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It's Time for Principles-Based Accounting Ethics

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Abstract The American Institute of certified public accountants (AICPA) has promulgated a *Code of Professional Conduct*, which has served as the primary ethical standard for public accountants in the United States for more than 20 years. It is now out of date and needs to be replaced with a code of ethics. Just as U.S. generally accepted accounting principles are being migrated toward "principles-based accounting" as part of a convergence with international financial reporting standards, a similar process needs to occur with ethics. This article organizes the primary rules of the AICPA Code around five essential virtues: objectivity, integrity, inquisitiveness, loyalty, and trustworthiness. These virtues correspond to the general principles set forth in the *Code of Ethics for Professional Accountants* of the International Federation of Accountants (IFAC). From this virtue ethics perspective, various rules of the AICPA Code are critiqued as being inadequate at best, and poorly crafted at worst. The article concludes with the proposition that principles-based ethics serves the profession and the financial reporting process better than the current rules-based approach.

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Introduction

The accounting profession in the United States and around the world is in the process of harmonizing its financial reporting standards (Benston et al. 2006). This process involves two initiatives. First, the accounting standards within various jurisdictions, such as the generally accepted accounting principles (GAAP) used in the United States, are being converged into international financial reporting standards (IFRS). IFRS are also known as International GAAP (iGAAP). Second, as part of this process, countries whose financial standards have generally been understood to have been "rules based" are re-working those standards so that they are more "principles based". The United States is generally recognized as a jurisdiction within which accounting standards are mostly rules based (Bennett et al. 2006).

This harmonization of local financial reporting standards is being coordinated under the auspices of the International Accounting Standards Board (IASB). The IASB is currently closely working with the U.S. Financial Accounting Standards Board (FASB) in an effort to achieve complete harmonization of U.S. GAAP and iGAAP within the next few years. This allows corporations and other entities to use the same reporting standards that are used elsewhere, and will make it easier for investors to compare the financial performance of publicly traded corporations around the globe.

Before this harmonization process, U.S. GAAP has emphasized, and relied on, rules-based standards (Nobes 2005). In part, this has been in response to the demand of corporate managers and their auditors, who have sought clear and precise guidance for the reporting of transactions.

This has had the advantage of providing clarity to accounting professionals, as well as a precise standard of care that has served in the defense of accountants and managers when they have been sued by plaintiffs charging them with accounting negligence.

Detailed accounting protocols have not served the profession or its stakeholders well in the long run. Corporate managers have honed their skills at finding and using loopholes and technical exceptions to complex rules, so they have been able to finesse the rules and augment their financial results. The result has been financial statements that comply with the technical rules of GAAP, but do not provide a fair representation of the corporation or other economic entity. This, in turn, has served to camouflage problems at reporting entities, until those problems become so large that the entity itself is swallowed up by them.

And so the drive toward principles-based accounting standards, as part of the convergence of U.S. GAAP and iGAAP is, in part, an effort to improve financial reporting in the United States and elsewhere. Principles-based accounting is intended to allow reporting standards to be more closely aligned with the objectives of financial reporting, such as relevance and usefulness. They are intended to be based on a carefully crafted and consistently applied conceptual framework that minimizes exceptions and avoids loopholes. An appropriate amount of implementation guidance is necessary and expected, within the principles-based approach, but a balance is sought between generalized and abstract concepts, on one hand, and very specific, almost mechanical, rules, on the other (Benston et al. 2006).

Along with the movement from rules-based accounting standards to principles-based accounting standards, there is an opportunity for the accounting profession in the United States to improve its ethical standards. In fact, the AICPA has committed to conforming its *Code of Professional Conduct* to an international *Code of Ethics for Professional Accountants*, but has yet to complete that project (AICPA 2008a). Just as academic research has served to enliven and assist the discourse among accountants and their constituents in the area of convergence of financial reporting standards (Fülbier et al. 2009), we offer some suggestions to enhance the ethical standards of the accounting profession.

The AICPA's Code of Professional Conduct

The AICPA is the national professional organization of certified public accountants in the United States. Its code of conduct serves as the ethical standard for purposes of self-regulation within the profession. The AICPA code consists of a set of principles and a set of rules (AICPA 2008a). Each will be discussed briefly in the following. It should be noted, however, that the bylaws of the AICPA require that members adhere to the rules, but not the principles.

Principles

The principles section sets forth the objectives of the code in somewhat lofty, if not compulsory, language. It is suggested, for example, that accountants should "exercise sensitive professional and moral judgments in all their activities," and should seek to "continually demonstrate their dedication to professional excellence." Service to the public trust "should not be subordinated to personal gain an advantage," and members should "maintain objectivity and avoid conflicts of interest." Other ideals, such as competence, cooperation with other members of the profession, and self-governance, are also commended. Although some of the text of the principles section includes language that seems to be mandatory and authoritative, such as the assertion that integrity requires AICPA members to be honest and candid within the constraints of confidentiality, the principles themselves are nonbinding.

