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Steven Mintz *Editor*

Accounting for the Public Interest

Perspectives on Accountability, Professionalism and Role in Society

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Accounting for the Public Interest

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Perspectives on Accountability, Professionalism and Role in Society

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Introduction

Accounting, accountability and ethics are national and global concerns and are framed in the context of the role of professions within society. The chapters in this book explore the role of accounting as a social practice and community of professionals charged with protecting the public interest.

Professional accountants are engaged in internal management decisions, auditing, financial reporting, and tax planning. The authors examine what does it mean to be an accounting professional and what obligations exist as a result of the importance of accounting to society.

Accountants as professionals working in the public arena are explicitly charged to serve the public good. Demand for transparency in corporate reporting is evolving in response to creditor and investor concerns about corporate social and environmental accounting as part of the publicly available corporate report with assurance or attestation by the professional accountant.

Perceptions of whistle-blowing and facilitation payments by corporations are examples of two areas where the public interest is at stake. The Foreign Corrupt Practices Act and Dodd-Frank Financial Reform Act in the US, and bribery laws in the UK and Australia, deal with these issues in the context of professional responsibilities. In addition to financial statement fraud, these practices present challenges to the way in which books and records are kept and whether the internal controls help to expose such practices.

The chapters summarized below are the thoughts of scholars who have devoted a great deal of time to analyzing the role of accounting to society. I am deeply indebted to them for their contribution to this book and furtherance of the dialogue that must continue to evolve as professionalism in accounting meets the challenge of reporting on matters that threaten the public interest.

Reviewers generously gave their time and diligence to critically assess the value of the contributions to this book. Without their efforts it would not have been possible to produce thought-provoking pieces that I hope will stimulate continued discourse on how accounting professionals can better meet their public interest obligation.

Steven Mintz
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Part I
Professionalism in Accounting: Myth or Reality?

Chapter 1
Call of Duty: A Framework for Auditors' Ethical Decisions

Michael K. Shaub and Robert L. Braun

1.1 Introduction

Although over a decade has passed since Enron, WorldCom, and the Sarbanes-Oxley Act thrust auditing into the spotlight and forced the accounting profession to re-examine its responsibilities, it is still unclear how the profession's views of its obligations have changed. The establishment of the Public Company Accounting Oversight Board (PCAOB) to regulate the U.S. auditing profession resulted, at least in part, from a perception that auditors were largely pursuing self-interest rather than fulfilling their professional responsibilities in the public interest. But while the establishment of the PCAOB meant the end of self-regulation, there is little evidence that the auditing profession has made any structural adjustments to reinforce professionalism.

What exactly does it mean to be a professional? What is the auditor required to do in order to fulfill the responsibilities of a professional? We believe the answers lie within the concept of duty. The purpose of this chapter is to build a proactive case for the auditing profession to assume its responsibility—its duty—to serve the public interest. In doing so, we will contrast a duty-focused approach to the current emphasis on consequentialist calculation reinforced in codes of conduct and authoritative standards. Subsequent sections explore duty's central role in defining professions and discuss how shifting toward the duty perspective is crucial for the auditor to fulfill the obligations of the profession. The chapter concludes with recommendations for the profession.

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1.2 Characteristics of a Profession

Accountants have long regarded themselves as professionals, and virtually every code of conduct governing associations of accountants presumes that they are. Although no universally accepted standard exists establishing the essential qualities of professions, three characteristics are salient throughout the literature, beginning with Carr-Saunders and Wilson's (1933) pioneering work. These attributes are (1) development of intellectual skill or knowledge, (2) adherence to shared values reflected in a code of conduct, and (3) responsibility to serve in the public interest.[1]

These attributes are common to other professions. For example, the American Medical Association (2011) Code of Medical Ethics includes principles to, among other things:

1. "…continue to study, apply, and advance scientific knowledge [and] maintain a commitment to medical education … ."
2. View the principles as "… standards of conduct which define the essentials of honorable behavior for the physician… ."
3. "… be honest in all professional interactions… .", and
4. "… recognize a responsibility to participate in activities contributing to the improvement of the community and the betterment of public health."

