpired Temporary Card *(INS Form I-688)*
7. Unexpired Employment Authorization Card *(INS Form I-688A)*
8. Unexpired Reentry Permit *(INS Form I-327)*
9. Unexpired Refugee Travel Document *(INS Form I-571)*
10. Unexpired Employment Authorization Document issued by the INS which contains a photograph *(INS Form I-688B)*

OR

LIST B

Documents that Establish Identity

1. Driver's license or ID card issued by a state or outlying possession of the United States provided it contains a photograph or information such as name, date of birth, sex, height, eye color and address
2. ID card issued by federal, state or local government agencies or entities, provided it contains a photograph or information such as name, date of birth, sex, height, eye color and address
3. School ID card with a photograph
4. Voter's registration card
5. U.S. Military card or draft record
6. Military dependent's ID card
7. U.S. Coast Guard Merchant Mariner Card
8. Native American tribal document
9. Driver's license issued by a Canadian government authority

For persons under age 18 who are unable to present a document listed above:

10. School record or report card
11. Clinic, doctor or hospital record
12. Day-care or nursery school record

AND

LIST C

Documents that Establish Employment Eligibility

1. U.S. social security card issued by the Social Security Administration *(other than a card stating it is not valid for employment)*
2. Certification of Birth Abroad issued by the Department of State *(Form FS-545 or Form DS-1350)*
3. Original or certified copy of a birth certificate issued by a state, county, municipal authority or outlying possession of the United States bearing an official seal
4. Native American tribal document
5. U.S. Citizen ID Card *(INS Form I-197)*
6. ID Card for use of Resident Citizen in the United States *(INS Form I-179)*
7. Unexpired employment authorization document issued by the INS *(other then those listed under List A)*

Illustrations of many of these documents appear in Part 8 of the Handbook for Employers (M-274)

- "Approach the audit with objectivity and skepticism, notwithstanding prior experiences with or belief in management's integrity."
- "Question the unusual and challenge anything that doesn't make sense."
- "When faced with a 'gray' area, perform appropriate procedures to test and corroborate management's explanations and representations, and consult with others as needed."

Auditors carry out their responsibilities and perform services in the context of serving the public interest. In this role, CPAs are thought of as "professionals." Although professionals have earned a level of respect, the key concept in this context is that professionals also are expected to adhere to a higher level of performance. Therefore, it is helpful to consider how the legal system views CPAs. The New York Court of Appeals, in 1974, defined a profession as having certain distinguishable characteristics including: (1) requirements for formal training and learning, (2) admission to practice by qualifying licensing, (3) a code of ethics beyond that generally established in the marketplace, (4) a system to discipline its members for violation of the code of ethics, and (5) duties of members to conduct themselves honorably.[2] At its core, the term "professional" communicates that the client places an above-normal level of trust on the provider and/or a fiduciary duty exists between the client and the provider. The CPA profession is characterized by each of these traits and is legally considered a profession. Consequently, CPAs are expected to provide competent service characterized by ethical behavior consistent with carrying out fiduciary duties.

Auditors must balance competing interests to perform their public service role. Although a major responsibility is ensuring that financial statements are prepared in accordance with the rules (GAAP), protection of the public interest is paramount. The auditor's job has become more difficult as the number of accounting rules and the complexity of these rules has increased in recent years. Although U.S. standard setters are under pressure to promulgate simpler rules that converge with International Accounting Standards (IAS), the changing landscape of simpler rules may not relieve pressures on auditors. These pressures are best mitigated by the consistent application of ethical decision making. Therefore, understanding the role of ethics is essential in the development of an accounting professional expected to exercise professional judgment in this dynamic environment.

Rules-Based Profession

Accounting has long been a rules-based profession. Future CPAs begin their professional careers studying detailed rules such as GAAP, GAAS, and the Internal Revenue Code. The AICPA requires candidates to demonstrate competency in these areas and others during the CPA exam, which is a prerequisite to the licensing of accountants as CPAs.[3] Rules are intended to improve financial reporting in order to help protect the public interest. However, in today's environment, is mastery of and conformity with the rules sufficient for the practice of accounting?

