The Origin of Ethics

For as long as human beings run businesses, consultants will be hired to advise them that the best business decision is to do the ethical thing.

By Tony Powell

Accounting firms and other clients call consultants for any number of reasons, including improving efficiency, staff motivation, staff development, developing accountability, and so on. Consultants are called in with a particular mandate—and besides their stated purpose—they may see other problems that are degrading the performance of the firm. Often overlooked is ethics, which to many clients seems like a softer, less tangible, area that is less amenable to hard numbers.

With CPAs growing their practices with ethical consulting, we examine a simple fact: When faced with the choice of doing the ethical thing or something that is dodgy at best or even downright wrong, doing the ethical thing is the better choice. Whether it is within your own firm or at clients' firms, an ethical firm is far more likely to be well-run, efficient, and profitable. The temptation to cut corners to save money or to boost earnings is a false economy.

The matter is not simply that following ethical standards is the right thing to do (then again, for some people following that axiom is simple) or that the AICPA's peer-review program attempts to ensure that firms maintain quality standards and, hand-in-hand with that, ethical standards. In the real world, the forces that drive a firm to succeed, or for that matter survive, can make it difficult for the employees and partners to take a step back, look at themselves, and remember that ethical standards can improve the bottom line.

We always talk about the tone at the top, but maybe people below the top feel pressure or aren't supported or may not feel like a valued member of the team. This sets the stage for temptation to be too easy, whether it's cutting corners or looking the other way for a client or worse. As for the top, there is always sheer greed or mere human nature at work. In their paper, "Why do corporate managers misstate financial statements?," published in 2007, researchers Jap Efendi, Anup Srivastava, and Edward P. Swanson found that the risk of fraudulent accounting at a firm rises if the CEO holds a large number of stock options that are in the money because his or her firm's equity is overvalued. This risk rises dramatically when the ratio of the CEO's in-the-money-options to his or her salary base goes above 80 percent of comparable firms.

The beginnings

Ron Baker, co-founder of the VeraSage Institute, in Petaluma, Calif., teaches a course in ethics for the California Society of CPAs, along with other states. He is also the author of several books. We spoke with him to get a grounding in the subject.

Q: What are ethics?

A: We spend about four hours of the course on what ethics is. At the end of the day, it's philosophy: How do we define what doing the right thing is?

Q: An auditor might see a client is doing something funky and the client might ask him or her to look the other way. My question is, from a business perspective, in a lot of cases, doing the ethical thing is not merely the right thing to do for some abstract notion of right and wrong, rather, doing the right thing is just better business.

A: Absolutely. One of our favorite definitions of ethics comes from the Josephson Institute, a think tank in southern California. They say, "Ethics is how we meet the challenge of doing the right thing when that will cost more than we want to pay." That's a great definition of ethics. There are all sorts of bumper-sticker definitions of ethics, for example, doing the right thing when nobody is looking. Doing the right thing for the right reason is another. But, doing the right thing when that will cost more than we want to pay—and that doesn't mean just a financial price, it means sometimes losing friends, losing relationships, by taking your stand and doing the right thing. Nowhere does that apply more than for auditors and CPAs. Look at Enron and WorldCom. Here, the firms were not willing to pay the price. They weren't willing to walk away from the clients. I hate to say it, but Arthur Andersen knew Enron was being very aggressive with GAAP.

The prior CEO of Anderson, a man named Leonard Spacek, would have fired Enron. He had no compunction against saying, "Yes, we'll lose $25 million in revenue. We may have to close offices and fire people. But if we lose our reputation, that's going to hurt more."

Doing the right thing in the long run, can only save you. It might cost a short-term pain, you might have to pay a high price, but in the long run it's the only choice that makes sense. To paraphrase Oscar Wilde, "No man is rich enough to buy back his past."

Q: Are there broad changes in society or culture or even some phenomenon of the weakest link, as in, it only takes one misstep for a prestigious firm such as Arthur Andersen to completely go out of existence?

A: Your reputation is your most important asset. It's the only thing that matters. And you don't own it: your reputation is what others say about you, what others think about you, how others perceive you. If you're out there cutting corners, or if you're taking on clients who are walking the line, doing things that may be completely legal but just don't look good when they end up on the front page of the New York Times, that's going to kill you in the long run. It can destroy a firm overnight. Arthur Andersen went down pretty quick. Long before Andersen was indicted, it started losing clients left and right. Its reputation was shot.

