

Ethics Series: Blinded by Pressure

Participant Workbook



OBJECTIVES

After this session, you will be able to:

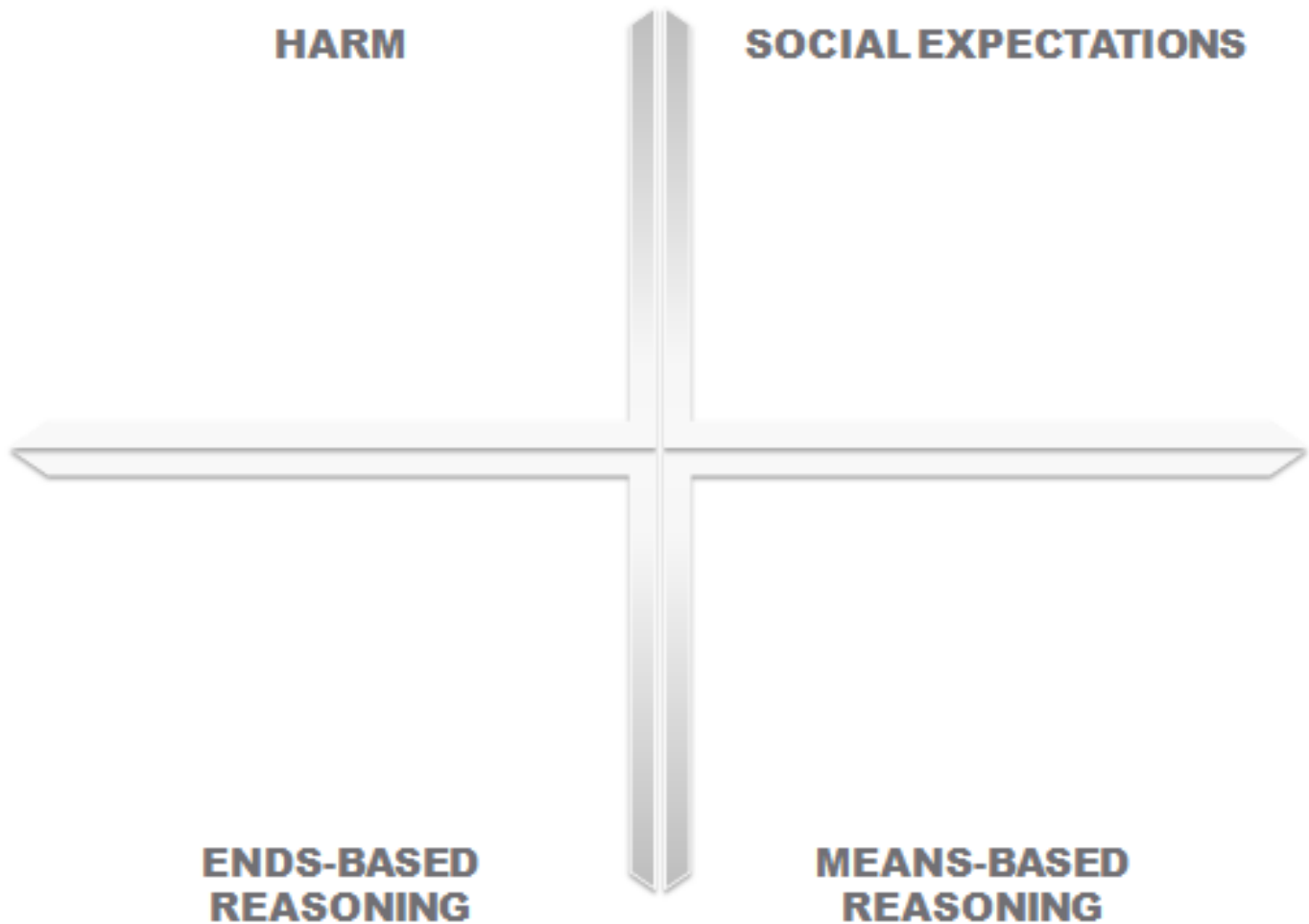
- Recognize an ethical dilemma within an organization.
- Identify improper departures from U.S. Generally Accepted Accounting Principles (GAAP) reporting as a means to improve reported results.
- Recognize the appropriate ways to increase profits within GAAP and ethical guidelines.
- Identify an auditor's role and responsibility when faced with an ethical dilemma.