Pincus (2000) argues that a rules-based system is inherently suboptimal. Ironically, she attributes suboptimization to the tendency of human decision makers to act as if optimization of a rules-based system were possible. "Human decision makers tend to treat prescriptive rules as definitional—that is, they tend to treat rules as determining how a game is played, rather than as guidelines for right behavior. They tend to become rule-bound, rather than rule-guided" (Pincus 2000, 247).

Consistent with Levitt's (1998) description of "The Numbers Game," Pincus explains that a rules-based system can degenerate into a high-cost game of *ex post* justification of decisions. The sources of these costs can be dichotomized into "(1) an absence of rule problem, and (2) a presence of rule problem" (Pincus 2000, 247).

[2] See, e.g., *Hospital Computer Sys. Inc. v. Staten Island Hosp.*, 788 F. Supp. 1351, 1361 (D.N.J. 1992) (quoting *In Re Estate of Freeman*, 311 N.E.2d 480 (N.Y. 1974)).

[3] Licensing of CPAs is a function of local jurisdictional boards of accountancy. There are 54 jurisdictions (all 50 states, the District of Columbia, Virgin Islands, Puerto Rico, and Guam). The AICPA prepares, administers, and grades the Uniform CPA exam used in all 54 jurisdictions.

An absence of rule problem can occur when rules do not address a particular transaction or event. As a result, decision makers may see an opportunity for "creative accounting." That is, as long as their position is not expressly prohibited by a rule, why wouldn't it be acceptable? As Pincus describes, "Since no rule-based system can hope to specify all the factual predicates, a vicious cycle of absence, abuse of absence, and rule making is the result" (Pincus 2000, 248).

Unfortunately, problems can also arise when rules are present. According to Pincus (2000), "A presence of rule problem exists when decision makers follow the letter of the rules, but ignore their spirit." In this context, detailed rules can lead to degenerative game-playing behavior.

Principles-Based Accounting Standards

The FASB is currently under pressure to shift from the traditional model of rules-based standards to principles-based standards. R. K. Herdman (2002), Chief Accountant, U.S. Securities and Exchange Commission, expresses concerns about the timeliness, transparency, and complexity of U.S. GAAP. His criticisms described the standard-setting process as too slow, too complex, and rules-based that "focuses on a check-the-box mentality that inhibits transparency." Herdman's (2002) proposed corrective actions include meaningful SEC participation in setting the FASB's agenda, SEC review of adopted standards, and to "ensure that the FASB promulgates principle-based standards, which adapt faster to changing business environment and emphasize overall accuracy and completeness. We believe that FASB's standards, at least going forward, should evolve to become general and principle-based, instead of encyclopedic and rule-based, standards." Herdman goes on to say, "we believe that principle-based standards in general are better suited to the sort of rapidly changing financial landscape in which companies operate. In addition, this approach to standard setting allows the standards to be issued more quickly, which is increasingly important."