Rules

There are eleven rules of the AICPA code, and most of the rules are supported by interpretations. The AICPA also provides short hypothetical ethics rulings that serve to provide additional interpretation. Some of the rules are relatively brief, and can only be understood by reference to the AICPA interpretations. Rule 101—Independence simply requires that accountants maintain independence from their clients when performing such attestation services as audits or reviews. The AICPA interpretation 101-1, however, is a complex and lengthy document that details such relationships as immediate family and close relatives (for example, grandparents are and domestic partners are included, but aunts, uncles, cousins, and in-laws are not). It prescribes those circumstances in which an accountant may own or hold one share of stock in the firm's attestation client, and when he or she may not. Rule 101 is further bolstered by a separate "conceptual framework" document that prescribes procedures for gauging independence in situations where the interpretation provides insufficient guidance.

Rule 501—Acts Discreditable is another very short rule backed up by various interpretations and rulings. The rule simply requires that AICPA members not commit an act "discreditable to the profession." The term "discreditable" is not defined, but the interpretations of Rule 501 provide examples of such acts. For example, interpretation of 501-1 is a lengthy set of instructions pertaining to how accountants ought to respond requests by clients and former clients for records. The interpretation provides, among other things, that client records prepared by an accountant should

be provided to the client, unless there are fees due to the accountant. Unfortunately, some accountants have from time to time been tempted to increase their final fees charged to a departing client, and then hold the client's records ransom. For all its detail, the interpretation 501-1 encourages, rather than discourages, this type of "discreditable" behavior.

Other rules are poorly drafted. Rule 102—Integrity and Objectivity, for example, mandates that AICPA members "shall be free of conflicts of interest." In fact, accountants face conflicts of interests nearly every day of their working lives, and are required to navigate those conflicts in a way that optimizes their professionalism. Unfortunately, the AICPA code does not provide insight or guidance in regard to this necessity. Similarly, the same rule prohibits members from subordinating their judgment to others (except, presumably, the requirements of the AICPA and other authoritative bodies affecting the work of the accountant).

The idea of honesty is also clumsily addressed. Rule 102 establishes a very low ethical watermark by requiring that AICPA members "not knowingly misrepresent facts." Of course, dishonesty and deceit is not limited to outright lies. On its face, this rule leaves open the possibility of misleading others by omission, deliberate vagueness, circumlocution, or purposeful efforts to confuse without outright misrepresentation. Oddly, Rule 502—Advertising sets a higher standard than does Rule 102. There, accountants are prohibited from advertising "in a manner that is false, misleading, or deceptive." As written, the code holds accountants to a stricter standard of honesty in their advertisements than in their work and other communications.

The AICPA code has come under other criticism as well. Neill et al. (2005), for example, suggested that the enforcement of the code was ineffective because it was largely dependent on grievances filed by clients, former clients, and other accountants. As a result, no comprehensive system is in place to assess whether members are acting in compliance with the code. The lack of compliance assessment by the AICPA (or third parties) not only weakens the effectiveness of the code in transforming the professional behavior of accountants but also deprives the public from access to data regarding whether AICPA members are complying with the code.

These criticisms remain relevant today. Through its enforcement process, the AICPA investigates members who are accused of violating the code and imposes sanctions as it deems appropriate. Sanctions range from the assignment of required ethics education, to a temporary suspension of membership, to a termination of membership. If, for example, a member has been disciplined by a governmental agency or other organization that has oversight authority (such as the Securities and Exchange Commission, or the Public Company Accounting Oversight Board), the AICPA routinely takes action to sanction that member by requiring ethics education or by suspending membership. If a complaint is filed against the member by a client, another accountant, or third party, the AICPA joint ethics enforcement panel and joint trial board will conduct an investigation to determine whether similar sanctions should apply.

As Neill et al. (2005) observed, the AICPA maintains a peer review process whereby accounting firms visit each other and assess the quality of each other's work. However, the subject matter of this review process is limited to quality control concerns in regard to compliance with technical accounting standards. Ethical problems, and its risks of potential ethics violations, are not explicitly addressed.

The IFAC Code of Ethics for Professional Accountants

The International Federation of Accountants (IFAC) includes 157 accounting organizations from 123 countries and jurisdictions worldwide. IFAC develops and promotes high-quality international accounting standards and facilitates collaboration and cooperation among its member bodies.

The IFAC maintains an International Ethics Standards Board for Accountants (IESBA) as an independent standard-setting board. The IESBA has recently established a *Code of Ethics for Professional Accountants* (IESBA 2009). The IESBA develops ethical standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IESBA, and the IESBA Consultative Advisory Group, which provides public interest input into the development of the code. Some jurisdictions may have requirements and guidance that differ from those contained in the IFAC code. Professional accountants in those jurisdictions are required to comply with the more stringent requirements and guidance unless prohibited by law or regulation.