Q: When you teach your students or advise clients, what do you say to them about handling dilemmas?

A: In our ethics course, we tell people, if you only remember one thing from this course, remember this: there was a Greek senator by the name of Plenides, who said in about 400 B.C., "To lead a moral and ethical life, you must do more than is required and less than is allowed." That is a great line. What it means is just because something is legal, that doesn't make it ethical. The legality of something is the floor that we all walk on. We need to strive for more than that. Nobody wants their tombstone to say, "Here lies Ron Baker, he abided by all his contracts." As human beings, we should strive for a higher goal.

In our ethics course, we teach people about the various ethical frameworks. There's utilitarianism, in which an act is judged on whether or not it causes the greatest happiness for the greatest number. That's a cost-benefit way of looking at a situation. How many people are you hurting? How many people are you helping? Do the pluses outweigh the minuses?

Then there's the framework provided by Immanuel Kant, who believed in deontology, which is doing the right thing for the right reason. I subscribe more to that school. I think Kant was more right in the area that you should do your duty and you should do the right thing for the right reason. The ends don't justify the means. We should behave the way we want others to behave toward us, the Golden Rule. It's also a matter of when we make a decision, considering whether we would want *everybody* else to make the same decision if they were in our shoes. Whatever decision I make with this ethical conundrum, would I want it to be universal? Would I want everybody to do it? I think that's a good framework. Kant had something called the "categorical imperatives," which comprised three questions he wanted people to consider before making a decision to help them come to the right conclusion.

There is also the mirror test, or the New York Times test: Can you live with yourself if you make this decision? Would you be proud to tell your mother or your son about it? Can you look at yourself in the mirror? Can you go to sleep at night with a clear conscience knowing you did what you did? If CPAs are cutting corners for their clients and knowing that it isn't, say, violating the law but violates the spirit of the law, I argue that it's not worth it. If it's against your whole reputation and ends up all over the front page of the local paper, your firm is going to be destroyed.

Q: There are people in this world who are unethical, unconscionable, who will do something unethical and not think twice. But what about people, pressured by circumstances, perhaps economic hardship, or possibly influenced by the tone at the top, what process do they go through? When they get to the brink, what makes them decide to either not cross the line or cross it?

A: The difference between right and wrong is usually not the problem. Most people, CPAs, most professionals, most human beings, know right from wrong. Even people in prison have enough sense to know right from wrong. The real dilemmas in ethics are right versus less right. It's the gray areas where we're not exactly sure which is the right decision to make. One of the things that behavioral economists study is the question of "Why do people cheat?" It's a very interesting question.

Q: Why do people cheat?

A: There is social pressure. In a company or on a college campus, if we know our peers are cheating, we are more likely to cheat. If something is one step removed from money, we are more likely to cheat. Think of the difference between, say, taking a quarter out of your employer's petty cash versus taking a pencil home. Most people would have no problem taking a pencil that costs twenty-five cents, but they might feel squeamish about taking a quarter. There's no real difference except that the pencil is one step removed from the cash; so, it seems okay. You've probably seen where, if people are given too much change in store, a lot of people will give it back, but if the cashier fails to ring something up, say, a turkey or ham, people are less likely to go back and tell them about it—because it's one step removed from cash.

A place where this can play out is in the financial markets, where there are options and derivatives, which are one step removed from cash; so, people are more likely to cheat in that scenario. The same thing happens with time sheets in firms. Professionals may lie because time sheets are so far removed from billing clients.

Interestingly enough, if people are reminded of the Ten Commandments or asked to recall the Ten Commandments, they are less likely to cheat. This is why universities and some employers have their people sign an honor code. When people sign such a code, they want to act consistent with it. So, there is social pressure.

Lockheed performed a study after it got nailed for bribing foreign government officials for defense contracts back in the 1970s. This episode led to the Foreign Corrupt Practices Act (FCPA) of 1977. Lockheed wanted to know what made really smart people, such as, literally, rocket scientists, cheat. What makes them do the wrong thing?

