Corporate Greed vs. IMA's Ethics Code

Recent corporate financial scandals—Enron, WorldCom, and others—damaged accounting's image, but IMA's Standards of Ethical Conduct can provide guidance for future ethical dilemmas.

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IN RECENT YEARS accountants and the profession have come under fire as a result of breakdowns and misdeeds in the financial reporting process. An apparent lack of ethical behavior exhibited by decision makers forms a core area of concern.

The predominantly negative media coverage of the financial and accounting activities of Enron, Tyco, WorldCom, Adelphia, and other U.S. companies has been exhaustive. Thanks to this barrage of negative images, it is probable that many observers of the profession think that the reputation of financial professionals has been damaged irreparably—that it's unsuitable to use the terms "ethical" and "accountant" in the same sentence. What's more, the potential exists for this image to become even more magnified if we don't attempt to restore confidence in the financial reporting

Institute of Management Accountants' Standards of Ethical Conduct*

STANDARD	Members have a responsibility to:
COMPETENCE	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, and technical standards.
	Prepare complete and clear reports and recommendations after appropriate analyses of relevant and reliable information.
CONFIDENTIALITY	Refrain from disclosing confidential information acquired in the course of their work except when authorized, unless legally obligated 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.
INTEGRITY	Avoid actual or apparent conflicts of interest and advise all appropriate parties of any potential conflict.
	Refrain from engaging in any activity that would prejudice their ability to carry out their duties ethically.
	Refuse any gift, favor, or hospitality that would influence or would appear to influence their actions.
	Refrain from either actively or passively subverting the attainment of the organization's legitimate and ethical objectives.
	Recognize and communicate professional limitations or other constraints that would preclude responsible judgment or successful performance of an activity.
	Communicate unfavorable as well as favorable information and professional judgments or opinions.
	Refrain from engaging in or supporting any activity that would discredit the profession.
OBJECTIVITY	Communicate information fairly and objectively.
	Disclose fully all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, comments, and recommendations presented.

*"Standards of Ethical Conduct for Practitioners of Management Accounting and Financial Management, Statement No. 1C" (revised), Institute of Management Accountants, Montvale, N.J. April 30, 1997. Complete text is on the IMA website, www.imanet.org, in the Ethics Center.

process and trust in finance professionals.

One starting point in developing a case for public trust in our profession is to consider how ethical perspectives have been breached in the past and how to avoid these violations in the future. The Institute of Management Accountants' (IMA) "Standards of Ethical Conduct for Practitioners of Management Accounting and Financial Management" convey how ethical behavior should be practiced in the profession. In these Standards, IMA has identified areas of ethical professional conduct for its members. They are competence, confidentiality, integrity, and objectivity. As shown in the above table, IMA delineates the professional's responsibilities in each of these four areas.

These Standards are one of the most important, powerful, and positive tools available to financial professionals in communicating the importance of ethical conduct as part of our professional responsibilities. We discuss this point and describe how members can also use the Standards to better understand the ethical dimensions of past abusive practices that were reported in the media.

A FRAMEWORK FOR ETHICAL CONDUCT

The IMA Standards of Ethical Conduct are designed to be proactive, helping finance professionals to link ethical perspectives directly to their ongoing workplace responsibilities. In a perfect world, IMA members would employ these Standards in their professional lives, and there would be little or no notice of this by the general public. Given the barrage of reported misdeeds in recent months, however, the Standards can take on added meanings and uses.

It's probable, for example, that most people (including young men and women who will be deciding upon future career paths) are familiar with the term "ethics" but are less likely to be able to identify what "ethical behavior" should mean to an accounting/finance professional. Stated differently, media reports of the past year suggest a clear picture of wrongdoing but are less instructive on why and how such behaviors were *unethical*.

To better understand the connection between ethics and the alleged corporate crimes, we relate some of these incidents to specific violations of the IMA Standards of Ethical Conduct regarding professional responsibilities for competence, confidentiality, integrity, and objectivity. Understanding the ethical implications of past conduct can help us in developing strategies for restoring public trust in the future.

The IMA Standards are presented below in bold type and are followed by a discussion of types of behavior that violate specific aspects of these standards. All these incidents have been reported in numerous media.

COMPETENCE

◆ **Perform their professional duties in accordance with relevant laws, regulations, and technical standards.**

Relevant Laws: It's against the law to destroy evidence in an official proceeding, yet several professionals have been charged or convicted of doing so. For example, in the summer of 2002, a Houston court convicted Arthur Andersen of obstructing justice by shredding documents and deleting files connected with the Enron investigation. In another example, the State of New York indicted Dennis Kozlowski, former Tyco CEO (and accountant), for evading taxes on $13 million of art purchased with Tyco's funds. During this investigation, Kozlowski allegedly removed a shipping bill of lading from a file being sent to investigators.

It's also against the law to lie to federal investigators. Douglas Faneuil, a Merrill Lynch brokerage assistant who helped execute Martha Stewart's sale of ImClone shares, pleaded guilty to originally lying to federal investigators. He first said that Stewart had a standing agreement with her broker to sell the shares if they fell below $60. He later retracted his initial statement and told officials that there was no agreement.