The code contains three parts. Part A establishes fundamental principles of ethics for professional accountants and provides a conceptual framework that professional accountants shall apply to:

- Identify threats to compliance with the fundamental principles
- Evaluate the significance of the threats
- Apply safeguards to eliminate or reduce threats

Safeguards are necessary when the professional accountant determines that the threats are not at a level at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, that compliance with the fundamental principles is not compromised.

Parts B and C of the code describe how the conceptual framework applies in certain situations. They provide examples of safeguards that may be appropriate to address threats to compliance with the fundamental principles. They also describe situations where safeguards are not available to address the threats, and consequently, the circumstance or relationship creating the threats should be avoided. Part B applies to professional accountants in public practice. Part C applies to professional accountants in business. Professional accountants in public practice may also find Part C relevant to their particular circumstances.

The IFAC code establishes ethical requirements for professional accountants and provides a conceptual framework for all professional accountants to ensure compliance with five fundamental principles of professional ethics. Under the IFAC framework, all professional accountants are required to identify threats to these fundamental principles and, if there are threats, apply safeguards to ensure that the principles are not compromised. A member body of IFAC, such as the AICPA, may not apply less stringent standards than those stated in the IFAC code.

Fundamental Principles

The IFAC code requires that a professional accountant shall comply with the following fundamental principles:

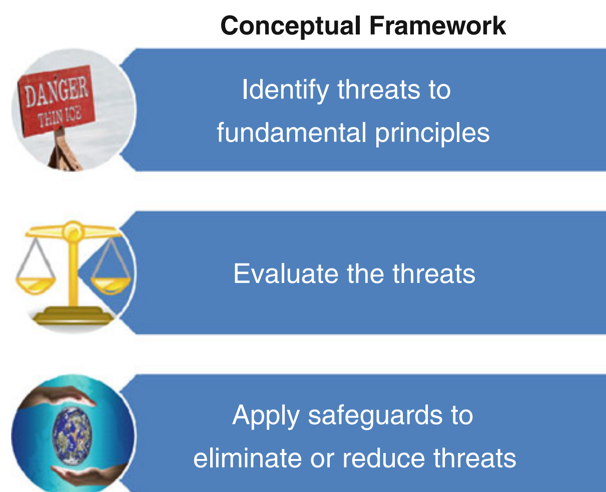
Integrity	To be straightforward and honest in all professional and business relationships.
Objectivity	To not allow bias, conflict of interest, or undue influence of others to override professional or business judgments.
Professional competence and due care	To maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation, and techniques and act diligently and in accordance with applicable technical and professional standards.
Confidentiality	To respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the professional accountant or third parties.
Professional behavior	To comply with relevant laws and regulations and avoid any action that discredits the profession.

Conceptual Framework Approach

The IFAC code establishes a conceptual framework that requires a professional accountant to identify, evaluate, and address threats to compliance with the fundamental principles. The conceptual framework approach assists professional accountants in complying with the ethical requirements of the code and meeting their responsibility to act in the public interest. It accommodates many variations in circumstances that create threats to compliance with the fundamental principles and can deter a professional accountant from concluding that a situation is permitted if it is not specifically prohibited.

When a professional accountant identifies threats to compliance with the fundamental principles and, based on an evaluation of those threats, determines that they are not at an acceptable level, the professional accountant shall determine whether appropriate safeguards are available and can be applied to eliminate the threats or reduce them to an acceptable level. In making that determination, the professional accountant shall exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at the time, would be likely to conclude that the threats would be eliminated or reduced to an acceptable level by the application of the safeguards, such that compliance with the fundamental principles is not compromised.

A professional accountant shall evaluate any threats to compliance with the fundamental principles when the professional accountant knows, or could reasonably be expected to know, of circumstances or relationships that may compromise compliance with the fundamental principles. The following illustration outlines the conceptual framework approach.



Revised Code

The IESBA has issued a revised *Code of Ethics for Professional Accountants*, clarifying the requirements for all professional accountants and significantly strengthening the independence requirements of auditors. The revised code has been released following the consideration and approval by the public interest oversight board (PIOB) of due process and extensive public interest consultation. The revised code, which is effective on January 1, 2011, includes the following changes to strengthen independence requirements:

- Extending the independence requirements for audits of listed entities to all public interest entities
- Requiring a cooling off period before certain members of the firm can join public interest audit clients in certain specified positions
- Extending partner rotation requirements to all key audit partners
- Strengthening some of the provisions related to the provision of nonassurance services to audit clients
- Requiring a pre- or post-issuance review if total fees from a public interest audit client exceed 15% of the total fees of the firm for two consecutive years
- Prohibiting key audit partners from being evaluated on or compensated for selling nonassurance services to their audit clients

The revised code maintains the principles-based approach supplemented by detailed requirements where necessary, resulting in a code that is robust but also sufficiently flexible to address the wide-ranging circumstances encountered by professional accountants. The International Federation of accountants' statements of membership obligations have as a central objective the convergence of a country's national code with the *Code of Ethics for Professional Accountants.* Furthermore, the requirements specify that member bodies should not apply less stringent standards than those stated in the code.