Lockheed came up with four criteria. One was that people think it's in the best interest of the organization. They think it's an acceptable business practice. They think if they don't do it, their competitors will do it. And usually there's a constraint on resources. That's another reason people

About Ronald J. Baker

Co-founder of the VeraSage Institute, Ronald J. Baker started his career in 1984 with KPMG's Private Business Advisory Services in San Francisco. Today, he is the founder of VeraSage Institute, the leading think tank dedicated to improving the profession for posterity.

As a frequent speaker, writer, and educator, his work takes him around the world. He has been an instructor with the California CPA Education Foundation since 1995 and has authored 15 courses for them.

He is the author of the best-selling marketing book written specifically for the professions, PROFESSIONAL'S GUIDE TO VALUE PRICING, Sixth Edition, published by CCH (out of print). His book, THE FIRM OF THE FUTURE: A GUIDE FOR ACCOUNTANTS, LAWYERS, AND OTHER PROFESSIONAL SERVICES, co-authored with Paul Dunn, was published in April 2003 by John Wiley & Sons, Inc., and was the 2003 Book of the Year on SmartPros.com and is in its sixth printing. His Intellectual Capitalism Series (John Wiley & Sons, Inc.) consists of three books so far: PRICING ON PURPOSE: CREATING AND CAPTURING VALUE, published in February 2006; MEASURE WHAT MATTERS TO CUSTOMERS: USING KEY PREDICTIVE INDICATORS, released September 20, 2006; MIND OVER MATTER: WHY INTELLECTUAL CAPITAL IS THE CHIEF SOURCE OF WEALTH, published in November 2007; and his latest book published in December 2010, IMPLEMENTING VALUE PRICING: A RADICAL BUSINESS MODEL FOR PROFESSIONAL FIRMS.

Ron has toured the world, spreading his Value Pricing message to over 100,000 professionals. He has been appointed to the American Institute of Certified Public Accountant's Group of One Hundred, a think tank of leaders to address the future of the profession, named on Accounting Today's 2001, 2002, 2003, 2004, 2005, 2006, 2007, and 2011 Top 100 Most Influential People in the profession, and received the 2003 Award for Instructor Excellence from the California CPA Education Foundation.

He graduated in 1984 from San Francisco State University with a Bachelor of Science in accounting and a minor in economics. He is a graduate of Disney University, Cato University, and the University of Chicago Graduate School of Business course: *Pricing: Strategy and Tactics*. He is a member of the Professional Pricing Society and presently resides in Petaluma, California.

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cheat, they feel constrained by the institution itself—and they do believe what they're doing is in the institution's best interests.

There's no such thing as business ethics

Q: Are there different kinds of ethics?

A: It bears commenting that on cable news these days you'll see, say, a "medical ethicist" talking about life issues or cloning or whatever. Or you might see a "business ethicist" talking about business ethics. We tend to categorize things and say there are medical ethics, accounting ethics, or legal ethics. Well, there aren't. There are only ethics. They're no such thing as business ethics. Ethics is about how human beings make decisions no matter what type of environment they are in. Whether they are in a hospital, in a not-for-profit organization, in government, in a school or church, or in a business, ethics is ethics. It's all about human behavior. When we start categorizing things, "Oh, that's business ethics" or "That's accounting ethics," that's a dangerous road to go down, because ethics applies across the board.

In an article titled, "What Is 'Business Ethics'?," that he published in The Public Interest in 1981, Peter Drucker says, "If 'business ethics' continues to be 'casuistry,'"—meaning we have to define ethics by specific examples—"then it's speedy demise in a cloud of ill-repute can be confidently predicted." In other words, let's stop this nonsense of medical ethics, business ethics, accounting ethics, because it's ridiculous. It gives people permission to do the wrong thing.

In our course on what ethics is, we look at virtue ethics, like the Greeks taught, meaning we have virtues and vices that make up our character, and character is destiny. The frameworks we teach about are helpful to firm leaders and individuals in making the right decision and doing the right thing for the right reason. I think the big thing is the Plenides quotation, "Do more than is required and less than is allowed." If we lived our lives based on that premise, that would be really good. And ethics is about doing the right thing when that will cost more than you're willing to pay. ✦