Technical Standards: Violating GAAP breaches the competence Standard as well, and reported incidents about three telecommunication companies illustrate how GAAP was disregarded in order to boost profits. Global Crossing purchased more than $1 billion in telecom capacity from its customers, who then bought $1 billion from it. This is known as a "swap." Qwest also dealt in swap agreements, and executives in both of these firms reportedly accounted for these agreements incorrectly. They treated them as capital rather than as operating expenses, booking the revenue up front but expensing the amount over a period of time. This practice violates the matching principle.

Additionally, WorldCom treated billions of dollars of ordinary operating assets as capital assets over a period of 15 months. Scott Sullivan, WorldCom's chief financial officer, reportedly used this method to keep WorldCom's profits high. WorldCom's auditor, Arthur Andersen, failed to determine if these transactions were reported in accordance with GAAP even though such expenses tend to be some of telecom companies' biggest.

CONFIDENTIALITY

◆ **Refrain from using or appearing to use confidential information acquired in the course of their work for unethical or illegal advantages, either personally or through third parties.**

The SEC has charged many corporate executives with insider trading. One highly publicized case involved ImClone's CEO Samuel Waksal. The SEC said Waksal told family members to sell the stock after the Food and Drug Administration failed to review its application for a cancer drug. The day after Waksal learned of the FDA's decision, certain family members sold $10 million of ImClone stock. He apparently tried to unload 80,000 shares, but two different brokerage houses wouldn't process the sale.

Also, WorldCom executives and board members were actively unloading their stock during many of the company's improprieties, such as inflating revenue and improperly capitalizing expenses.

INTEGRITY

◆ **Avoid actual or apparent conflicts of interest, and advise all appropriate parties of any potential conflict.**

Enron's former treasurer, Jeffrey McMahon, approached Jeffrey Skilling, its CEO, about the inappropriateness of finance chief Andrew Fastow's running Enron partnerships while still an employee at Enron. In response, Skilling reportedly arranged for the treasurer to take a position outside the finance department.

◆ **Refrain from engaging in any activity that would prejudice their ability to carry out their duties ethically.**

Bernard Ebbers, former WorldCom CEO, owed massive debt to many banks. His personal loans were backed by large amounts of WorldCom stock. When banks asked for margin calls, Ebbers stated he would have to sell millions of shares to meet the requirements. If Ebbers did this, the board members' own stock would have significantly decreased in value. The directors then decided to lend Ebbers more money even though he already had borrowed millions from the company.

◆ **Refuse any gift, favor, or hospitality that would influence or would appear to influence their actions.**

Bribes and favors tend to skew professional judgment. Merrill Lynch and WorldCom provide examples of this transgression. First, Douglas Faneuil initially told federal investigators that an agreement was in place for Martha Stewart's broker to sell ImClone shares if they fell below $60. In exchange for not telling federal prosecutors the truth originally, Faneuil reportedly received a small amount of money, airplane tickets, and an extra week's vacation.

Bernard Ebbers allowed the head of the executive-compensation committee, Stiles Kellett, to lease WorldCom's jet for $1 per month (an amount understated by about $90,000 per month) as well as lend him $650,000 for a margin call. These lease and loan agreements appeared to have influenced Kellett's decision to give Ebbers a generous severance package.

◆ **Refrain from either actively or passively subverting the attainment of the organization's legitimate and ethical objectives.**

Newspaper headlines in 2002 also detailed executives' lavish spending of not only their own money but of company funds, too. Adelphia's Rigas family apparently believed company funds were their own lines of credit. The family bought homes, country club memberships, golf courses, and sports teams with Adelphia money. Adelphia filed suit against the family members for violating the Racketeer Influenced and Corrupt Organizations (RICO) Act and for breaching their fiduciary duties.

Dennis Kozlowski was notorious for spending Tyco money. He reportedly used hundreds of millions of dollars to pay for personal luxury items such as plush apartments, mansions, and outrageously expensive home décor. Tyco also partly paid for a $2 million birthday party for his wife. If that weren't enough, Tyco set up a "forgiven-loan program" which forgave $96 million in executives' loans, one third of that being Kozlowski's.

Bernard Ebbers of WorldCom owed more than $400 million to the company. He reportedly used much of the proceeds of the debt to construct a new house and pay more than $25 million for personal expenses and personal business transactions. The Board claimed that it did not know the loans would be used for personal items.

◆ **Communicate unfavorable as well as favorable information and professional judgments or opinions.**

WorldCom's former Senior Vice President and Controller David Myers reportedly tried to prevent a subordinate from bringing accounting concerns to the board and the company's auditors. Steven Brabbs, an executive in London, inquired why WorldCom had reduced his division's expenses by $33 million (a ploy to make the division look better). Myers ordered Brabbs to have no other contact with Arthur Andersen after he had raised several issues. Moreover, Scott Sullivan, former CFO of WorldCom, reportedly at first ignored and then tried to subvert Internal Audit Director Cynthia Cooper's findings regarding the misclassification of capital expenditures.