Virtues as Ethical Principles

Both the AICPA and IFAC codes contain ethical standards, but the content of the latter is more principles based than that of the former. In regard to honesty, for example, Rule 102 of the AICPA code prohibits intentional misrepresentation. This rule begs the interpretation of the extent to which actions are "willful," and the extent to which actions constitute "misrepresentation." The emphasis is on the element of wrongdoing associated with behavior of the accountant. To determine whether an accountant has violated Rule 102, it becomes necessary to examine whether a specific statement made by the accountant constitutes a willful misrepresentation.

Section 110 of the IFAC code, by comparison, brings more focus to the character of the professional accountant as a person. Honesty is associated with "straightforwardness." Accountants are prohibited from being associated with reports, returns, communications, or other information that contains statements or information furnished recklessly, or omits or obscures information in a way that would be misleading. In other words, the emphasis is on the accountant's responsibility for the overall quality of his or her work.

Each of these two codes also provides a different approach to conflicts of interest. Rule 102 of the AICPA code states that accountants shall be free of conflicts of interest when rendering professional services. To make any practical application of this part of Rule 102, the definition of "conflict of interest" must be so circumscribed and limited that it does not take into account the complexity of commerce in the twenty-first century (or the even greater complexity of the accounting discipline within a globalized society). Some readers of the AICPA code, who are mindful of the fact that auditors are usually compensated by their own audit clients, may reasonably conclude that the profession's notion of conflict of interest is driven by its own myopic manner of defining its code language.

The IFAC offers no pretense about the fact that accountants are then faced by a myriad of real or potential conflicts of interest in many circumstances. The IFAC code does not prohibit the existence of conflicts of interest or undue influence. Instead, it requires that accountants not allow conflicts of interest, undue influence of others, or even their own personal bias to override professional or business judgments. This is a more realistic standard that speaks to the professional accountant as a person, and challenges the accountant to rise above the realities of such conflicts.

Among the differences between the AICPA code and the IFAC code is a greater emphasis, within the latter, on those qualities and behavior patterns that characterize the "ethical accountant." Such virtues as honesty and integrity are described in greater detail, and held out as the ideal ethical standards to which accountants ought to aspire. The IFAC code tends to point toward the highest levels of excellence and professionalism, rather than to simply delineate minimally acceptable ethical standards.

This emphasis on personal character is consistent with the "virtue theory" approach to business and professional ethics that has gained greater currency in recent years. As Whetstone (2001) notes, moral philosophizing during the last half century or so has tended to focus either on act-oriented theories (such as the consequentialism of Bentham's utilitarianism and the deontology of Kant's rational

ethics) or on virtue-oriented theories. When applied, the former focuses on normative rules, whereas the latter tends to result in the articulation of ethically optimal habits and characteristics. Whetstone suggests that both are important, but that principles-based ethics (PBE) has the advantage of emphasizing the promotion of virtuous judgment.

Dawson and Bartholomew (2003) expand on Whetstone's approach by suggesting that an important role of business ethics generally, and codes of conduct in particular, is the promotion of those virtues that, in turn, foster human flourishing. Bertland (2009) offers an additional insight by taking into account the extent to which the advocacy of virtues, and virtuous judgment, can not only promote human flourishing in general but can also enhance the use of human capabilities in particular. Indeed, some have argued that it is the cultivation of character or virtue that is a precondition to any reasonable expectation that rules would be respected and understood as minimum standards of behavior (Arjoon 2000). That is, in part, because virtue ethics emphasizes both behavior and motives, rather than behavior in isolation from motives (Blackburn and McGhee 2004).

Here, we consider the implications of this emphasis on virtue-oriented PBE on the professional ethics of accountants. We draw from traditional concepts of Aristotelian virtue theory. As Graafland (2010) explains, virtues, under this classical view, are habits of character that constitute a "golden mean" between the vices of deficiency, on one hand, and excess on the other. For example, the Aristotelian virtue of courage represents an optimal balance between its deficiency (cowardice) and its excess (recklessness, boorishness, or overconfidence). The proper roles of ethical epistemology and the development of ethical protocols (such as codes of conduct and codes of ethics) are to enhance such virtues and move them to higher levels of excellence and prudence. The intellectual project of virtue ethics is the identification of the most desirable virtues, as well as the development of disciplines and habits that will foster such virtues. The *bell curve* in Fig. 1 depicts the optimization of virtues and the *block arrow* represents the development of skills and disciplines that foster such virtues.

