Ethics and Accounting: Understanding Stock Market Impacts Associated with Ethical Violations

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SENIOR HONORS THESIS

Submitted In Partial Fulfillment of Requirements of the

College Scholars Honors Program

North Central College

May 15, 2017

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Abstract

This thesis aims to understand the impacts of unethical activities and necessity of ethical behavior in accounting. This research considers accounting, reporting, and disclosure standards and the ethical standards which govern their application. To measure the impacts associated with unethical accounting reporting, this thesis explores how stock prices have reacted to public announcements of ethical breaches. Specifically, this study examines thirty companies that violated ethical rules and were then investigated and punished by the U.S. Securities and Exchange Commission (SEC). Using Accounting and Auditing Enforcement Releases available on the SEC’s website to identify violators, historical stock prices were obtained for a period before and after the release date. Preliminary findings indicate that there was generally not a material decrease in stock prices. This finding suggests that accountants and management must be ethical by their own choice, because fear of punishment, in the form of reduced market value, is not motivation enough.
Introduction

Ethics is an important component of any occupation, but it is fundamental to the accounting profession. The public places a great amount of trust in accountants and the work that they do. Users of financial statements trust that accountants and management have prepared the statements faithfully and accurately. Therefore, in order to properly and truthfully serve the public, accountants must act ethically in their work. However, every year, hundreds of companies and individual accountants are investigated and convicted of financial fraud. In some cases, accountants are the ones committing the fraud for personal gain. In other instances, they succumb to pressures from upper management to perhaps make the company appear more successful than it is, over-report expenses to receive tax breaks, or overstate income in order to receive performance-based bonuses. Another common reason for committing accounting fraud is to make the company look good to the public and investment firms in order to increase stock prices. Whatever the reason, when an accountant acts unethically and commits financial fraud, he or she deceives the users of the financial information.

These unethical choices can have painful consequences for consumers. If an investor is viewing falsified financial statements, he or she may retain an investment with a company that is misrepresenting its profitability, or invest in a company that they would otherwise not invest in if the financial information was reported correctly. A consumer may invest money in a company, but the money is then used for other purposes and the client may actually lose a portion or all of their money to this dishonest act. There are, of course, penalties for these acts, such as monetary fines or other professional sanctions, but these consequences do not seem to be enough to stop future fraud from occurring. For this project, I sought to understand what happens to a company’s stock price after its management is convicted of committing unethical behavior, and...
how this consequence compares to unethical behavior in non-accounting fields. I also tried to understand, based on the results, the best ways to stop unethical acts from happening in the future. By analyzing and comparing the graphs of both cases, I wanted to determine if the stock market reacted the same to accounting and non-accounting unethical business behavior.

**Background information**

In order to understand the importance of ethics and how it relates to accountants, one must know the difference between personal and business ethics. According to Merriam-Webster, ethics is defined as “the discipline dealing with what is good and bad and with moral duty and obligation. A set of moral principles, a theory or system of moral values.” In other words, ethics is the discipline that examines how an individual decides what is right and wrong and how to act accordingly. An individual’s ethical standards, therefore, are unique to that individual. In other words, what is “right” to one person may be “wrong” to another person, though it is difficult to say what the correct way of thinking is. Thomas Nagel, in *Encyclopedia of Philosophy* described this dilemma as “certain norms that apply to everyone in a certain group and that should be recognized as valid for everyone by each member of the group although their separate individual aims and desires may differ and lead them into conflict with one another” (Nagel, 2006). An example of this could be the way different people view lying. For example, some believe that “white lies,” lies that do not cause direct harm to other people, are an acceptable thing to do, while others that have a stricter ethical standard believe that all lies are wrong. A person that adheres to a high ethical standard is more likely to follow all rules than a person who follows a looser ethical guideline.

Because of the differing levels of personal ethics, many businesses implement a code of conduct for their company. This code of conduct is a standard by which all employees must
behave, which acts as an internal control to reduce unethical behavior. The code of conduct is not comprehensive, but it can aid employees in making small decisions on a daily basis. Of course, the code is only effective if it is followed and adopted by the individuals in the company, so it cannot prevent all fraud from occurring. If management or accountants are only following the code of conduct to avoid punishment, they are more likely to break it if they see a chance for personal benefit. Management can put pressures on accountants to unethically alter the financial information. For example, if a company has performance-based incentives, managers may encourage accountants to misrepresent income so that the company meets the revenue goal to get the bonus. In these cases, accountants need to adhere to a high standard of personal ethics in order to withstand the negative pressure.

