

Current Issues in Business Ethics – 2022

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Learning Objectives

- Understand the attitudes of other related to ethics
- Understand laws, rules and regulations which apply to CPAs
- Understand consequences of violating the laws, rules and regulations
- Understand and learn from current ethical violations

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Ethical Attitudes

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Gallup Poll (Dec 2021) – rate honesty and ethical standards “high” or “very high”

- | | |
|--|-----------------------|
| • Advertising practitioners vs. Auto mechanics vs. Bankers | • Auto mechanics |
| • Business executives vs. Car salespeople vs. Clergy | • Clergy |
| • Day care providers vs. Grade-school teachers vs. Judges | • Teachers |
| • Lawyers vs. Lobbyists vs. Local officeholders | • Local officeholders |
| • Medical doctors vs. Members of Congress vs. Military officers | • Medical doctors |
| • Newspaper reporters vs. Nursing home operators vs. Pharmacists | • Pharmacists |
| • Police officers vs. State officeholders vs. TV reporters | • Police officers |

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Gallup Poll (Dec 2021) – rate honesty and ethical standards “high” or “very high”

Nurses	81	Nursing home operators	27
Medical doctors	67	Local officeholders	22
Grade-school teachers	64	Lawyers	19
Pharmacists	63	Newspaper reporters	17
Military officers	61	Business executives	15
Police officers	53	TV reporters	14
Day care providers	50	State officeholders	12
Judges	38	Advertising practitioners	11
Clergy	36	Members of Congress	9
Auto mechanics	35	Car salespeople	8
Bankers	27	Lobbyists	5

Updates to Previous Cases

Rita Crundwell

- Embezzled over \$50M from Dixon, Illinois, a town of 16,000 people
- Sentenced to nearly 20 years in prison.
- What is the update?
 - Expected to be released in 2029, released in the summer of 2021 due to health reasons



Theranos / Elizabeth Holmes



BAD BLOOD

Secrets and Lies
in a Silicon
Valley Startup

John Carreyrou

Charges

- Investors lost over \$700M
- SEC report in March 2018
 - “Massive fraud.” Company claimed it had \$100M in revenues. Actually was \$100,000. Holmes settled - \$500k fine, forfeiture of (worthless) shares, barred from leadership positions with a public company for 10 years
- June 2018 - Charged with wire fraud and conspiracy to commit wire fraud
 - “Investors and doctors and patients were defrauded.”
 - “Defendants were aware of the unreliability and inaccuracy of their products, but concealed that information”
 - Up to 20 years in prison
- Claimed Theranos technology could run 200 blood tests.
 - It could only run 12, and those were not reliable

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Elizabeth Holmes – What is the update?

- Trial to begin was to begin in June 2021, but Holmes gave birth in July
- Trial took 3 months and wrapped up in December of 2021

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Elizabeth Holmes – What is the update?

- Found guilty in January of 2022
 - One count of conspiracy to defraud investors
 - Three counts of wire fraud
- Acquitted on 7 counts (additional wire fraud and defrauding patients)
- Faces up to 20 years in prison for each count
- Scheduled for sentencing in September of 2022

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Carlos Ghosn

- Turned around Nissan and was hailed as a hero
- Arrested in Japan
 - Underreported about \$80 million of deferred compensation
 - Personal use of company assets (big one was \$18 million worth of homes)
 - Assigned to Nissan a loss on a personal swap contract of \$16 million.
 - Paid himself an extra \$8 million
- Facing a 99% conviction rate in Japan
- With the help of two Americans (a father-son duo), fled Japan in a box to his home country of Lebanon
 - Father had a business helping clients escape “complex situations overseas” and charged between \$20,000 to \$2 million per job
- Japan and Lebanon do not have an extradition treaty



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Carlos Ghosn – what is the update?

- Ghosn remains in Lebanon
 - France has now issued an international warrant for his arrest
- Two Americans arrested, extradited to Japan
 - Found guilty, 20-24 months in prison
- Nissan executive Greg Kelly accused of conspiring to hide about \$80M of Ghosn's true compensation over 8 years
 - Due to executive compensation limits in Japan, Kelly was afraid Ghosn would leave Nissan
 - Kelly was examining how to pay Ghosn in retirement as a consultant
 - Sentenced to 6 months (delayed for 3 years), allowed to go home while appealing. Likely won't have to serve time

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Issues raised by COVID-19

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In your opinion, what is the biggest ethical challenge presented by working from home?