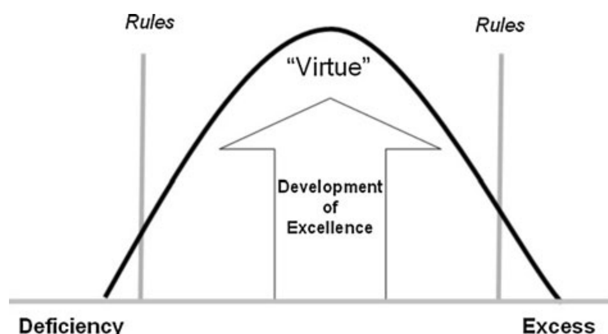


Fig. 1 Virtue as the development of excellence

Ethical rules, by comparison, tend to delineate the vices. To the extent that codes of conduct establish the boundaries between acceptable and unacceptable behavior, they emphasize the negative. That is, they emphasize the crossover point at which behavior becomes impermissible. The intellectual project of rule making is the identification and justification of such crossover points.

Figure 1 depicts this tension and interaction between rules and virtues. The *vertical lines* represent the rules, or boundaries, beyond which an accountant's actions are ethically unacceptable. They are the outer limits of allowable behavior. Virtues are those habits and characteristics that result in actions at or near the midpoint between the two extremes. Virtues are enhanced, or made more excellent, by disciplines such as ethical "best practices" that foster ethical habits. Codes of conduct can focus on the rules that delineate acceptable behavior, or they can emphasize the cultivation of virtues.

Five Cardinal Virtues of Professional Accountants

If both the AICPA and the IFAC codes are examined through the lens of virtue ethics, five "cardinal virtues" for professional accountants seem to emerge. These are integrity, objectivity, diligence, loyalty, and professional behavior. All five of these virtues are addressed in the "Principles of Professional Conduct" that comprise the preamble to the rules of the AICPA code of conduct. As noted above, this preamble is not employed or enforced as part of any disciplinary self-regulation by the AICPA. These five virtues are reflected to some extent in the rules themselves, but only in terms of minimum standards. They are more clearly articulated in the IFAC code, which is generally organized around them.

Integrity

As used within the context of the accounting profession, the concept of integrity has two elements: honesty and courage. Accountants are communicators: They communicate information derived from data with which they work. For this reason, accountants must be truth tellers first and foremost. This requires not only competence in truth seeking but also courage in the telling of truth. One of the greatest temptations faced by accountants, or any other communicators of information, is the temptation to discount, exaggerate, or otherwise mold the communication process so as to please (or, at least, to avoid displeasing) the receiver of the information.

As described earlier, the critical element of truth telling is poorly articulated in Rule 102 of the AICPA code. To establish a standard of honesty that is limited to the

avoidance of willful misrepresentation is to overlook the critical role that honesty plays within the accounting discipline. To be fair, some of the AICPA's interpretations of Rule 102, and some other pronouncements by the AICPA, expand the notion of honesty beyond this minimal threshold, but the rule itself is largely unhelpful as a standard that encourages optimal honesty by accountants. As also described above, the IFAC code, like the preamble to the AICPA rules of conduct, does a better job of articulating what it means for an accountant to strive for optimal, if not absolute, truth telling in his or her professional work.

As a virtue, integrity in the telling of truth requires a balance. Often, the vice of dishonesty results in misleading, if not false, financial information. But there can be too much information disclosed by an accountant. For example, the duty of confidentiality in regard to trade secrets and other information properly owned and protected by an employer or client must not be disclosed. For the professional accountant, the finding of a proper balance between transparency and improper disclosure requires a certain amount of skill and wisdom.

Objectivity

To be objective is to acknowledge that there is an external standard by which one measures his or her work or communication. Within the accounting discipline itself, for example, the objective standard for financial reporting is a "fair representation" of the economic activities of a particular business or other organization. Accounting standards serve as the objective principles by which the quality, reliability, and usefulness of financial reports are measured. Compliance with such standards is not only a technical issue but also an ethical issue: Accountants who attest that their work comply with such standards are making a claim that has both technical and ethical content. The ethical content is the assurance that their work is consistent with those standards, at least to the best knowledge and belief of the accountant.

The AICPA code does not define objectivity per se, but it requires that conflicts of interest be avoided, and that the judgment of accountants is not subordinated to others. Presumably, this latter requirement means that judgment is not subordinated to others, except to comply with such external standards as GAAP and IFRS. This is separately addressed in Rule 202—Compliance with Standards, and Rule 203—Accounting Principles of the AICPA code. Similarly, Sect. 120 of the IFAC code avoids any definition of objectivity, but acknowledges that the principle of objectivity imposes an obligation on all professional accountants not to compromise their professional or business judgment because of bias, conflict of interest, or the undue influence of others.

Professional judgment allows, and sometimes requires, an accountant to supplement, modify, or even deviate from, financial accounting standards, in appropriate circumstances. These departures from established standards must be disclosed in the interest of transparency, but the fact that such departures can occur shows that objectivity in accounting means more than mere compliance with accounting standards. It demonstrates that financial accounting strives to meet an ideal that is largely but not entirely articulated within the standards. By striving to find an optimal balance between noncompliance with standards and legalistic over-compliance with standards, the accountant is exhibiting true objectivity.