Likewise, the American Bar Association (2011) Model Rules of Professional Conduct require that attorneys be competent and "cultivate knowledge of the law beyond its use for clients… ." In addition, "[t]he profession has a responsibility to assure that its regulations are conceived in the public interest and not in furtherance of parochial or self-interested concerns of the bar."

Of the three attributes, the duty to serve in the public interest seems to pose the greatest controversy and challenge. The idea that skills are important is not controversial. Indeed, even the simplest definition of the term professional as, "one who is engaged in an activity as a main paid occupation" suggests a level of skill and proficiency that is worthy of compensation. But, if the discussion began and ended with skill, athletes would be professionals of the highest order—an assertion that flies in the face of our understanding of professionalism.

Most would agree that the notion of professionalism extends beyond skill to include values. Generally, accountancy has been willing to be subject to a code of conduct that reflects its values. For example, the Anderson Committee (AICPA 1986) that produced the AICPA's restructured Code of Professional Conduct in 1988 argued for a principles-based code centered on fundamental values (Shaub 1988). While the Code retains rules that are minimum standards that must be met and interpretations and rulings to explain the application of the rules, it is driven by principles that are aspirational. As such, it represents an attempt to embody the collective conscience

[1] Elsewhere in this volume, Fogarty (2014) provides a complementary analysis of attributes of a profession. The five attributes employed in his chapter correlate highly with the items presented here.

of the profession in recognition of its moral dimension (Frankel 1989). We cede discussion of the extent to which auditors embody the intellectual skill and shared values to Fogarty's (2014) contribution to this monograph (i.e., his discussion of specialized knowledge and community of practice) choosing, instead, to focus on public interest and autonomy.

The public interest attribute presents the greatest challenge to the profession. The assertion of a duty to serve in the public interest is not controversial, per se. The International Federation of Accountants' Code of Ethics for Professional Accountants (IFAC 2010, 100.01) asserts that, "A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest." The Code of Professional Conduct of the American Institute of Certified Public Accountants (AICPA) contains similar language and also states its public interest principle as follows, "Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism." (AICPA 2012a, ET 53) Indeed, it is arguable that auditing is unique among professions in that the public is the primary beneficiary of the work of the auditor, not necessarily the contracting client. That is, while the public interest outcome is a product of the doctor/patient or lawyer/client relationship, the public interest outcome is the very reason that the audit is required. Does the profession fully embrace its duty to serve the public? Or, is the profession too willing to "moralize without examining its morals" as Terrell and Wildman (1992, 403) observed regarding the legal profession?

While the accounting profession has stated its commitment to the principle of putting the public interest first, ethics rules that shield client information as confidential and that allow the provision of adjunct services to audit clients undermine this claim. In addition, individuals outside the profession have argued that auditor independence is impossible (Bazerman et al. 1997) or that government employees could more faithfully execute audits in the public interest (Westra 1986). These concerns invite consideration of a fourth attribute commonly associated with professions—autonomy.

Autonomy, in the sense that the community grants power to train, license, and regulate to the profession itself, is commonly included in the analysis of professions (Greenwood 1957). We do not include it with skill, values, and duty to the public interest, however, because it is contingent upon, rather than equal to, the others. The erosion of autonomy in the accounting profession post-Sarbanes-Oxley emphasizes this point—especially with regard to the public interest characteristic. The decision to rescind a portion of the auditing profession's autonomy did not result from the view that auditors lack specialized knowledge. In fact, the complexity of the manipulative devices used by Enron and others enhanced public appreciation of the need for significant audit skills. Nor did the provisions focus on reexamination of the values of the profession, though the extent to which auditors embraced those values was questioned. Regulations to limit autonomy resulted from the perception that auditors were not placing public interest at the forefront of their professional responsibilities, "their inability to respond effectively to market expectations" in the words of IFAC (2003, 10). In order to prevent further erosion of autonomy, auditors need to renew their commitment to serve the public interest. Auditors can answer the "call of duty" by enhancing their understanding of the concept of duty and implementing the concept in decision-making.