REFLECTION

Think of a time when you were faced with an ethical dilemma (either personal or professional). How did you handle it?

What do you hope to get out of this workshop?

FACTORS OF AN ETHICAL DILEMMA



SCENARIO PRACTICE: EVALUATE FINANCIAL DATA

In this exercise, you will be asked to review key financial data for a fictional company named ABC Company and evaluate if any red flags should be raised.

Let's assume you are acting as the cost accounting manager for ABC Company where upper management is finalizing their budget for next year (20X4).

We'll begin by taking a look at pricing charged in the prior year by ABC Company's approved vendors.



Prior Year(20X3) Pricing (per unit)			
Vendors	0-500 units	501-750 units	Over 750 units
TM Suppliers	0.87	0.72	0.65
WD Wholesalers	0.87	0.73	0.62
Elite Product Co.	0.86	0.71	0.64
Historical Unit Purchases			
ABC Co. Historical Purchases	20X2	20X3	Budget 20X4
TM Suppliers	687	687	687
WD Wholesalers	1,584	1,959	2,882
Elite Product Co.	400	650	650
	2,671	3,296	4,219
ABC Co. Historical Costs	20X2	20X3	Budget 20X4
TM Suppliers	\$ 445.18	\$ 494.64	\$ 494.64
WD Wholesalers	\$ 932.98	\$ 1,214.58	\$ 1,786.84
Elite Product Co.	\$ 275.20	\$ 461.50	\$ 461.50
	\$ 1,653.35	\$ 2,170.72	\$ 2,742.98

At first glance, we notice that pricing will depend on quantities purchased. Next, let's take a look at our historical unit purchases and extended product costs by vendor.

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Vendors	0-500 units	501-750 units	Over 750 units
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WD Wholesalers	0.87	0.73	0.62
Elite Product Co.	0.86	0.71	0.64

ABC Co. Historical Purchases	Units	Price Per Unit	Cost
TM Suppliers	687	0.72	\$ 494.64
WD Wholesalers	1,959	0.62	\$ 1,214.58
Elite Product Co.	650	0.71	\$ 461.50
	3,296		\$ 2,170.72

A quick validation demonstrates that 20X3 historical costs tie back to the appropriate per-unit costs noted in the 20X3 pricing schedule.

Next, we'll take a look at the budgeted figures for the new 20X4 year.

Current Year Budget Analysis			
ABC Co. Historical Purchases	20X2	20X3	Budget 20X4
TM Suppliers	687	687	687
WD Wholesalers	1,584	1,959	2,882
Elite Product Co.	400	650	650
	2,671	3,296	4,219

ABC Co. Historical Costs	20X2	20X3	Budget 20X4
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Our external Research department has provided us with the following information:

1. Economic trends are expected to remain the same for 20X4.
2. WD Wholesalers has been a primary supplier to ABC for more than 40 years.
3. A hostile takeover of WD Wholesalers by Elite Product Co. is imminent in 20X4.

Based on all information provided to you in this scenario, which red flag(s) (if any) do you see with ABC's 20X4 budget? Discuss your answers with your team, and be prepared to present your findings to the class.



CONTRIBUTORS TO THE SCHEME

- Why would they have gone along with it?
- What should they have done?

FRAUD TRIANGLE




SCENARIO PRACTICE: RESOLVE AN ETHICAL DILEMMA

Now it's your turn to choose an appropriate way to increase profits within GAAP and ethical guidelines. Let's return to our red flag scenario and pose an ethical dilemma.

Suppose in a recent private meeting, you brought the red flags to the attention of your boss, Amy Dublin. Shortly after your discussion, Amy sends you an e-mail.