Diligence

In accounting, diligence is expressed mostly by the virtue of truth seeking. Accountants cannot be effective truth tellers unless they are truth seekers. This requires an intention as well as the skills to implement the intention. Mere curiosity will not suffice, nor will mere data gathering without an alert and informed focus on the purpose of the data gathering. Accountants must be aware of, and must be ready to identify, sort, prioritize, and address, red flags that signal potential weaknesses, fraud, or other problems within an accounting information system.

In the AICPA code, diligence is addressed in Rule 201—General Standards, wherein accountants are required to ensure that their work reflects professional competence, due professional care, planning and supervision, and the gathering of sufficient relevant data. Section 130 of the IFAC code, similarly, details the concepts of professional competence and due care by emphasizing such qualities as professional knowledge and skill, sound judgment, thoroughness, timeliness, carefulness, and transparency in the performance of accounting services.

Prudence in the area of diligence requires that accountants avoid both negligence, on one hand, and obsessive perfectionism, on the other. Accounting is an art, not a science, and it is an art that must be practiced within the confines of the marketplace. For example, there can be no such thing as a "perfect" financial audit, if for no other reason than the reality that the market (that is, the audit client) will not pay for an audit that is guaranteed to uncover every possible defalcation, departure, or deficiency within an accounting system. And so the notion of diligence requires the seeking of an Aristotelian Golden Mean between competency and overkill.

Loyalty

For professional accountants, loyalty involves a balance between faithfulness to an employer or client, on one hand,

and to society on the other. Loyalty to the client or employer most often includes the necessary maintenance of confidentiality of information about that client or employer. Although most legal jurisdictions do not provide for an accountant–client (or accountant–employer) privilege similar to that of physician–patient, lawyer–client, or clergy–parishioner, the premise behind the duty of confidentiality is similar to the reasoning behind these privileges. That is, an accountant must have the complete confidence of his or her employer or client, to promote communication between them. As noted above, the work of the accountant is as much about truth seeking, as truth telling. The truth-seeking function necessitates that barriers be removed in the discourse between the accountant and his or her employer or client. The duty of confidentiality, articulated in a similar manner in both the AICPA and IFAC codes (as well as in statutes and court cases in many jurisdictions), supports this openness of communication between the accountant and his or her employer or client.

In addition to a duty of loyalty to his or her client, the professional accountant owes a larger duty of loyalty to society as a whole. That is because many tasks of professional accountants involve financial statements, tax returns, or the providing of other information that is used by investors, creditors, employers, consumers, government entities, and other stakeholders and elements within society. To some extent, this duty to the public is often met as long as the accountant maintains integrity, objectivity, and diligence. That is, telling the truth is not inherently wrong or unethical, unless that telling discloses confidential information. And so the protection of confidential information, out of loyalty to employer or client, can sometimes be harmful to society. A tax return that fails to disclose taxable income, financial statements that fail to disclose related party transactions, and any number of other circumstances can become the fulcrum in the balancing of the accountant's loyalties. To assist with the balancing of these interests, both the AICPA and the IFAC codes permit the duty of confidentiality to be set aside in some circumstances, such as when an accountant responds to a court subpoena or testifies in open court under oath. The IFAC code, in addition, offers guidance for the accountant to use in deciding whether to disclose confidential information, taking into account the interests of all parties, the type of communication involved, and the extent to which parties to whom the communication is addressed are appropriate recipients.

Professional Behavior

Trustworthiness is a key foundation for any ethical system (Schwartz 2002), and it can be argued that the overriding meta-virtue for accountants is trustworthiness. Each of the four preceding virtues supports the trustworthiness of the accountant, and generally pertains to the accountant's work as such. Accountants who maintain integrity, objectivity, diligence, and a proper notion of loyalty can be, and are, more readily trusted than accountants who do not develop, maintain, and optimize these virtues

For accountants who are engaged in attestation services, such as audits and reviews, the appearance of independence from the client is necessary for the accountant to have the credibility required to render an opinion. An accountant might be honest and loyal and diligent, but if those who might rely on his or her opinion find it difficult to believe in the accountant's honesty, loyalty, objectivity, or diligence, because of the accountant's closeness or relationship with the client, the virtuousness of the accountant will not matter. The accountant's opinion will not carry the weight and impact, even if it is correct and proper.

The AICPA has expended a great deal of time and effort developing rules regarding independence. The AICPA code requires that accountants who work on attestation engagements must be independent in the performance of those services as required by standards promulgated by the AICPA and other authoritative bodies. This simple one-sentence requirement is supported by 15 interpretations composed of more than 18,000 words, and further supported by a "conceptual framework" document that is intended to cover situations not sufficiently or specifically addressed by the interpretations. All of this is in support of the notion that even if an accountant is capable and willing to perform services objectively and with the highest integrity, an impression of a lack of independence, created by too much relational proximity to the client, can sabotage the credibility of the accountant and the attestation engagement. In this regard, the appearance of independence is important, but it is as much impression management as it is ethics. This may help to explain why the IFAC addresses independence for audit and review engagements, and for other assurance engagements, separately from its articulation of fundamental principles of ethics for professional accountants.