- A. Communication / Teamwork
- B. Confidentiality / Privacy
- C. Productivity
- D. Separating work/home lives

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Discussion

- What steps do you take when working from home to:
 - Maintain confidentiality?
 - Stay productive?
 - Communicate with co-workers and keep morale high?
 - Balance work / home lives?

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Case study

- You learn that one of your divisions may be acquired by a competitor
- You fear that some good people may lose their jobs
 - This includes the controller, a good friend, who is unaware of the potential acquisition
- Are there any risks of discussing this potential acquisition with the controller?

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1.700 Confidential Information

- 1.700.001 Confidential Client Information Rule
 - A member in public practice shall not disclose any confidential client information without the specific consent of the client

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2.400.070 Confidential Information Obtained From Employment or Volunteer Activities

- Do not disclose employer's (current or past) confidential information gained from your employment relationship
- Same goes for information obtained about an entity due to your volunteer activities
- Changed jobs?
 - Don't use prior confidential information to competitive advantage
- Be alert to the possibility of inadvertent disclosure
 - Close business associates, close relatives, immediate family members

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CEB – The Transaction

- January 5th headline: “Gartner to Acquire CEB for \$2.6 Billion in Cash and Stock”
- Gartner – “World's leading information technology research and advisory company”
- CEB – “Industry leader in providing best practice and talent management insights”
- Merger announced January 2017, deal closed April 2017

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CEB – The Players

- CAO - Unnamed
- William Wright – Corporate controller of CEB
- Christopher Clark – Wright's brother-in-law and a loan officer
- Christopher Clark's son - Unnamed

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William Wright's role (corporate controller)

- CEB maintained policies and procedures concerning confidential information and insider trading.
- Wright was required to, and did, confirm compliance with these policies on an annual basis
- CAO learns of acquisition, worried he could lose job, tells (his good friend) William Wright
- Wright (controller) tells Clark (friend)

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Clark (friend) went all-in

- Liquidated wife's IRA (less than \$5,000)
- Drew down final \$6,000 on a line of credit
- Maxed out loan value on car
- Along with his son, began buying call options on CEB in December 2016
- At one point, Clark and his son held 100% of certain call options in CEB
- Merger announced on January 5, 2017
 - Stock price jumped 21%
- Options sold over the next month, profits totaled almost \$300,000

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FINRA

- A week after deal closes, FINRA asked for list of people with knowledge of transaction
 - Wright presumably identified
- In March, CEB employees (including Wright) had to review of list provided by FINRA
- Wright acknowledged knowing Clark, but made it sound casual
 - In reality, they socialized a lot...social events, holiday parties, children's basketball practices, texts, and calls

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Maybe not the first time Wright tipped off Clark?

- In the previous 8 years, Clark traded 18 times on earnings announcements
 - “Guessed” correctly 15 of 18 times
- Consequences
 - Wright is prohibited from being an officer of a public company
 - The case against Clark was surprisingly thrown out. No clear evidence against him, only suspicion

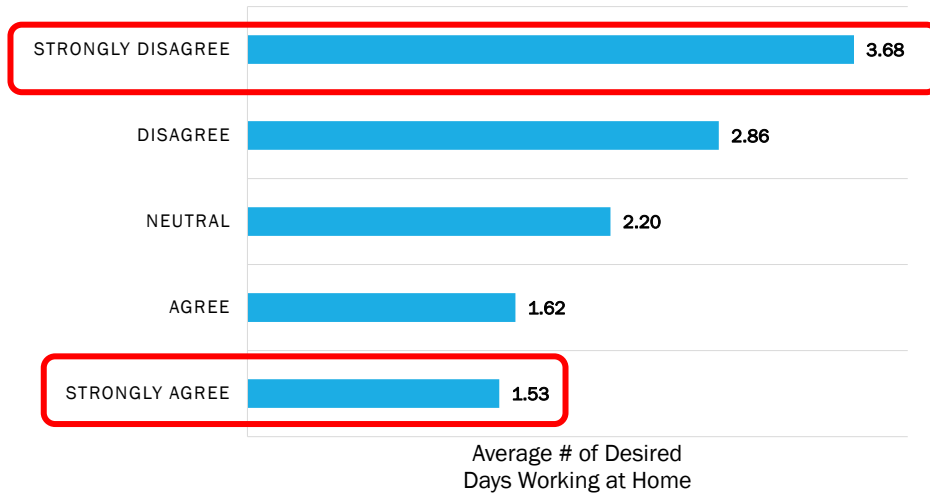
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Work-from-home considerations - Productivity