Send

To: you@abc-company.com

From: adublin@abc-company.com

Subject: Re: 20x4 Budget Concerns

Thank you for bringing the inflation and takeover issues to my attention. As you are aware, we face many challenges in the year ahead. Maintaining our shareholder value and protecting company assets and reputation are among them.

One of the ways we protect shareholder value is to set reasonable expectations for analysts on Wall Street. Since budgets are educated guesswork at best, we want to make certain we don't create unnecessary concerns by reflecting pricing increases that may never happen. Assumptions of this nature could compromise stock prices, the ability to acquire necessary capital resources to support growth, and perhaps create the need for employee downsizing plans.

I'm sure you understand the sensitivity of this matter and I'm counting on you to embrace the estimates provided in order to protect the well-being of this company. Any actions on your part which compromise our ability to properly manage the well-being of this company will not be well received and may result in disciplinary action including termination.

I trust you will make the right decisions and remain a valued and well-appreciated employee for many years to come.

Respectfully,
Amy Dublin





A full evaluation of this scenario may require further research. Review the Statement of Ethical Practices from ABC's Employee Handbook and the company's organizational chart below to explore other information that may be helpful in determining the appropriate next step you should take.

ABC Company: Statement of Ethical Practices

1. Every employee is expected to conduct themselves, upholding the highest standard of ethical and honest behavior.
2. Every employee is entitled to work in a healthy workplace free of sexual harassment or acts of bigotry toward any race, religion, ethnic background, sexual orientation, or age.
3. Employees who witness or experience any acts noted in item 2 above are required to report said acts to Human Resources.
4. All employees are expected to conduct themselves in a professional manner always keeping our company stakeholder's best interest in mind.
5. Employees have an assumed responsibility to uphold the highest standards protecting shareholder value and maximizing company profitability.
6. All questionable business practices or ethical dilemmas should be discussed in detail with your immediate supervisor.
7. Failure of any employee to comply with this Statement of Ethical Practice will result in severe disciplinary action including termination of employment.



Ethical dilemmas often do not present options that are clearly right vs. wrong. From the logical choices displayed on the screen, select one of the options that best reflects the recommended next step in this ethical dilemma, despite the potentially negative consequences.

Option		Potential Consequences
	Escalate your concern to the CEO to ensure proper and ethical accounting practices are being adhered to.	Selecting this option may be construed as violating items 4, 5, and 6 of the Statement of Ethical Practices. This may result in you receiving severe disciplinary action or perhaps being fired.
	Do as you are told, and leave the calculations as they are. Should the action be questioned at a later date, it will be clear you were just following orders.	Selecting this option may be construed as aiding the deliberate misrepresentation of costs in order to meet analysts' and management's expectations. This option could cause significant impact on stock prices as investors question the integrity of ABC's financial data. Knowingly misrepresenting costs is also a violation of items 1 and 4 of the Statement of Ethical Practices. This may result in you receiving severe disciplinary action or perhaps being fired.
	Report the deliberate understated costs to the SEC.	Selecting this option may be construed as violating item 6 of the Statement of Ethical Practices. This may result in you receiving severe disciplinary action or perhaps being fired. In addition, this action could impact the company negatively as it compromises the integrity of information being reported to Wall Street, which may cause a drop in company valuations.
	Change the figures to reflect more appropriate cost estimates, and don't tell anyone.	Selecting this option may be construed as insubordination. You've been instructed what to do by your boss, yet you've taken it upon yourself to make changes. Because you don't have the authority to make changes that could directly impact stock price valuations, your actions may have a negative impact on the company and would demonstrate a deliberate violation of items 1, 4, and 5 of the Statement of Ethical Practices. This choice runs a high risk of you being fired.



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MANAGEMENT ACCOUNTING TOOLS

- Variance Analysis
- Benchmarking
- CVP Analysis

SCENARIO PRACTICE: AUDIT A SAMPLE COMPANY

For this exercise, you will act as the auditor examining the current period financials of Company A. Company A is a small family-run business. The owner has expressed his pride in his company and his ability to negotiate incredible deals with vendors. This gives him a competitive edge on his direct competition (Company B and Company C), which operate in the same town, because his cost of goods sold runs about 4% lower than his competitors.



