Journal of Business and Educational Leadership
Vol 7, No 1; Spring 2018

ETHICAL STANDARDS FOR ACCOUNTING STUDENTS: A CLASSROOM EXERCISE ON INTERNAL CONTROLS

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ABSTRACT

Our goal is to produce leaders well equipped with the tools to be at the forefront of business. Therefore, we must produce better business students, those with greater ethical awareness, among other qualities. We have developed a mock classroom exercise that requires all accounting majors to become more familiar with the audited financial statements of a corporation and determine if internal control shortcomings exist. Accounting students will improve their ability to identify internal control concerns and incorporate corrective action plans. Furthermore, the students will review the materials with a critical lens and not only develop a corrective action plan but also collaborate with their fellow accounting peers to develop and document best practices. This classroom exercise provides real-world experiences in auditing, management, and operations and also enhances the critical thinking abilities of the participating students. These future CPAs will exercise their critical thinking skills through this real-world audit experience by applying their knowledge base to solve potential ethical dilemmas and by identifying and eliminating the opportunity component of the Fraud Triangle. It is our intention that this exercise will not only implore our students to investigate and seek ethical solutions; it will also illuminate the need for ethical decision making as well as enhance the ethical "toolkit" of our professional accounting majors.

Key Words: Operational Best Practices, Critical Thinking, Student Engagement, SOX, Audit Implementation Steps and Timeline

INTRODUCTION

The importance of business ethics education has been discussed for decades. The discussion took on a heightened tone with the passage of Sarbanes Oxley (SOX) legislation in 2002, which was a direct response to a series of large corporate scandals and bankruptcies. In the aftermath of ethical failures including Enron, Tyco, Adelphia, Waste Management, HealthSouth, WorldCom, American International Group (AIG), Lehman Brothers, Bernie Madoff, and Freddie Mac, there was heard a renewed cry for business ethics education. The public disgust, anger, and disappointment in our corporate leaders soon turned to a questioning of how such unethical individuals could have entered and succeeded in the business world with such an obvious lack of personal and professional integrity. Much of the ensuing flurry of activity has come in the form of adjustments to business curricula by either more fully integrating business ethics within and throughout existing courses or by adding a dedicated, stand-alone course. With the renewed impetus on business schools to do a better job of turning out ethical business professionals, it is perhaps time to offer new methodologies and interactive approaches for the instruction of business ethics.

The authors agree with the general premise often leveled as criticism: that one cannot teach college students to be ethical. Students have long formed whatever moral foundations or moral compass they will carry into adulthood before they reach college age. Nonetheless, it is our premise that business ethics should indeed be taught and that a course in business ethics is time well spent. Discussion of business ethics promotes ethical issue identification and awareness (McDonald & Donleavy, 1995), preparing young professionals to anticipate potentially unethical situations. We argue that discussion of business ethics reinforces that ethical business behavior is not only important, but expected. Exposure and discussion allow for moral imagination, and provide a foundation of preparedness for entering the business arena. Preparedness hopefully leads to proactivity and prevention, and we fully acknowledge that students do not enter the collegiate environment with a complete understanding of the types of situations that are common in business settings. Thus, raising their understanding of ethics, learning how to apply it and producing a best practices document will better prepare them for their role as a business leader. To that end, we propose a new take on the traditional case presentation for the instruction of business ethics for accounting students in particular, one with a specific focus on identification of internal control weaknesses and potential solutions.

BACKGROUND AND LITERATURE REVIEW

When approaching a college course in business ethics, one almost certainly begins with some sort of assessment of how ethical the students are at the present. The literature documenting the prevalence of cheating is voluminous and has concluded for decades that cheating in its various forms is rampant in the American educational system, with reported cheating ranging from the low 40s to the high 90s in terms of percent of students engaging in some form of academic dishonesty (e.g., Michaels & Miethe, 1989; Diekhoff, et al., 1996; McCabe, et al., 2001; Gallant & Drinan, 2006).