- Boz’s capstone class research surveys – Feb/March 2021
 - Nearly 1,300 total responses (mainly those with an accounting/finance background)
- People want to work at home almost half of the time
 - More so with females and younger employees
- About $\frac{1}{4}$ of people report they are less productive when working at home, but...
- About the same ratio report they are more productive working at home, but...
- Nearly $\frac{1}{3}$ of people feel that those who report to them are less productive
 - Only 14% feel that those who report to them are more productive
 - But there is good news...

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It Takes Me Longer To Complete A Task At Home



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Work-from-home considerations - Teamwork

- Nearly 1/3 of people feel that working from home has negatively impacted their relationships with coworkers
- About 18% find it difficult to receive guidance from team members
- 62% are communicating with coworkers less (10% are communicating more)

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Work-from-home considerations - Loyalty

- When asked what increases loyalty to their current job/employer
- Compensation was #1 – 58%
- Good bosses/mentors and good colleagues were both just under 51%
- Well above: challenge, engagement, belief in the company's mission, location, and advancement opportunities
- “Working from home has completely killed our company culture. Everything fun and exciting about my job has been taken away.”

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Disclosure Issues

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Case Study

- During the quarter, you learn a client is at risk of breaching debt covenants they provided to its banks. Quarterly financial statements ultimately show that no breach occurred
- You later learn they pulled-in a material amount of revenue from future periods, by encouraging customers to buy services/products much earlier than normal. As services were performed and products delivered, your client feels that they properly recognized revenue, and you tend to agree.
- Do you have any other concerns?

RETAIL

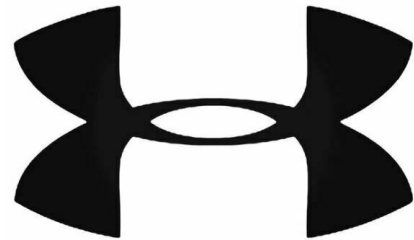
Under Armour faces federal investigation over its accounting practices

PUBLISHED SUN, NOV 3 2019•5:27 PM EST | UPDATED MON, NOV 4 2019•8:25 AM EST

- “The company began responding in July 2017 to requests for documents and information relating primarily to its accounting practices and related disclosures,” Under Armour said in the statement.
- “The company firmly believes that its accounting practices and disclosures were appropriate.”
- Stock drops 18% in one day

Under Armour

- Things were great!
- For 26 straight quarters from 2010 to 2016, Under Armour reported year over year revenue growth of more than 20%.
- But then demand weakened. Options?
 - A. Do your best but report lower results
 - Stock price will take a hit!
 - B. Advance revenues from future periods



Under Armour

- Is advanced revenue okay?
 - Yes! If substance and legal form exist
 - A company must disclose if materially impact reported results
- For 6 quarters in 2015/2016, advanced revenues from future quarters.
 - Partially to continue the 20% streak, partially to beat analyst revenue estimates
- Provided customers with discounts and extended payment terms if they would take delivery a quarter earlier than expected

Under Armour

- Began in September 2015 (Q3 of 2015) when \$45M of Q4's sales were advanced (4% of total revenue)
- Advances often happen to some extent, so why was this a problem?
 - Directed by top management as a means to bolster eroding core operating results
 - Material and not disclosed
- Why must they be disclosed?
 - Future quarter revenues won't be as strong, unless...
 - A company advances more!
- In Q4, \$99M of revenue was advanced from Q1 of 2016 (8.5%).