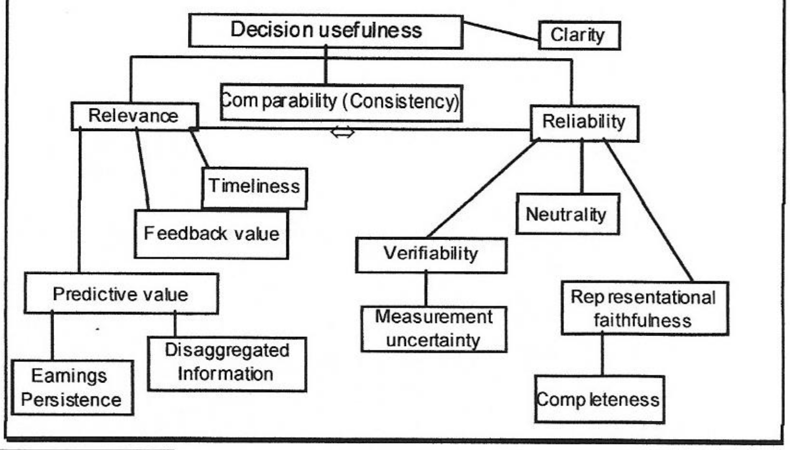
Katherine Schipper (2002), a board member of the FASB, responded to the criticisms in a presentation to the American Accounting Association on August 16, 2002. Schipper discusses the criteria used by the FASB to make decisions. She refers to the FASB's Conceptual Framework (FASB 1978, 1980a, 1980b, 1984, 1985, 2000) (Figure 1) as augmented by Jonas and Blanchet (2000, 359). As Figure 1 depicts, standards must first meet the test of decision usefulness. Other criteria include relevance, reliability, comparability, consistency, and clarity. She cautions, however, that if future, principles-based standards contain less implementation detail, there will be required "shifts in behavior from *all* involved parties: FASB, other standard-setting bodies, preparers, auditors, SEC" (Schipper 2002). She maintains that the FASB must "articulate, within each standard, the objective (what is intended) within the context of the FASB's Conceptual Framework." The behavior shifts for preparers and auditors are central. According to Schipper (2002), this "requires explicit expectations about the exercise of professional judgment in meeting the stated objective of the standard."

Robert Herz, recently appointed Chairman of the FASB, is supportive of principles-based accounting standards. In an August 2002 interview with the *BusinessWeek online* associate editor (Stone 2002), Herz responded to a series of questions about principles-based standards.

> When asked to explain the concept of principles-based accounting standards, he said, A principles-based system is one where the accounting standard simply lays out objectives of good reporting in an area. It may include some rules, based on the objectives, but it doesn't try to answer every question or provide a rule for every situation. So the standard would be more like 10–12 pages than 200 pages. We would tell people that, if you can't see a particular rule to fit your situation, go back to the main objective or principle. There are no exceptions to the basic principle. It would be very different than standards now. This is something the Sarbanes-Oxley legislation requires the SEC to study ... It is aimed at eliminating the vast array of exceptions we have in existing standards. Right now ... rules are issued by four different bodies and we have thousands of pages of rules. The problem with that, in my view, is that for those who want to comply with the rules, they are not always sure of everything they need to look at. One rule may contradict another. Those looking to get around the rule ... can use legalistic approaches to try and do it. So the current system has downsides for those who want to comply with rules and

FIGURE 1
Criteria Used by the FASB to Make Decisions

Conceptual Framework, augmented by Jonas and Blanchet
(*Accounting Horizons,* September 2000)



Source: Jonas and Blanchet (2000).

benefits for those who don't want to. When asked why the idea of principles-based standards is controversial, Herz replied, "The flipside is it requires the exercise of good judgment by both companies and auditors. Those who don't like a principles-based approach say, 'I don't trust people to do that.' They think people need rules to follow or they will find a way to make an objective fit almost any situation.

Increasing Emphasis on the Role of Ethics

Pincus (2000) illustrates that rules-based systems can lead to two different types of problems. In summary, she characterizes these as absence of rule problems (anything goes if not expressly prohibited) and presence of rule problems (technical rule conformance that violates the intent of the rule). "Rules meant to serve as guides to right behavior also can serve to lead accountants down the path of least resistance" (Pincus 2000, 253).