This body of work investigates the determinants of cheating behavior at both the individual level and the institutional level. Of particular concern to the authors is whether such observed behavior in the classroom demonstrates a larger propensity to act unethically in the professional world. Lawson (2004) finds a strong relationship between student propensity to cheat and attitudes towards unethical behavior in the real world, with many students feeling that unethical behavior is the norm in the business world. According to Winrow (2016), cheating behaviors can be linked to the perceived importance of ethical business behavior, which means if students perceive that ethical behavior is of low importance in the business world they are more likely to cheat in the classroom. Indeed, the literature on cheating often argues the salient point that cheating in schools is merely an indicator (or an indictment) of cheating in society as a whole, including in corporate America (Lee, 2009; Whitley, 1998).

Corporate greed, devastating fraudulent activity and lack of ethical behavior had seemingly become commonplace as scandals perpetrated by entities that previously held the public's trust came to light, including: Enron, WorldCom, Waste Management, Tyco, Freddie Mac, American International Group (AIG), Lehman Brothers, and Bernie Madoff. The discovery of such scandals angers and disgusts (or disappoints) the public, to no surprise. The legislative response was the Sarbanes–Oxley Act of 2002 (SOX). As a result, corporate awareness has been heightened, internal controls have been strengthened, fines have been levied, the public accounting role has been enhanced, and top management has had to play a larger role in ensuring accountability. Certainly, these measures are not fool proof, but are heading us in the correct direction as the theory behind SOX was to ensure that businesses were run ethically, and that management was held responsible for the implementation and outcomes of corporate financial strategies. An important offshoot was intended for a very different population: students of business schools – the future leaders of corporate operations.

The accounting profession bears a unique responsibility to demonstrate ethical behavior because of the public trust placed in the independent auditing function. As such, public accounting firms serve not only their clients, but also the public by providing reasonable assurance that the information contained within financial statements fairly represents the true financial position and accurately follows reporting requirements. Since the passage of SOX, corporate awareness has been heightened, internal controls have been strengthened, significantly larger fines have been levied, the public accounting profession has come under government regulation, and top management has been forced to accept greater operational and financial accountability.

SOX is widely respected as the most important legislative action since the inception of the Securities and Exchange Commission in 1934. It has successfully enacted one of its prime directives: to reassure a doubting public that businesses could be run ethically and those that were not would see top managers held accountable.

We contend that students will benefit greatly from business ethics discussions that bring into focus the types of scenarios requiring professional judgment and an understanding of proper internal controls and the risks inherent in control weaknesses that may fail to prevent or even encourage unethical behavior. The educational suggestion put forth in this paper strives to highlight that aspect of teaching business ethics. We present an alternative to the traditional case study that models itself on the flipped classroom idea and propose that students take part in developing the case, providing one or more scenarios of questionable ethics or control weaknesses and subsequently discussing risks and potential solutions to the issues.

We take a forward-looking stance and present a pragmatic approach to exposing students to real-world scenarios, fostering critical analysis and creative thinking, encouraging moral imagination, and promoting teamwork. Our approach draws upon suggestions regarding the importance of case studies and class projects in ethical reasoning provided in Solberg, et al. (1995). We remain optimistic about the importance of business ethics education (Trevino & McCabe, 1994; Salimi, et al., 2016) and its role in creating ethical awareness to help students delineate ethical from unethical decisions (Premeaux, 2005). Training future business and accounting professionals requires exposure to the complexities of real-world decision making, as this allows them to sharpen their ethical decision-making skills (Lawson, 2004). Jonson, et al. (2015) support teaching ethics in a way that exposes students to the complexities of real world situations that require more context-dependent reasoning and understanding. In other professional settings, case study is considered paramount in fostering ethical reflection and is a primary method for relating the complexities of ethical situations in practical ways (Ferguson, et al., 2016). There is much to be gained from exposure to business scenarios with potential ethical pitfalls, regardless of the current level of ethics of the students or their perceptions of the level of ethics present in corporate America.