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Under Armour

- Discussed internally that weather had a negative effect
- The SEC found that Under Armour downplayed the impact of weather in the earnings call
- In the earnings call, an executive said, "Did [weather] affect our business in the way some thought it would? No, it did not. . . . Our business is more diversified than it has ever been, we do not let weather play a decisive role in dictating our success."

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Motives

- Why does a company do this?
- “Bridge the gap” and hope core operating results quickly improve
- They almost did...
- In 2016 Q1, they only advanced \$17M and in 2016 Q2, they only pulled in \$10M
- But it got worse again in the third quarter - \$65M advanced
- “We just brought a bunch of your goods in early to help out your quarter. . . Now you want more. . . More..More..more..30% [price discount] please.”

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Q4 of 2016

- Executive comments: The customer “isn’t setting [Under Armour product in its stores] until February... Really [the customer] doesn’t want any of that product in December but we are shipping it and they are absolutely taking it from us as a favor. **If we were a privately held company, we would not ship that product to them in December.**”
- Pulled forward \$172M (13% of total sales). Decided not to do any more than that
 - “Been living in this bubble for a while,”
 - “Not healthy”

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The streak is over

- Did not meet analyst estimates and streak of 26 straight quarters of 20% growth was ended.
 - Stock price dropped 23%
- In its fourth quarter 2016 earnings call, a senior Under Armour executive stated: “I want to be clear. Our growth story is intact. Our brand is truly stronger than it’s ever been.”
- But without \$172M of non-core revenue advances, they would not have grown

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Violations / Consequences

- Violation of Item 303(a)(3)(ii) of Regulation S-K
- Requires that reports describe, among other things:
 - “any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations” in its annual report on Form 10-K
- Fined \$9M

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Lessons Learned?

- Create realistic expectations
- Create a culture of transparency
- Communicate issues timely
- Avoid “borrowing” from the future

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Current Ethical Violations – Bribery of Public Officials

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Case Study

- A business owner is seeking a building permit from a city
- An employee of the city who approves permits also owns a side business venture
- The business owner may do some purchasing from this side business venture
- Would this violate any laws or standards?

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Conflicts of Interest - Three steps as prescribed by the AICPA's Code of Conduct:

- Identify a conflict of interest
- Evaluate a conflict of interest
 - Significance of threat/safeguards. If not at acceptable level, must apply more safeguards
 - Restructuring or segregating certain responsibilities and duties
 - Obtaining appropriate oversight
 - Withdrawing from the decision making process related to the matter giving rise to the conflict of interest
 - Consulting with third parties, such as a professional body, legal counsel, or another professional accountant
 - If can't get to acceptable level, decline services or withdraw from the relationship
- Disclose a conflict of interest (if at acceptable level)
 - To relevant parties – threat and safeguards
 - Documentation

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Dwaine Caraway

- Former Mayor / City Council member of Dallas
- Accepted \$450,000 worth of bribes in exchange for supporting products produced by a vendor
- In addition to cash, custom-made suits, fully funded trips, casino chips, fake loans, and funeral expenses
- Did not pay taxes on (most) of the bribes
- Sentenced to 4 ½ years in prison

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18 U.S. Code § 201 - Bribery of public officials and witnesses (selected language)

- Whoever directly or indirectly, corruptly gives, offers or promises anything of value to any public official with intent to influence any official act...
- Whoever being a public official directly or indirectly, corruptly demands, seeks, receives, accepts, or agrees to receive or accept anything of value personally or for any other person or entity, in return for being influenced in the performance of any official act...
- Shall be fined under this title or not more than three times the monetary equivalent of the thing of value, whichever is greater, or imprisoned for not more than fifteen years, or both

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Jeffrey Blackwell

- Former City of Philadelphia employee in the Investigations Division of the Office of the City Controller. Received bribes from five people:
 1. Store owner paid Blackwell for permits to park a storage container on the street.
 2. Homeowner paid Blackwell for permits to allow that renovation.
 3. Owner of a construction business paid Blackwell to obtain a plumbing permit.
 4. Owner of an auto body shop paid Blackwell in the hope of getting a license to buy and sell cars, as well as a City contract to install decals on police vehicles.
 5. Permits to renovate a house (person was cooperating with FBI)
- Routed payments through a side contracting business and those making payments that they could get anything then needed “at a price.”