This fifth virtue of professional behavior also adds to the preceding four by directly pointing to the overall character of the individual. An accountant may, for example, perform his or her work in a manner that is entirely consistent with these virtues, but may not be considered trustworthy because he or she engages in activities that discredit him or her, and/or the profession. Accountants who do not take care to file their own tax returns, for example, or accountants who make exaggerated claims for the services they are able to offer, may actually perform good work, but nevertheless engender a lack of trust and credibility. The AICPA code addresses this concern by simply prohibiting the committing of any act discreditable to the profession. The term "acts discreditable to the profession" is not defined in the code, but that

Table 1 Five cardinal virtues of professional accountants

	Deficiency	Optimal ethical	Excess
Integrity	Misleading statements	Honesty and transparency	Too much disclosure
Objectivity	Unreliable statements	Fair and reliable representations	Rules-based statements
Diligence	Negligent misrepresentation	Statements based on relevant data	Excess costs
Loyalty	Breach of confidentiality	Useful work product	Too little disclosure
Professional behavior	Untrustworthiness	Credibility	Inflexibility

prohibition, found in Rule 501, is supported by various interpretations that serve as examples of such discreditable acts. Section 150 of the IFAC code takes a similar approach, requiring that professional accountants not bring the profession into disrepute.

Trustworthiness is inevitably determined by others. John may try to assure Sally that he is trustworthy, but at the end of the day only Sally can decide whether John is worthy of her trust. Similarly, an accountant may be a truthful reliable good citizen of high character, but this does not guarantee that the accountant is considered credible or trustworthy by every member of society. For this reason, the virtue of professional behavior does not require that accountants live perfect lives that would somehow meet anyone's standard for professionalism and trustworthiness. It does, however, require that accountants be mindful of their professional reputation, and the credibility of the accounting profession, as they go about their work and their decisions that are likely to reflect on their professionalism.

Table 1 summarizes these five cardinal virtues for professional accountants. Each deficiency and excess represents habits and behaviors that violate the ethical principles of the respective virtues. Most of the deficiencies and excesses violate both the AICPA and the IFAC codes. When an accountant does not avoid the deficiencies or excesses associated with each virtue, the accountant is also at risk for violating the CPA licensure regulations of most states. Civil and sometimes criminal liability can also result when an accountant does not avoid these extremes. As noted above, the primary difference between the AICPA code and the IFAC code is that the former focuses on excesses and deficiencies, whereas the latter emphasizes the virtues themselves and the underlying principles represented by those virtues.

Moving Toward a Principles-Based Professional Ethics Process

Under a rules-based code of conduct, such as the AICPA code, the ethical goals of the organization are promoted through a disciplinary process that pays attention to noncompliance with the rules. Avoiding noncompliance is the primary objective, with the hope that by minimizing noncompliance within the organization, the overall ethos of the profession will be improved. Under this approach, the AICPA, and each of its state associations or societies, maintains ethics panels that receive and investigate complaints about members. If a member is found to have violated one of the ethics rules, that number is warned, chastised, or sanctioned.

The IFAC code requires more than mere rule enforcement. In support of the fundamental principles of its code of ethics, the IFAC requires accountants to be aware of circumstances, habits, behaviors, or other conditions that would threaten adherence to the fundamental principles. This conceptual framework is designed to foster more than mere compliance with a minimal set of rules. Instead, it guides the accountant toward the optimal ethical principles that are being sought by the profession and requires the accountant to consider how to improve his or her habits and practices so that they better reflect those principles.

The AICPA has adopted this conceptual framework approach, but not in regard to ethical principles. Instead, the AICPA has focused on one rule in particular, Rule 101—Independence and has required that in addition to the 15 interpretations of that rule (described earlier), its members consider risks or threats to independence above and beyond the restrictions set forth in those interpretations. In some ways, this is an unusual application of the threats-and-safeguards approach of the IFAC. That approach is designed to foster continuous improvement toward ethical principles, but it is used by the AICPA as a backup procedure to support a single rule (that, in turn, is less an ethics principle than an impression management protocol).

The professional ethics division of the AICPA did propose, in 2007, an interpretation of Rule 102—Integrity and Objectivity, that would require AICPA members to apply the threats-and-safeguards approach to the fundamental ethical principles as found in the preamble to the code (AICPA 2007). In other words, the AICPA attempted to shoehorn the preamble into an interpretation of one of its rules, thereby overriding the organizational bylaws and

making the preamble enforceable. That proposal was never developed beyond the exposure draft phase, and the exposure draft is still outstanding at this time.