OUR PROPOSITION: FLIP THE CASE

We sampled web sites from colleges and universities across the globe; with no surprise, each addressed academic integrity and the various forms of academic dishonesty. Educational institutions have an obligation to turn out ethically grounded and insightful students equipped with clarity of thought and maturity in decision making. Producing better business leaders starts in the classroom. Reinforcing the knowledge of internal controls and the appropriate follow up actions is the capstone of this lesson plan which requires students to identify potentially unethical situations as well as to develop the solution. The finale is the development of a best practices document that will catapult our students forward with a well-stocked "toolkit" with which to navigate the ambiguities and complexities that await them as they transition into the corporate world.

Business students, especially accounting majors, are exposed to a wide variety of regulatory agencies, advising bodies, and governing entities which include International Financial Reporting Standards (IFRS), Financial Accounting Standards Board/Governmental Accounting Standards Board (FASB/GASB), Securities and Exchange Commission (SEC), and the Public Company Accounting Oversight Board (PCAOB), to name but a few. The students are familiar with the resource, the regulation and even the impact, therefore the intention of this exercise is to expose them to insufficiencies and allow them the opportunity to identify the shortcoming(s) as well as develop the correction plan for the noted item(s).

CASE INTRODUCTION

As a class, students will become familiar with the audited financial statements or 10K of an assigned fortune 500 company. (To further bring the case to life, we plan to use the 10K of a fortune 500 company of which the CEO is an alumnus of our institution. It is our hope and intent for the CEO to be a guest speaker in the class.) Students will focus on the Notes to the Financial Statements, becoming very familiar with each note and the operational impact of the note as well as the corresponding financial statement reference point(s).

Prior to beginning our classroom exercise, the class will revisit SOX and the Fraud Triangle (pressure, rationalization, opportunity), students will be given a note that is fictitious which depicts an area of potential weakness or represents an opportunity for potential fraudulent activity. The sample solution to this classroom activity is detailed below and is in **bold.**

Sample Fictitious Note:
Note XX

Management describes their success over the past few years and attributes it to the dedication of their employees. A senior manager states *"we have employees so dedicated to their post that they have not taken a vacation in over 2 years"*.

The students will identify that this note could violate **required absences.** Once the area of potential weakness is identified as a class, we will develop audit correction steps and then collaborate on other possible solutions. Culminating with a best practices document.

A. Each student will identify the internal control concern and how it relates to the Fraud Triangle
    1. The internal control concern is required absence; which represents opportunity in the Fraud Triangle.
    2. This absence, of 2 consecutive weeks, will allow a co-worker to be responsible for those duties. Continued presence and influence over records/data is broken.
    3. As we visit the Fraud Triangle; employees having access to company records on a continued basis could have the opportunity to manipulate them. Fraud and/or embezzlement are more likely to occur when checks and balances are not in place.
B. Each student will identify the ethical dilemma the employee could face or be subjected to

   1. An employee with continued presence could have the opportunity to exert undue influence over processes and/or record keeping.
   2. Operational oversight is lacking and/or inefficient.
   3. Employees are not crossed trained, ineffective processes and the creation of operations in a silo.

C. Identify resources to support corrective actions
   1. SOX section 302
   2. https://www.sec.gov/rules/final/33-8238.htm
   3. https://www.newyorkfed.org/banking/circulars/10923.html

D. Propose corrective action steps
   1. Based on industry standards and operation size, a list of sensitive positions is developed.
   2. Each employee on the list is required to schedule and take that vacation which is a minimum of 2 consecutive weeks.
   3. Introduce a cross training initiative.

E. Corrective Action timeline
   1. Development of sensitive positions list- Immediate.
   2. Implementation of 2 consecutive week vacation schedule- Immediate.
   3. Cross-training Initiative-Near future.

F. Identify areas of the organization impacted by the opportunity and/or weakness
   1. Historically, sensitive positions would include all finance and finance related positions.
   2. As well as management in which undue influence could be exerted over a process.
   3. An area in which accomplishment of a goal improves the position of an individual vs. the company.