1.3 Balancing Ethical Decision-Making

The skill, values, and duty referred to earlier as being the standards for a professional provide a framework for balanced ethical decision-making. Balance is implicit in IFAC guidance in which fundamental principles linked to duty and virtue are identified (IFAC 2010, 100.04), and used in a process whereby "…a professional accountant should determine the appropriate course of action that is consistent with the fundamental principles identified. A professional accountant should also weigh the consequences of each possible course of action." (IFAC 2010, 100.17) While consequences are to be considered, the guidance is clear that they are not to be the first or only considerations.

Balanced ethical decisions require not only the technical skill to know what to do, but the moral courage to do it. This involves identifying duties and consequences related to an ethical decision (Hunt and Vitell 1986, 1993, 2006) and acting in a virtuous manner. Rest's four-component model identifies four processes involved in producing a moral act (1979, 1983, 1984, 1985, 1986, 1994; Bebeau and Thoma 1999; Rest et al. 1999; Bebeau 2002) The four processes are (1) sensing that the situation involves the well-being of others,[2] (2) reasoning as to what ought to be done,[3] (3) deciding to take a moral action (as opposed to a self-interested action),[4] and (4) acting in a manner consistent with moral conviction.[5] The model emphasizes the importance of feed-back and feed-forward loops among the four processes in which failure in any one of the processes can result in moral failure (Dellaportas et al. 2011).

Duties, virtue, and consequence evaluation are three perspectives from which moral agents approach the execution of the four processes. Figure 1.1 demonstrates how each of the three perspectives might be invoked in the four-component process.

[2] Without sensitivity as to the role of duty in a decision context and an understanding of how to incorporate duty into reasoning processes, the auditor cannot reach an appropriate ethical judgment.

[3] Auditors are made intellectually aware of their duty as professionals to protect the public interest through accounting education and professional socialization (Frankel 1989).

[4] According to Thorne (1998, 298), "… *moral virtue* is the positive attribute of character which describes an individual's direct concern for the interests of others despite personal risks (Pincoffs 1986), and *ethical motivation* describes an individual's willingness to place the interests of others ahead of his or her own (Rest 1994)." This is the stage at which the auditor assumes the moral duty to protect the public interest.

[5] Aristotle (1925, 1103a–1103b) recognizes the importance of ethical behavior in building virtue: "we become just by doing just acts, temperate by doing temperate acts, brave by doing brave acts." The virtuous person fulfills duties by acting.

In order to act morally, I need to engage in four different processes, at some level. First, I need to sense that an issue has a moral component. If I were unable to sense the moral component, my decision might not be immoral, but the process would be amoral. Second, I need to apply a reasoning process that takes morality into account. Third, I need to make a moral choice that places values and principles ahead of self-interest. Finally, I need to have the courage to act in accordance with the moral decision. The table below relates those four components of moral action to the major classifications of ethical perspectives. The ethical perspectives are discussed more fully thereafter.

Process	Duty	Virtue	Consequentialism
Sensing—This is how I identify the dilemma and frame the issue.	I identify dilemmas in which my roles are in conflict. I view the ethical choice in terms of the responsibilities that I have to the stakeholders.	I identify dilemmas in which my values are in conflict. I view the ethical choice in terms of the kind of person that I want to be and what my choice says about who I am.	I identify dilemmas based on the conflict between desired and potential outcomes. I view the ethical choice in terms of the outcomes that I might produce.
Reasoning—This is how I engage ethical judgment. These are the factors I consider.	In making ethical judgments, my focus is on the responsibilities that I have (and everyone has) going into the situation and what duties I have within the situation. My focus is on my duties rather than my inclinations.	I consider my own character traits and motivations within the situation and the motivations of others in making ethical judgments. I consider the purpose (or reason for being) of the item under consideration. I attempt to discern the essential nature of my role.	My focus is on the future. What will happen as a result of each of the alternatives? Which alternative produces the most good (or least bad)? I try to quantify all of the consequences associated with each alternative in making ethical judgments.
Deciding—This is how I arrive at my ethical intention. This is the decision rule that I use.	My ethical intention is to act according to a law that I give myself as a rational human being. My choice should be universalizable. I should wish that everyone would make the same choice. I should treat people as a worthy end rather than a means to an end. Principle: The best decision is the one that uses a process that respects the basic rights of the individuals involved.	My ethical intention is to choose the action that reflects the most honorable virtues and that is consistent with the essential purpose of the items involved. Principle: The best decision is the one that is consistent with important virtues.	My ethical intention is to choose the alternative that produces the greatest good. Principle: The best decision is the one that produces consequences that are best for… • Society (utilitarian). • Me (egoism).
Acting—This is what I hope to achieve through my ethical behavior.	My behavior is right based upon the rational process by which anyone would objectively determine it to be right, not necessarily based upon the outcome. It is consistent with my responsibilities in any situation.	My behavior should contribute to the development of my character and make the world a "better" place.	My behavior should produce the most good.

