

engagement exceeds the personal competence of a member or a member's firm. Each member is responsible for assessing his or her own competence—of evaluating whether education, experience, and judgment are adequate for the responsibility to be assumed.

4. Members should be diligent in discharging responsibilities to clients, employers, and the public. Diligence imposes the responsibility to render services promptly and carefully, to be thorough, and to observe applicable technical and ethical standards.
5. Due care requires a member to plan and supervise adequately any professional activity for which he or she is responsible.

ARTICLE VI: SCOPE AND NATURE OF SERVICES

A member in public practice should observe the Principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.

1. The public interest aspect of certified public accountants' services requires that such services be consistent with acceptable professional behavior for certified public accountants. Integri-

ty requires that service and the public trust not be subordinated to personal gain and advantage. Objectivity and independence require that members be free from conflicts of interest in discharging professional responsibilities. Due care requires that services be provided with competence and diligence.

2. Each of these Principles should be considered by members in determining whether or not to provide specific services in individual circumstances. In some instances, they may represent an overall constraint on the nonaudit services that might be offered to a specific client. No hard-and-fast rules can be developed to help members reach these judgments, but they must be satisfied that they are meeting the spirit of the Principles in this regard.
3. In order to accomplish this, members should
 - Practice in firms that have in place internal quality-control procedures to ensure that services are competently delivered and adequately supervised.
 - Determine, in their individual judgments, whether the scope and nature of other services provided to an audit client would create a conflict of interest in the performance of the audit function for that client.
 - Assess, in their individual judgments, whether an activity is consistent with their role as professionals.

CASES

CASE 1. *An Auditor's Dilemma*

As she sorts through a stack of invoices, Alison Lloyd's attention is drawn to one from Ace Glass Company. Her responsibility as the new internal auditor for Gem Packing is to verify all expenditures, and she knows that Ace has already been paid for the June delivery of the jars that are used for Gem's jams and jellies. On closer inspection, she notices that the in-

voice is for deliveries in July and August that have not yet been made. Today is only June 10. Alison recalls approving several other invoices lately that seemed to be misdated, but the amounts were small compared with the \$130,000 that Gem spends each month for glass jars. I had better check this out with purchasing, she thinks.

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Over lunch, Greg Berg, the head of purchasing, explains the system to her. The jam and jelly division operates under an incentive plan whereby the division manager and the heads of the four main units—sales, production, distribution, and purchasing—receive substantial bonuses for meeting their quota in pretax profits for the fiscal year, which ends on June 30. The bonuses are about half of annual salary and constitute one-third of the managers' total compensation. In addition, meeting quota is weighted heavily in evaluations, and missing even once is considered to be a death blow to the career of an aspiring executive at Gem. So the pressure on these managers is intense. On the other hand, there is nothing to be gained from exceeding a quota. An exceptionally good year is likely to be rewarded with an even higher quota the next year, since quotas are generally set at corporate headquarters by adding 5 percent to the previous year's results.

Greg continues to explain that several years ago, after the quota had been safely met, the jam and jelly division began prepaying as many expenses as possible—not only for glass jars but for advertising costs, trucking charges, and some commodities, such as sugar. The practice has continued to grow, and sales also helps out by delaying orders until the next fiscal year or by falsifying delivery dates when a shipment has already gone out. "Regular suppliers like Ace Glass know how we work," Greg says, "and they sent the invoices for July and August at my request." He predicts that Alison will begin seeing

more irregular invoices as the fiscal year winds down. "Making quota gets easier each year." Greg observes, "because the division gets an ever increasing head start, but the problem of finding ways to avoid going too far over quota has become a real nightmare." Greg is not sure, but he thinks that other divisions are doing the same thing. "I don't think corporate has caught on yet," he says. "But they created the system, and they've been happy with the results so far. If they're too dumb to figure out how we're achieving them, that's their problem."

Alison recalls that on becoming a member of the Institute of Internal Auditors, she agreed to abide by the IIA code of ethics. This code requires members to exercise "honesty, objectivity, and diligence" in the performance of their duties, but also to be loyal to the employer. However, loyalty does not include being a party to any "illegal or improper activity." As an internal auditor, she is also responsible for evaluating the adequacy and effectiveness of the company's system of financial control. But what is the harm of shuffling a little paper around? she thinks. Nobody is getting hurt, and it all works out in the end.

Questions

1. Is the IAA code of ethics really helpful in resolving Alison's dilemma? Why or why not?
2. Greg blames the incentive system for the dilemma. Is he right?

CASE 2. *Accounting for Enron*

Enron Corporation has come to symbolize the worst of recent corporate corruption scandals. Billions of dollars were lost by investors, and thousands of people lost their jobs and

their retirement savings when the one-time seventh-largest United States corporation went bankrupt, the largest bankruptcy in history at the time, as a result of the fraud

From Joseph R. DesJardins and John J. McCall, *Contemporary Issues in Business Ethics*, 5th ed. (Belmont, CA: Thompson Wadsworth, 2005).