G. Develop follow up and monitoring mechanisms
   1. Develop protocols for existing positon review for sensitive status consideration.
   2. Develop protocols for new hire /new positon for sensitive status consideration.
   3. Periodically review list of sensitive positions.
   4. Compare current list and all updates, updated by whom and who approves list alterations.
   5. Review time-off requests and match to time keeping records.
   6. Ensure electronic access has terminated for each employee, for the correct period.

7. Verify the hiring protocols clearly outline the consecutive 2-week vacation requirement.

H. Development of future enhancements to further reduce opportunity
    1. Verify the Policies and Procedures will be revamped to include a cross training initiative.
    2. Introduce 360 evaluations.
    3. Introduce staggered vacations and different timeframes per year and per employee.

THE CASE

To further enhance the critical thinking aspect, each student will then be assigned a different area of concern and repeat the steps above, on their own.

Partial list of possible topics with internal control concerns include:

- Required Absences **(classroom exercise with sample solution provided)**
- Segregation of Duties
- Procedural Manual/ Training Modules
- Physical Control
- Real Time/ Timely Completion, Reporting and Disclosure
- Pre-Numbered Documents and Document Maintenance
- Organizational Chart/Reporting Structure

FLIP THE CASE

Distribute the completed cases to a class member (other than the preparer(s)) for identification of the new concern and completion of the steps above. This exercise is intended to raise awareness and increase exposure to situations and items that could be problematic while allowing the student to be proactive with opportunity reducing solutions. Recognition of the dilemma is key; development of the corrective action measures allows the student to apply critical thinking techniques and requires them to research legitimate accounting and regulatory sources which support their corrective action steps. Development of critical thinking skills and reducing opportunities are very applicable to the audit function, in addition applying controls and action implementation steps and timelines will allow for continued operational effectiveness. Critically thinking about the structured dilemmas increases knowledge base and continued exposure to the structured dilemmas builds confidence with the material which will aid in the preparation of these young accountants for the unexpected business scenario as well as reinforcing the importance of proper internal controls and operational protocols.

FLIP BACK

Students have the knowledge base to identify areas of concern, research resource support and follow the template for audit correction steps. Students will now participate in a complete review of the scenarios, collaboration and apply critical thinking to the development of a best practice document. Collaborating with their peers requires the ability to discuss the issue, present and explain their findings; which requires thorough understanding of the topic as well as the task. In addition, these accounting students will be required to discuss identification protocols, compare short-term and long-term solutions as well as an implementation timeline and monitoring mechanisms. The culmination of the Flip Back component will be the formulation of best practices document. Best practices will broaden the students' understanding of internal control concerns while providing a comprehensive foundation for the future auditing assignments.

CONCLUSION

It is argued that ethics cannot be taught in the classroom because it is multifaceted and polygonal, requiring constant review of our behaviors and ethical foundation as well as the application of intrinsic principles. The process of educating should include, in large part, an ability to inspire others because it is a continual stream of consciousness and discovery; through education students should be able to achieve desired outcomes. To combine the two into ethics education is to seek to inspire accounting students to discover more about themselves and to infuse in them a desire to grow in ethical awareness and make ever better use of their moral frameworks and principles to guide them in unfamiliar and questionable situations. The basic principle of ethical behavior is based on a guideline that is used situationally to balance right and wrong. If we are attempting to graduate accountants that behave in an ethical fashion, then we need to raise their level of ethical awareness and critical thinking. To that end, we feel this educational exercise is an interesting way to increase awareness, widen the decision-making umbrella, and dissect components of the operations for a complete understanding of their impact. If we want corporations to perform more ethically, then we need to prepare the employees of the corporations and the auditors examining those corporations to do just that: to evaluate situations with an ethical lens when making and implementing decisions, and to maintain that ethical lens with a mindset of continual review and improvement of the implemented decision for adherence to a higher ethical standard.

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