Fig. 1.1 Producing a moral action—a framework

The figure illustrates the fundamental differences in the perspectives. A consequentialist perspective focuses on the outcomes while a duty perspective focuses on the rational processes that can be universally applied. According to the duty perspective, morality stems from autonomous choice that can be applied categorically rather than hypothetically based upon outcome. The virtue perspective is contrasted to the others through its inward focus, examining the extent to which alternatives are consistent with the character and values of the decision maker. Although an individual tends to adopt a particular perspective that influences his or her approach, viewing moral issues from other perspectives could lead to more balanced moral behavior. This may be especially important for auditors who tend to default to consequentialist perspectives. Balancing decision-making by considering duty and virtue can help the auditor to meet public interest obligations. The International Education Standards Board of the IFAC (2003) emphasizes this point by including education related to consequences, virtue, and duties. While consequence-based utilitarian theories dominate business school education (Shaub and Fisher 2008), the principles of the profession are oriented toward duty and virtue. Figure 1.1 provides the opportunity to engage each of the major perspectives throughout the process of producing moral action.

Duties may arise from a number of sources: responsibilities to the company or to shareholders, professional codes of conduct (AICPA, IFAC, IMA, IIA, etc.), family responsibilities, and personal and moral convictions. One of the explicit duties of the professional is to make the public interest primary, consistent with the IFAC definition of the profession above. "The coverage of values and attitudes in education programs for professional accountants should lead to a commitment to … the public interest and sensitivity to social responsibilities." (IFAC 2004) This public interest focus is identical in the exposure draft revising this international education standard (IFAC 2011) and is also one of the six principles driving the AICPA Code of Professional Conduct (AICPA 2012a).

Even people who generally ignore duties consider consequences at some level when making ethical decisions. Some people consider only consequences to themselves, qualifying as psychological egoists; or, if they consider that approach the only ethical behavior, they are ethical egoists (Rachels 1986). Many people consider the consequences to others as well, following decision processes that resemble utilitarianism[6] in their efforts to maximize the excess of good over bad consequences for all. But it is very difficult for people to be objective in these calculations, as they tend to overweigh the importance of costs and benefits to themselves or to causes or organizations that especially matter to them.

The call for balanced ethical decision-making holds that it is not enough for auditors to do a complex calculation of consequences, even one that is utilitarian and does not favor the benefits or costs of one person over another (Freeman 1984). In fact, the ICAEW (2008, 13) indicates that "[t]he role of audit is not to assess and balance different stakeholder expectations and determine that they have been met …" Auditors must seriously consider the duties that may restrain behaviors that would maximize personal benefit, or even total benefit to all. The primary reason that this is true is that the job assigned to the auditor by society is not to maximize benefits, but to minimize harm (Shaub 1996; Fogarty 2014). As a result, the auditor must be involved in behaviors that might otherwise be avoided, notably suspicious or skeptical behaviors, that Deutsch (1962) defines as behaviors to prevent harm.

Thus, the assertion of balanced ethical decision-making is that there may be times when auditors should engage in behaviors that do not maximize beneficial consequences, and that maximizing beneficial consequences does not relieve auditors of their duties. One reason for the moral hazard of ignoring duties is that duties

[6] Utilitarianism is a form of consequentialism. Utilitarianism is the dominant theory in classical economics.

are more effective than consequences at restraining unethical behavior. Only when there is no overriding duty would consequences become relevant.