Business ethics is slightly different from personal ethics, though there are some shared qualities of both. *Encyclopedia of Management* describes business ethics as “business ethics...is the application of the discipline, principles, and theories of ethics to the organizational context” (Hill, 2012). In other words, business ethics is the application of personal ethics in industry. Ethical decision-making in business does not always involve large sums of money, or only with top management, but rather it is involved with daily dilemmas faced by all levels of employees in business (Hill, 2012). Ethical standards are applied to all types of moral and ethical questions, such as following legal or company standards, interactions with clients, or the use of company assets or company time. Adhering to a high standard of ethics in business is important, because when firms are charged with infractions, especially those leading to legal investigations, the public’s trust in the firm is damaged, sometimes irreparably. Mutual trust between customers and suppliers is the foundation of a free-market economy (Hill, 2012). Trust is a key element in the
accounting profession, as clients and other users of financial information must trust that accountants are properly stating the financial statements.

Upper management may experience a conflict of interest with accountants. An accountant's job is to accurately and faithfully report the financial statements of the company for the public to view and use to make decisions. At the same time, management wants to make their company look as profitable as possible for various reasons, or show larger expenses in order to reduce taxable income and avoid paying high taxes. Managers want the company to maintain a good relationship with investors and banks, appear profitable for financial analysts and credit rating agencies, and often senior managers’ compensation are based on company performance (Cowton, 2013). All of these factors create a conflict of interest between what the managers want the numbers to be and what the accountants must report. This kind of situation requires the use of professional and personal ethics for the accountants when preparing the financial statements for the company.

Frequently, unethical decisions are beneficial in the short-term, but can be damaging for the long-term welfare of a company. For example, in an attempt to boost income for a period, management can cut research and development projects or reduce wages spent on extensive training programs. The decreased expenses make the company’s net income grow, but only for the amount of time that these expenses are cut. Cutting research and development can lead to a company not being able to stay competitive if other businesses in the industry are creating new products, potentially leading to a decrease in sales. If training programs are reduced or understaffed, newly hired employees will not be as efficient, likely resulting in poorly completed work by these employees or extra wages paid because jobs take longer for under-trained employees. While it is not illegal to cut research and development or training expenses, it is unethical to do
such things to inflate income. The long-term effects of such decisions can be disastrous, affecting employees and even the reputation of the company. Management and accountants need to consider the long-term effects of decisions when faced with ethical dilemmas such as these.

While accounting standards and ethical guidelines help reduce employee fraud, and the code of conduct aids in maintaining a professional work environment, these protocols can never be extensive enough to cover all scenarios that one may encounter. In order for accountants to abstain from acting unethically in their duties, there must be an overlap between personal ethics and business ethics. The application of one’s personal ethics or prior knowledge of how to handle ethical dilemmas will assist an accountant in making the right decision when faced with a problem not clearly defined in the code of conduct. One example where this would help in the accounting profession is the use of estimates. Estimates are used often in the accounting field, especially for valuing intangible assets or determining the useful life of an asset for depreciation. Sometimes, over-aggressive estimates can be used to make expenses or assets higher, depending on the goal of the estimate. For example, if a company was owed a large sum from a debtor, and knew that a portion of the debt was likely to not be paid back, they should make an allowance on the balance sheet for that debt. If the company “estimated” that all of the debt was to be paid back, it would make their accounts receivable account unrealistically higher, therefore increasing their assets wrongfully.

If a manager asks an accountant to use an overly-aggressive estimate in order to meet a financial goal, the overlap of the accountant’s personal ethics will help him or her make the right decision. Another example of when an accountant must exercise judgment is making assumptions about the future of the company. In an essay about ethics in accounting, Cowton says “...accounting numbers are dependent upon choices of method and assumptions about the
future…” (Cowton, 2013) This assumption is used when valuing assets or valuing the company as a whole, because managers and accountants must decide if the company is a “going concern” or not. Two accountants or auditors may look at the same data regarding a company and their financial situation and come to different conclusions regarding the future of the company. In these cases, accountants must follow the company’s policies and their training, not the potential pressures that may be placed on them (Cowton, 2013).