In 2008, the AICPA published some threats-and-safeguards guidelines to be considered for the purposes of compliance with Rules 102 through 505 of the code (AICPA 2008b). In other words, having already adopted the conceptual framework approach of the IFAC to enforce its independence standard, the AICPA proffered the same approach to enforce the remaining rules of its code. However, there is one major difference: independence under the conceptual framework is enforceable, whereas the remaining rules of the code are not enforceable, with the conceptual framework serving only as a recommended guide. For this reason, any violations of the guidelines are not investigated or addressed by the ethics disciplinary processes of the AICPA or its affiliated state organizations.

Recommendations

The AICPA is continually engaged in assessing, developing, and codifying ethics standards, in part to bring its code into closer alignment with the IFAC code. We recommend that the process should rise above prior efforts to adapt the principles-based emphasis of the IFAC code to the rules-based structure of the AICPA code. To move toward a principles-based code of ethics, the AICPA needs to adopt two fundamental changes: First, define what it means for an accountant to be an ethical professional (that is, by what virtues a professional accountant should be characterized). Second, develop a continuous improvement process that helps accountants to foster those virtues. Recommendations for the former have already been presented above. A recommendation for the latter is discussed next.

The ethics panels and disciplinary processes that are in place at the AICPA and its state affiliates continue to be necessary to address the most obvious and worst-case situations involving unethical behavior by accountants. But these damage-control mechanisms, while necessary, are no longer sufficient. The AICPA will need to develop other procedures and processes that serve to foster a revised code of ethics that emphasizes virtues and principles.

The notion of helping accountants to identify threats to the highest standards of professionalism is not new within the accounting profession. It already has a peer review system in place, but that peer review system applies only to accounting standards and the quality of accounting services, and not to ethical standards per se. To retain their membership in the AICPA, members who are engaged in the practice of public accounting are currently required to participate in a practice-monitoring program. These peer reviews are not designed to be punitive, but rather to enhance and ensure the quality of the accounting, auditing, and attestation services provided by public accounting firms. These peer review efforts also contribute to the quality and effectiveness of accounting firms. Although independence, integrity, objectivity, and due professional care are required on the part of accountants who participate in peer reviews, adherence to those standards by the firms being reviewed is not explicitly addressed as part of the review process. Firms and individual accountants enrolled in the AICPA peer review program are required to have a peer review of their accounting and auditing practice once every 3 years (AICPA 2009).

Peer reviewers within the AICPA peer review system tend to focus on ways in which the reviewed firm can improve the quality of their accounting services. A typical report by such a peer reviewer makes recommendations regarding such matters as how the staff employed by the accounting firm can be trained and supervised better, how the firm's partners can be more involved in the planning of engagements, or how checklists and other tasks and tactics can be employed to improve the quality of work. These types of suggestions are made by reviewing the firm, irrespective of whether the reviewed firm actually "passes" or "fails" the peer review. This reflects the profession's emphasis on improvement rather than punishment.

We recommend that the accounting profession in the United States develops a peer review process for professional ethics. This process, like the peer review process for accounting standards, should focus on ways in which participating firms can reduce the roadblocks to the development of a highly ethical *ethos* within the reviewed accounting firm. The threats-and-safeguards language of the IFAC code can serve as a foundation for such a review. Over time, however, a best practices approach could develop guidelines to reduce threats of unethical behavior, and increase the prospects for an ethical culture within accounting firms (and within the profession generally) that more closely reflects the virtues to which the accounting profession continues to aspire.

Conclusion

In their comparison of the differences between the original 1917 code of conduct and the 1988 version that continues to serve the AICPA today, Preston et al. (1995) noted the increasing specificity and number of rules. They concluded that these rules "at best regulated minor points of professional conduct," and "act as a benchmark from which malfeasance may be judged" (p. 536). Our current critique of the AICPA code leads us to the same conclusions about the shortcomings of the rules-based approach.

A code of ethics should, in our view, do more than establish minimum acceptable standards. As part of their

survey of codes of ethics of professional business organizations, Gaumnitz and Lere (2002) considered the role of a code of ethics. In their literature review, they noted the importance of ethics codes in providing guidance for individuals and firms in novel situations, especially when explicit norms and external regulations offer insufficient guidance. For the accounting profession, most licensing jurisdictions and many federal agencies, such as the securities and exchange commission, have rules that establish minimum behavioral requirements. As a common example, these external rules prohibit accountants from knowingly and willfully misrepresenting facts as part of their professional services. And so a professional code of ethics for accountants may properly address such problems as deception and the falsification of accounting information, but it should do more. It should provide guidance for the achievement of the highest ethical standards.

In our effort to find ways to improve the AICPA code, we have compared that code of conduct to the *Code of Ethics for Professional Accountants* as recently amended by the IFAC. This latter code is more principles based, and can serve as a model for the development of a principles-based code of ethics for U.S. accountants. A truly effective, relevant, and useful code of ethics for professional accountants, in our view, will require both a careful articulation of those virtues or qualities that characterize an ethical accountant or accounting firm and a continual improvement process similar to the peer review system already in place in the U.S.

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