In addition to duty, virtue—as described in Fig. 1.1—serves an important role in balanced ethical decision-making. MacIntyre (1984) indicates that virtues reflect the ideals of a community. Sommers (1993) argues that exposure to Aristotle's arguments for the importance of the virtues is effective in undermining a simple default to relativism, to believing that what is morally right depends on the person. In a world without reference to virtues, values can simply be another word for preferences.

Auditors' virtue is particularly important in the situations of uncertainty that lead to auditor-client disagreements (Mintz 1995; Jones et al. 2003). Libby and Thorne (2007) develop a measure of auditors' virtue consistent with MacIntyre's (1984) idea that the virtues should reflect the auditing community's ideals. Their chartered accountants' top five ranked non-instrumental (character) virtues are integrity, truthfulness, independence, objectivity, and dependability. The top five ranked instrumental (action) virtues are diligence, alertness, carefulness, resourcefulness, and being consultative. The commitment to virtuous behavior potentially energizes auditors' willingness to assume their duties.

While consequentialist calculation dominates the accountant's technical training, duty and virtue are the basis for the principles of the profession. Principles are the ideals toward which accountants are called to strive. The language of duty and virtue dominate the expression of principles in the AICPA's Code of Professional Conduct. Duty-based calls to observe responsibilities, obligations, and public interest appear throughout the principles, as do virtue-based calls to integrity, objectivity, and independence. These calls are not conditional upon the consequences that might result in the circumstances.

Auditors should always be cautious about the net benefits of making decisions that may look morally questionable later, especially when there is no obvious virtue involved in the decision. Even if there is no moral duty that is evident, people will focus on the CPA's calculations later as evidence of moral bankruptcy. The KPMG tax shelter case detailed by Stuebs and Wilkinson (2014) in this monograph and Arthur Andersen's shredding of Enron documents provide stunning examples.

Court decisions in the Enron and KPMG tax shelter cases sent a message that jurors see harm prevention as an accountant's duty.[7] In both cases, the accountants apparently believed that the chosen alternative would maximize benefit to the client and firm. In both cases harm prevention to those outside of the circle of influence over the decision was apparently disregarded. Jurors are more likely to punish behavior that violates norms, even if it does not explicitly violate rules or standards, unless extra steps are taken to prevent harm (Prentice and Koehler 2003; Kadous and Mercer 2011). Clearly, the accountants involved with Enron and those aggressively marketing tax shelters did not take these extra steps to prevent harm. Nor did they balance egoistic consequence-based reasoning with consideration of duties and virtues.

[7] Although this chapter focuses on auditors rather than tax accountants, the close professional association between the two groups makes it relevant. For a more detained discussion of professionalism in tax accounting, see Stuebs and Wilkinson's (2014) chapter in this monograph.

The KPMG partner's cold calculation that the benefits of client revenue would exceed the cost of fines and penalties, if detected (Bryan-Low 2003), served not only as proof of ethical failure but also as the basis for moral outrage. It was not the fact that the calculation was executed in such a woefully inept manner; it was the fact that a calculation contemplating an illegal act was made in the first place that motivated the $456 million settlement with the Securities and Exchange Commission (SEC) (Stuebs 2010).

Similarly, Arthur Andersen's decision to shred documents ahead of an expected Department of Justice investigation of their involvement with Enron is an example of a decision dominated by calculation rather than virtue. Although not presented as an explicit calculation, it was the image of auditors stuffing the shredders that sealed the firm's fate. The massive shredding operation began three days after an Andersen conference call in which high-level executives discussed the SEC's investigation of Enron (Department of Justice 2002). The idea that the auditors must have calculated that the evidence in the documents would be more costly than the penalties for destroying those documents could have motivated the indictment. In both the tax shelter and Enron cases, the accountant had an overriding duty to the public interest that made consequentialist calculation irrelevant and inappropriate. In both cases, the absence of virtues that the public expects of auditors fueled outrage.

Ironically, auditors unconvinced by an argument for virtue might be persuaded by the dire consequences associated with the absence of virtue. It was the calculating nature of the partners at KPMG—the complete absence of virtue—that served as the basis for the large penalties. Similarly, it was the perception of the act of shredding documents as a cowardly effort to avoid responsibility that left an indelible stain on Arthur Andersen. While a consequentialist argument for virtue or duty is antithetical to the tenets of Nichomachean ethics and the duty perspective, it may be what it takes to convince auditors inclined toward calculation of the merit of a more balanced approach to ethical decision-making.