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Jeffrey Blackwell

- Investigated by US attorney (DOJ), FBI, IRS, Philadelphia Office of Inspector General
- Charged with honest services wire fraud, filing a false tax return, and two counts of failure to file a tax return.
- 22 months in prison, three years of supervised release, and ordered to pay \$25,612 in restitution
- FBI: “Public corruption does so much damage to people’s trust in the system, at every level. That’s why the FBI is committed to holding crooked public employees like Blackwell accountable.”

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School District Fraud

Case Study

- You are on the Board of Directors for a school district. It is near the end of the current fiscal year and you are reviewing the initial budget for next fiscal year
- You notice that total expenses for the next fiscal year are expected to grow slightly over the current fiscal year's budget
- What additional questions may you have?

Sweetwater School District

- In June 2017, the fiscal 2018 budget is prepared, including raises of 1% over fiscal 2017's budget
- Problem: Board had recently approved raises of 3.75%
- General fund shows a current projected surplus and a balance of \$22M
- CFO was Karen Michel
 - Worked with Sweetwater Schools since 1996
 - CFO from 2014 – 2018

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Things start to unravel

- September 2017 – financial statements completed for fiscal year ended June 30, 2017. Expenses higher than budgeted, but fiscal 2018 budget not adjusted
- In December 2017, first interim report shows actual expenses much higher than budgeted, but full year budget not adjusted
- In March 2018, second interim report shows actual salary expenses \$12.5M higher than budgeted, but full year budget not adjusted
- Internal auditor: “‘It’s just so bad. Next year is gonna be so bad. It’s gonna be so bad. There’s going to be layoffs.’”

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Bond offering

- March 2018, Using falsified budgets, credit agency issues a bond rating of “A”
- April 2018, \$28M of bonds are issued
- September 2018, CFO Karen Michel retires, new CFO leads preparation of financials which show salaries are nearly \$19M more than budgeted
- October 2018, credit agency decreases bonds to “BBB+ with negative outlook”
 - Too late, as bonds had already been issued
- December 2018, final financials show a negative general fund balance of \$7M
 - Positive \$22M had been expected

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Outcome

- Michel fined \$28,000
 - Prohibited from participating in future security offerings
- SEC findings: “Michel included misleading budget projections which indicated that the district could cover its costs, when in reality the district’s finances were severely strained. Although Michel was aware of information showing that the projections were untenable, she omitted this fact,”
- June 2020 – Superintendent fired
- Audit firm was replaced

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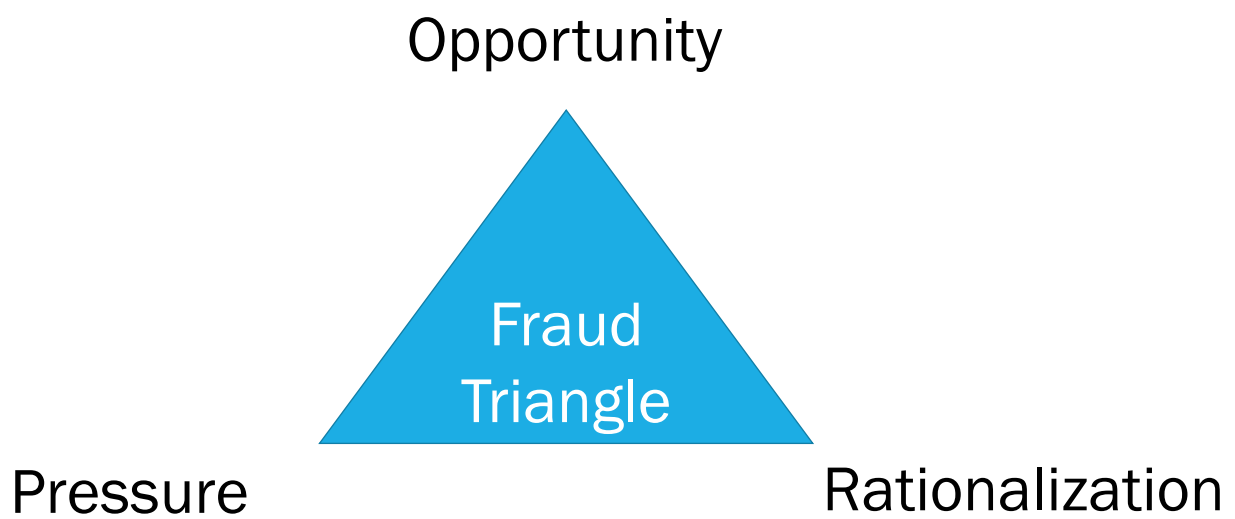
Reducing the risk of Fraud