Given the environment of widespread accounting breakdowns such as those alleged at Enron and WorldCom, coupled with an expected shift to principles-based accounting standards, the role of ethics and professional judgment is magnified within the accounting profession. Doucet and Ruland (1994) advocate that rules alone cannot ensure ethical behavior. Only the exercise of professional virtue ethics can accomplish this goal. They suggest that three virtues, based on Aristotelean virtue theory, are necessarily inherent in the proper execution of the accountant's role. Virtue theory, historically, has been based on development of moral virtues, or character traits that are at a mean between two extreme character traits (vices) *(Internet Encyclopedia of Philosophy,* Fieser and Dowden 2002). While not an exhaustive list, virtue expertise, virtue courage, and virtue integrity are necessary (Doucet and Ruland 1994, 10). Virtue expertise encompasses both technical expertise and ethical expertise. Without ethical expertise, accounting decision makers would be unable to exercise appropriate professional judgments. As an example, Doucet and Ruland (1994) discuss the case of pension accounting and the impact of rate of return assumptions on the measurement of pension liabilities: "Ethical expertise would include knowledge that the duty to inform the public requires use of the most realistic rate of return estimate. This is as opposed to an estimate acceptable to management which does not best inform the public. Thus, ethical expertise is necessary for informed decisions about whether to challenge the client when rate of return estimates are optimistic and would lead to understatement of pension liabilities" (Doucet and Ruland 1994, 7).

Virtue courage, defined by Aristotle as the mean between the extremes of rashness and cowardice, may have the most literal application to accounting and auditing *(Internet Encyclopedia of Philosophy* 2002). Without virtue courage, accounting decision makers may be unwilling to resist pressures and challenge management (or clients) to do the right thing to fulfill their responsibilities to the public. "In the pension example, the accountant must have the courage to challenge the client's use of overly optimistic rates of return. Otherwise the accountant (auditor) would allow the client to understate its pension liability" (Doucet and Ruland 1994, 7).

Virtue expertise and virtue courage are incomplete without virtue integrity. As Doucet and Ruland (1994, 10) explain:

> An accountant lacking integrity, on the other hand, could use his or her expertise and courage to an end that is counter to the duty to inform the public. Such an accountant could help structure transactions to meet the technical requirements of accounting rules while misinforming (or underinforming) the public. In the pension example, the accountant might help management choose a rate of return to achieve management's ends while misinforming the public of the extent of the liability.

ETHICAL DECISION-MAKING FRAMEWORK

With the dramatic shift from rules-based systems to principles-based systems suggested above, a critical question arises in how to address the development of trust outlined by Herz (Stone 2002). Trust in any system develops only through experience in dealing with that system and through examination of the outcomes of the system. Only after a system has been shown to generate consistent results can it be relied upon by the public. The profession's effort to provide consistent results across companies, across accounting firms and across individual offices and auditors is the basis for the current rules-based system. In moving away from this system to a principles-based system, professionals will be expected to consistently reach ethical decisions when faced with dilemmas in financial reporting and auditing. In this case, you are asked to consider a situation with conflicting and complex issues, essentially a normative question involving one or more value judgments. Pincus' (2000) discussion of the role of ethics, combined with an application of Aristotelian virtue theory, should provide foundational support for your views.

CASE REQUIREMENTS

1. Before you begin your research for the case, outline your initial reaction regarding whether your responsibilities as the auditor would be affected by your knowledge of the CFO's act.
2. As part of your duties as the auditor, should you contact the audit committee about the CFO's act? Support your answer by researching and discussing guidance provided in the authoritative literature. As a hint, first consider the general guidance provided by the AICPA *Code of Professional Conduct* (AICPA 1997) and Statement on Auditing Standards No. 54 (AICPA 1988). More specific guidance can be found by examining the Private Securities Litigation Reform Act (1995) and the Sarbanes-Oxley Act of 2002.
3. Address each of the following from the context of the impact on your financial statement audit work. Support each position by researching and discussing guidance provided by GAAS.
   a. Does the illegal act increase the potential for fraud in the financial statements?
   b. Assess the impact on the audit of the internal controls in the human resources department.
4. Write a memo to the audit partner informing her of your recommendation regarding Hogue & Company's resolution of this issue. Be sure to fully explain your reasoning and provide authoritative support for your proposed handling of this matter.
5. Does the fact that Bell Manufacturing is publicly traded affect your decision? If so, how?
6. To what degree was your initial reaction (question number one) based on your personal value set? Is your initial reaction consistent with GAAS and the requirement of the *Code of Professional Conduct,* Rule 102, to be objective, i.e., unbiased, as an auditor?