Shifting toward a more balanced approach in which duty to serve the public interest informs decision-making as described in Fig. 1.1 would require heightened awareness of three obligations that are inherent to the audit profession and then framing decisions, making decisions, and acting in a manner consistent with these obligations. We propose that three fundamental obligations of the auditor are:

1. Truth-telling
2. Dissenting and confronting
3. Honestly self-assessing independence and professionalism

Though a case can be made that auditors have other important obligations, these three important duties that are linked to the definition of auditing[8] help reinforce auditing's role as a profession. We assert that a tendency toward consequentialist

[8] Auditing is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users (American Accounting Association 1973, 2).

calculation has contributed to laxity in fulfilling these obligations. A more balanced approach in which duty and virtue play more significant roles would help auditors re-orient themselves toward the public interest. The discussion that follows expands the case for each of the obligations identified above through analysis of professional standards and extant research.

1.3.1 Truth-Telling

The first obligation of the audit professional is the duty to tell the truth (Libby and Thorne 2007). Though this would seem to be an obvious and simple obligation, institutional and economic forces are often aligned against the kind of transparency and full disclosure that this duty and virtue would require. That is, while aspirational principles of the Code of Professional Conduct call for truth-telling, the complexity of the environment in which auditors operate and the rules that govern how they are to operate in this complex environment suggest that optimizing or even satisficing behavior could be the norm. Integrity, objectivity, and transparency could be the casualties of this satisficing behavior (Shaub and Fisher 2008).

Integrity, a word deriving from the Latin root *integer* meaning intact or whole, can be applied to buildings of sound construction, data that is uncorrupted, territory that is undivided, and honor that is intact. Integrity implies reliability, that something is consistent with what it purports to be. And, according to the AICPA Code of Professional Conduct:

> Integrity requires a member to be, among other things, ***honest and candid*** within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the ***honest*** difference of opinion; it cannot accommodate ***deceit*** or subordination of principle. (AICPA 2012a, ET 54.02, emphasis added)

Though this duty is required of all CPAs, it is especially important for the auditor in order to protect the public. As is clear from rule 301 of the AICPA Code of Professional Conduct, client confidentiality does not restrain an auditor from revealing violations of accounting principles or auditing standards—first to the client and then to those relying on the misstatements through appropriate disclosures, including regulators.

According to the AICPA Code, "The principle of objectivity imposes the obligation to be impartial, ***intellectually honest***, and free of conflicts of interest (AICPA 2012a, ET 55.01, emphasis added)." And the AICPA Code establishes a duty of transparency (Shaub and Fisher 2008) on all CPAs in stating:

> Members employed by others to prepare financial statements or to perform auditing, tax, or consulting services are charged with the same responsibility for objectivity as members in public practice and must be ***scrupulous in their application of generally accepted accounting principles and candid in all their dealings with members in public practice***. (AICPA 2012a, ET 55.04, emphasis added)

The terms honest, candid, and intellectually honest appear in the Principles section of the AICPA's Code of Professional Conduct and are aspirational. For auditors who believe that duty extends only to rule observance, the duty to tell the truth may be obscured by rules emphasizing confidentiality (i.e., AICPA Code of Conduct Rule 301) and materiality. The duties that undergird a profession go beyond simple compliance with legal rules, and they often involve acting consistently with principles of behavior by possessing certain virtues, such as truthfulness (Libby and Thorne 2007). A simple default to rules ignores the inherent duty to maximize full disclosure and focuses on materiality.

1.3.1.1 Is "Not Materially Misstating" the Same as Truth-Telling?

An amount or disclosure is material if it would make a difference to a reasonably informed user of financial statements. The focus on the user of the financial statements should orient auditors toward a public interest perspective in its application. Ironically, the opposite appears to be true. Focusing instead on a calculation of what would be misleading, auditors reorient the focus of materiality toward consequentialism (Shaub 2005).