Discussion

- Why do people commit fraud?

Common Frauds

- Embezzlement
 - Rita Crundwell
- Insider Trading
 - Scott London
- Foreign Bribery
 - Wal-Mart Mexico
- Bribery of Government Officials
 - Ray Nagin
- Falsified Financials Statements
 - Autonomy



Case Study

- Your spouse serves as the President for a small non-profit organization in your local community
- The Treasurer abruptly resigned and community members have encouraged you to take on that role given your financial savvy
- The non-profit does not have an active board of directors
- You indicated you would not be comfortable taking on the role and they asked you what would need to change so that you could do so?

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Embezzlement – The Sharpers

- Anthony Sharper, CPA and his wife Deana Sharper were involved with a Charlotte area high school booster club
 - Anthony was interim President and Treasurer
 - Deana ran the concession stand and school store
- Embezzled over \$200,000 from a Charlotte high school booster club – from 2017-2020
 - Writing checks to themselves
 - Wiring funds to themselves
 - Using club debit/credit cards to pay for personal expenses

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Embezzlement – The Sharpers

- Did not pay tax on embezzled income = two counts of tax fraud!
- How did they cover the theft?
- A fake PPP loan of \$230,000
- Some reimbursed the booster club, some was used personally

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Charges

- Wire fraud
 - Maximum penalty of 20 years in prison and a \$250,000 fine.
- Two counts of making false statements to a financial institution
 - Maximum prison term of 30 years and a \$1 million fine per count
- Making a false statement to SBA
 - Maximum statutory penalty is 30 years in prison and a \$1 million fine
- Two counts of engaging in monetary transactions in criminally derived property
 - Maximum prison term of 10 years and a \$500,000 fine per count
- Two counts of filing a false tax return
 - Maximum penalty of three years in prison and a \$250,000 fine per count.
- Their attorney, “They are very nice people and as the legal process runs its course, everybody will find out more.”

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What do you think? Embezzlement is more common at?

- A. Large companies
- B. Small companies

- HISCOX, a specialty insurance company, found in a 2016 study that 80 percent of embezzlement occurred at small businesses (defined as those with less than 150 employees).

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How could this have been prevented?

- Oversight / separation of duties
- Avoid pressures and opportunities

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Ethical Leadership

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Discussion - Ethical Treatment of Employees

- What are ethical and unethical ways you have seen company leadership treat its employees?
- Watch the attached Simon Sinek video, and make note of some of the most powerful things you hear:
- <https://www.youtube.com/watch?v=ENlwAZZw8J0>

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Takeaways

- “The people who are doing the caring aren’t cared for.”
- “Why aren’t the people who are managing us caring for us?”
- “How many people are coming home fulfilled by the work they do?”
- “We would put ourselves at risk for our companies if we knew that our companies would put themselves at risk for us. But they don’t. So we don’t.”
- Question to consider...How could you better lead those who report to you?

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Key Takeaways

- Understand the relevant rules
- Discuss your decision with others who don’t have a stake in the outcome
 - Assume your decision will be discovered
 - Focus on the long-term
- Document your decision and support for your position
- “Ethics is knowing the difference between what you have the right to do and what is right to do.” – Potter Stewart, former Associate Justice of the U.S. Supreme Court

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Thank you!

- Questions, comments, or to stay in touch with Boz:
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