COMPETITIVE ANALYSIS

	Company A	Company B	Company C
Location	Cityville, NY	Cityville, NY	Cityville, NY
Square feet of location	1,285	1,327	1,297
Number of employees	27	25	30

	Company A	Company B	Company C
Revenues	\$ 1,234,586	\$ 2,158,954	\$ 1,978,524
Cost of goods sold	679,022	1,273,783	1,167,329
Gross Profit	\$ 555,564	\$ 885,171	\$ 811,195
Gross Profit %	45%	41%	41%
SG&A expenses	327,974	352,214	336,647
Profit before taxes	227,590	532,957	474,548
Profit before taxes %	18%	25%	24%

Company A's profit before taxes is about 18%. The owner feels the business is doing well, and the new controller appears to be keeping costs in line.

Using the benchmark tools and details provided, follow the facts to conclusion and detect any issues along the way.

The benchmark tools provide comparable financial statement data for Company B and Company C.

Drill down into the details for each line item to obtain more detailed information driving the figures reported in Company A's financial statement.

Last Name	First Name	Title	Home Town
Albertson	Nelson	CEO, Owner	Cityville, NY
Austin	Colin	Sales Representative	Cityville, NY
Bright	Cindy	Sales Representative	Albright, NY
Caldwell	Kathy	Accounting	Newton, NY
Hoffman	Daniel	Distribution Engineer	Newton, NY
Davis	James	Controller	Ruralville, NY
Lawrence	Debbie	Office Administration	Southside, NY
Farnsworth	Edna	Sales Representative	Westin, NY
Brooks	Tina	Office Administration	Eastin, NY
Godwin	Joanne	Distribution Engineer	Happington, NY
Garcia	Roberto	Accounting	Hoboken, NJ
Hawkins	Greta	Receptionist	Henske, NY
Smith	Harry	Accounting	Burlington, NY
Helmsley	Leo	Sales Manager	Newton, NY
Keppenger	Claude	Office Administrator	Carson City, CT
Livingston	Mary	Office Administrator	Cityville, NY
Williams	Terence	Procurement	Cityville, NY
Martin	Kim	Office Administration	Cityville, NY
O'Keefe	Nancy	Warehouse Manager	West Cityville, NY
Kaplan	Eileen	Office Administrator	Albright, NY
Collins	Ralph	Loading Doc Spec.	Northside, NY
Meyers	Ross	Sales Representative	Burlington, NY
Gates	Toby	Distribution Engineer	Burlington, NY
Saunders	Bill	Distribution Engineer	Cityville, NY
Stevens	Nigel	Accounting	Cityville, NY
Lee	Doreen	Distribution Engineer	Newton, NY
Matthews	Linda	Sales Representative	Cityville, NY



Revenue Breakdown	Company A	Company B	Company C
Price per unit	\$1.45	\$1.50	\$1.49
Units Sold	853,857	1,435,699	1,325,879
Total Revenue	\$ 1,234,586	\$ 2,158,954	\$ 1,978,524

Cost of goods sold	Company A	Company B	Company C
Cost per unit	\$0.80	\$0.89	\$0.88
Units Purchased	853,857	1,435,699	1,325,879
Total cost of goods sold	\$ 679,022	\$ 1,273,783	\$ 1,167,329

Selling, general, and administrative expenses	Company A	Company B	Company C
Commissions	\$ 37,038	\$ 86,358	\$ 61,334
Salaries	202,500	212,500	225,000
Office supplies	3,186	3,300	3,570
Building maintenance	57,358	35,256	34,643
Legal and professional fees	27,892	14,800	12,100
	<u>\$ 679,022</u>	<u>\$ 1,273,783</u>	<u>\$ 1,167,329</u>