Even certain Enron lawyers questioned the financial deals that they were devising, but supervisors often rejected their concerns. Sherron Watkins is one of the few apparent "heroes" to emerge from Enron for her efforts to raise awareness of questionable practices.

◆ **Refrain from engaging in or supporting any activity that would discredit the profession.**

Many corporate accountants and managers fabricated documents to purport fraud. Adelphia officials reportedly used more than $250 million of company funds to meet margin calls on their own stock holdings and covered up these transactions with fabricated receipts and financial reports. These executives also used two sets of accounting records for capital expenditures. One set overstated the amount spent on upgraded cable systems.

Similarly, former WorldCom CFO Scott Sullivan reportedly requested that subordinates report better performance than the correct waning revenue and profit numbers. To help do this, he and employees kept two sets of books.

Equally disturbing was the reaction of WorldCom's external auditors, Arthur Andersen. Steven Brabbs of WorldCom wrote a letter to Arthur Andersen, asking them to check on how capital expenditures were being recorded. Instead of a response from Andersen, Brabbs received a reprimand from the controller for raising the issue without his knowledge. Arthur Andersen also brushed off questions/inquiries from Cynthia Cooper, head of WorldCom's Internal Audit Department.

OBJECTIVITY

◆ **Communicate information fairly and objectively.** *(Many of the apparent violations of GAAP could be classified here. For example, observers of WorldCom have suggested that its misrepresentations seem to reflect violations of principles taught in "Accounting 101.")*

◆ **Disclose fully all relevant information that could reasonably be expected to influence an intended user's understanding of the reports, comments, and recommendations presented.**

For Adelphia, difficulties began in March 2002 when it disclosed that it was a co-borrower of $3 billion with the Rigas family. The Rigases reportedly used a large portion of this money to buy the company's stock and other personal items but did not disclose these transactions to the board. Deloitte & Touche, Adelphia's auditor at the time, requested that the Rigases disclose the loans, but they refused. Deloitte & Touche did not press the issue and failed to tell the audit committee about the request.

Furthermore, contrivers of Tyco's forgiven loan program reportedly required these executives to sign confidentiality agreements to not disclose the loans. Two board members apparently also engaged in related party transactions (sale of real estate and lease of a plane), but Tyco did not disclose such deals to its investors.

A STRATEGY FOR MOVING AHEAD

The ability to frame these reported past abuses within the IMA Standards of Ethical Conduct helps to underscore the types of pressures that can be placed upon us in fulfilling our professional responsibilities. Of course, IMA members and other accounting/finance professionals will also recognize that only some of the reported misdeeds were perpetrated by accountants. Indeed, company executives, directors, brokers, analysts, and others who had a stake in using accounting reports have exhibited unethical behavior. The fact that the scenarios identified above have been reported in the popular media as "accounting scandals" underscores the need for strategic thinking by accounting professionals to restore public trust.

The fallout from the unethical behavior in the examples noted is far-reaching, including widespread calls for reform in reporting practices and corporate governance. The Sarbanes-Oxley Act is one major example of government-mandated reform resulting from "accounting/finance" scandals. Now all companies and professionals involved with financial reports must reconsider their policies regarding the accounting and reporting environment. It's questionable, however, that public trust can be regained if strategies focus solely on meeting newly imposed regulatory requirements and are identifiable only with companies and not with accounting/finance professionals themselves.

A more positive approach can be gained as individual IMA members develop strategies to complement the positive messages being conveyed at the organization level. Nationally, the IMA has been quite proactive in raising the awareness of accounting professionals to the importance of ethical practices. In 2002, then IMA President Margaret Butler issued a call for members to reaffirm their pledge to uphold the Standards of Ethical Conduct. Another positive step is the development of the IMA Ethics Hotline (ethics@imanet.org), now open to all finance professionals.

Strategies for addressing ethical responsibilities also must be a priority for individual IMA members. In a real sense, we can be ambassadors for the organization and for the profession in our everyday lives. At the grassroots level, we have the potential to help restore public trust as we interact with coworkers, consumers, students, and others who now question our credibility.

For example, Sarbanes-Oxley may be perceived by consumers and the general public as a reform being forced upon a profession that has no ethical direction. As individuals, or as part of chapter operations, we can take our positive message of the Standards to civic groups and students in high schools, colleges, and universities. These groups are primarily aware of only the negative messages of past behavior.

Our ability to directly identify those practices as violations of our Standards for competence, confidentiality, integrity, and objectivity in our professional roles helps us to better communicate with those stakeholders who currently question our ethical underpinnings. Also, as individuals we can ask introspective questions about whether such past occurrences could be allowed to happen in our own workplace and how we can work together to assure that the answer is a resounding "No!"

We must move forward from these turbulent times of mistrust. An important part of our moving forward should be to employ the power of the IMA Standards of Ethical Conduct in our personal and professional lives. These Standards not only can empower us to understand the past but also can better prepare us for the future. ■

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