Most auditors would agree that materiality is a fundamental concept in audit planning. In fact, U.S. auditing standards have generally held that audit planning is fundamentally based on the auditor's evaluation of audit risk and materiality. Both auditing and accounting standards in the U.S. have incorporated materiality. The audit opinion uses "material" in both the scope and the opinion paragraphs, and each new U.S. accounting standard issued by the Financial Accounting Standards Board contains the following proviso: "The provisions of this statement need not be applied to *immaterial* items."

Rather than being morally governed by a duty to search for truth, auditors are guided by a consequentialist calculation. For instance, Houghton and Fogarty (1991) found in one study that auditors waived 75 % of all detected errors. The practical implication of a reliance on materiality alone is the tendency to think that there is no "truth." Financial statements contain numerous estimates, leading to serial materiality issues. And the more complex the company is, the greater the number of estimates that are necessary to produce the financial statements. This habit of imprecision creates the tendency for clients to believe that the amount of an audit adjustment, and even the audit adjustment itself, is negotiable. Gibbins et al. (2001) report that the practice of partners negotiating with clients regarding audit differences is more the rule than the exception. Hatfield et al. (2010) find that the magnitude of the difference and feelings of reciprocity based on prior negotiations influence proposed auditor adjustments in negotiations. Is it possible that along with audit adjustments, there is a perception that duty and public interest are negotiable?

The Giant Stores and Enron cases are two examples where public interest arguably did not even make it to the negotiating table. In the famous fraud at Giant Stores, management stopped arguing over the auditor's proposed adjustments once the earnings number reached their target (Knapp 2004). And Andersen passed on a

1997 adjustment that represented 48 % of Enron's earnings; according to the majority of quantitative materiality guidelines in the professional literature, this amount really was quantitatively "immaterial" (Brody et al. 2003), revealing a vulnerability to abuse in the U.S. auditing standards.

Even some quantitatively immaterial amounts may be qualitatively material. They are important not so much for their amount as for their nature. In Staff Accounting Bulletin No. 99, The SEC identifies a number of examples of potential adjustments that fit this description (SEC 1999). These and other examples have been incorporated into the U.S. auditing standards in AU 312.60 (AICPA 2012b) in response to the SEC's concern that auditors were allowing their clients too much freedom in determining what was material. Nelson et al. (2005) recommended that standard setters should mandate adjustment if a misstatement is material either in a single period or cumulatively—guidance that the SEC adopted in SAB No. 108. Previously, many firms allowed their clients to treat items as immaterial if they were considered immaterial on either a single period or a cumulative basis.

Auditors have rationalized fraudulent financial reporting on the basis of cumulative immateriality in audits of Sunbeam, Waste Management, Enron, Xerox, and others. Although the soundness of the assumptions invoked in those arguments is highly questionable, we assert that the tendency to invoke the materiality argument at all on detected misstatements is at odds with the auditor's duty to tell the truth. Consistent with this view, Hall (1988) calls materiality.

> . . . an understanding of what is important … . An auditor's sense of materiality lies at the heart of his professional judgment. … A well-developed concept of materiality is particularly important because the concept is subject to abuse. Many acts have been justified, many sins excused, on the basis of their alleged immateriality. (Hall 1988, 78–79)

Materiality is a construct that is invoked to relieve auditors of the need to audit the financial statements down to the penny. It is not intended to relieve auditors of the duty to hold clients accountable to the truth.

1.3.1.2 Consequentialism in Professional Standards—Effects on Truth-Telling

Although fundamental duties lie at the heart of the auditing profession, institutional and regulatory forces seem to orient practitioners toward consequentialism. Emphasis on enforceable rules of conduct such as materiality rather than unenforceable principles might suggest to auditors that it is appropriate to locate moral worth in consequential calculations rather than fundamental duties. Rather than relying on the accounting profession's historic commitment to a series of professional duties, the profession has adopted a consequentialist approach to many ethical issues. Consequentialist calculations make sense in evaluating audit risk or in determining whether an indirect investment impairs an auditor's independence. Accounting for contingencies is also consequentialist; for example, evaluations such as "probable" and "reasonably estimable" are required to record a loss contingency and also to evaluate material weaknesses in internal control (AICPA 2012b, AU 325.06).