**Commissions are calculated
at 3% of sales.**

**Salary information is
confidential. Please see
Nelson Albertson for
approval.**



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<i>Paperclips Office Suppliers</i>			
Item	Qty	Unit Price	Cost
Copy paper	30	23.95	\$ 719
Pens	50	1.49	\$ 75
Pencils	50	0.89	\$ 45
Wireless mouse	12	24.99	\$ 300
All-in-one copier	1	379.58	\$ 380
Binders	50	9.95	\$ 498
Binder tabs (set of five)	50	4.59	\$ 230
Labels	100	8.98	\$ 898
Envelopes	10	4.39	\$ 44
			\$ 3,186

Building maintenance	Company A	Company B	Company C
Utilities	\$ 23,130	\$ 23,886	\$ 23,346
Landscaping	6,425	6,635	6,485
Sub-contractor work	27,803	4,735	4,812
	\$ 57,358	\$ 35,256	\$ 34,643

Sub-contractor work	
Cityville Plumbing	1,897
Cityville HVAC	2,323
Cityville Landscaping	475
Ruralville Plumbing	1,800
Suburban Contracting Group	18,367
Lightning Electricians	2,241
Edward Doe	600
	\$ 27,803



Customer# 5234

Company A
832 Longstretch Road
Cityville, NY 11899

Date: January 12, 20X3

Invoice#: 1876532

Terms: Net 15 days

Work Performed:

1. Replace second toilet and re-grout area.
2. Fix drip in faucet 3.
3. Snake/Unclog trap in faucet 2.

Total Cost **\$1,897.00**



127 Main St.
Cityville, NY 11899

Company A
832 Longstretch Road
Cityville, NY 11899

Date: January 22, 20X3

Invoice#: 1298

Terms: Net 10 days

- ♦ Installation — G365 Condenser
- 2. Fix drip in faucet 3.
- 3. Snake/Unclog trap in faucet 2.

Amount **\$2,323.00**



January Snow removal

Amount Due \$475



1827 Abbot Court
Ruralville, NY 11555

RURALVILLE
PLUMBING

Invoice # 58324
December 31, 20X2

Reroute residential sink, faucet, dishwasher and refrigerator.

Materials	\$1,050
Labor	<u>\$ 750</u>
Total	\$1,800

All invoices due upon receipt.

Thank you for your business.

**297 Roundabout Lane
Ruralville, NY 11555**




January 3, 20X3
Invoice **58975**

Scope of work: Install new Kitchen

Deliver to: 843 Oak Lane
Ruralville, NY 11555

Materials	\$20,152
Labor	\$ 8,215
Total	\$28,367
Less: Downpayment (Paid)	<u>\$10,000</u>

Balance Due upon receipt **\$18,367**


297 Roundabout Lane • Ruralville, NY 11555

January 4, 20X3

Invoice **198G**

Scope of work: Wire new residential Kitchen

Work Address 843 Oak Lane
Ruralville, NY 11555

Balance Due upon receipt **\$2,341**

Based on the information you have reviewed, select the appropriate statement:

I am satisfied that the financial statement shown accurately reflects the transactions of the period shown.

There is one December invoice that is reflected in January costs. Other than that, all reporting and supporting documentation appears to be in order.

There is reason for concern. I suspect misappropriation of company funds may have occurred. I need to alert my audit firm.



EPILOGUE

- What was the company impact?
- What was the personal impact to the CEO?
- What was the personal impact to the CFO?
- What are the key takeaways for you? How can you apply what you've learned to ensure ethical practices are followed at your company?



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SUMMARY

- What guidelines should management accountants follow to uphold strict ethical practices?
- What are the four overarching ethical principles in the *IMA Statement of Ethical Professional Practice*?
- What are the four standards of ethical professional practice?



CASE STUDY LEARNING POINTS

- How were the overarching ethical principles circumvented in the Diamond Foods case?

- How did Diamond Foods deviate from each of the four standards of ethical professional practice?

COMPETENCE	CONFIDENTIALITY
INTEGRITY	CREDIBILITY



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ACTION PLANNING

List **3** things that you learned today or were reminded about.

What **2** new strategies can you use to uphold ethical professional practices?

What **1** thing are you going to do TOMORROW?



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