While there is not one concrete standard for “ethics,” accountants in the U.S. do have a written standard that they must follow for financial reporting. GAAP, or Generally Accepted Accounting Principles, is the standard for measuring and disclosing financial information. While GAAP is not a code of ethics, it is a written protocol for how public companies must record their financial activity and report it on the respective financial statements. The Securities and Exchange Commission (SEC) requires all public companies are required to file their financial statements in accordance with GAAP, while private companies do not have to do so, though most choose this method. While this is a national standard for all accountants to follow, it is by no means comprehensive, in that it cannot cover every ethical dilemma that one may encounter. Of course, if an accounting practice violates GAAP, it is illegal and therefore unethical. However, in the more difficult decisions that management and accountants must make, they must use personal and business ethics in order to make the right decision that will benefit the clients and maintain the trust of the public in the accounting profession. Accountants are often faced with situations in which they must use professional judgment, often in situations that are not explicitly covered under accounting guidelines.

Because GAAP allows for the use of estimates for certain accounting procedures, accountants have some leeway in how they record certain items. For example, under the current
standards, leases can be treated as “capital” leases or “operating” leases. A capital lease is on the balance sheet as a liability, while an operating lease is on the income statement as an expense, and not placed on the balance sheet. There are four tests that must be applied in order to determine if a lease is a capital lease. If the lease does not pass any of the tests, it is classified as an operating lease. Sometimes, if a company does not want the extra liability on its balance sheet, management can structure the terms of the lease so that it does not meet any of the criteria, even by the smallest margins. The company still has the liability of the contracts, but it is not classified as a liability on the balance sheet, and can affect several ratios of the company, such as the debt to equity ratio or asset to liability ratio. Some of these ratios are used by banks in order to determine whether or not a company can qualify for a loan, so if accountants are structuring a large amount of leases as operating leases, the liabilities will stay off the books. While this is completely legal under U.S. GAAP, it is debatable whether or not this practice is ethical, because it can hide debt that a company has.

In addition to GAAP, the International Ethics Standards Board for Accountants (IESBA 2010), which was established by the International Federation of Accountants (IFAC) developed the Code of Ethics for Professional Accountants as a guideline to refer to when faced with ethical dilemmas (Cowton, 2013). This code emphasizes the fact that a professional accountant’s responsibility is not solely to satisfy the needs of an individual client or employer, but rather to serve the public interest as a whole. This concept is seen in the five fundamental principles that it identifies: integrity, objectivity, professional competence and due care, confidentiality, and professional behavior (Cowton, 2013).

In the past 15 years, ethics has become and increased focused in accounting education. Many states, including Illinois, require that accountants pass an ethics exam that is incorporated
in the CPA exam in order to receive the certification. At North Central College, for example, all of the accounting classes have ethics requirements within them, including completing case studies and answer ethics-based questions on exams. Three professors from West Virginia University collaborated on an article about the importance of this education, in which they identified the two typical learning objectives of ethics education: understanding applicable codes of conduct, and identifying ethical dilemmas and proposing solutions (Apostolou, 2013). In other words, the main goals of ethics education are to identify how to act ethically, and how to apply this knowledge when faced with hypothetical, yet realistic dilemmas. The ultimate goal of this education is to instill ethical standards in accounting students that they can then use in their future careers. If students can learn these standards while they are developing the framework for their profession, they can use their knowledge to correctly handle inevitable ethical dilemmas. Despite the increased emphasis of ethics education in school, fraud is still common in the workplace. One explanation for this is that accountants and managers do not truly accept the ethical guidelines, but rather comply with the rules out of necessity and are therefore willing to violate them if possible. If one is following the rules to simply avoid punishment, that person is likely to break the rules for personal gain if they feel that they will not be caught. Adopting a strong ethical code is important because it will help the individual make the right decision even when he or she may not be caught.

Ethics education at the collegiate level is certainly important, but there is also a need for ongoing ethics training at the professional level. In school, hypothetical situations are typically used to train students how to make ethical decisions. This is certainly valuable because it helps future accountants to prepare for the difficult situations they will encounter at work, but it is different than actually experiencing the pressure of a manager or coworker. Sometimes even if a
student feels prepared to face ethical dilemmas, when faced with the actual situations at work, he or she may find it incredibly difficult to make the right decision. Ongoing ethics education at work is important because it reinforces the need to act ethically and helps remind employees how to handle difficult situations. Some companies implement this kind of training, and many companies also have a strong human resources department where employees can call anonymously for help or to report unethical behavior. These are two ways that companies can help accountants and managers to act ethically and make the right decisions.

While certainly not all accounting fraud results in the complete collapse of the company, it is important to note some of the most famous accounting scandals in U.S. history when talking about accounting ethics. These cases should serve as a warning to all future accountants and managers about what can happen when integrity and ethics are not applied at work. In the following cases people went to prison, employees lost their jobs, and trust in accountants and auditors was severely damaged. It is important to think about these scenarios when faced with ethical dilemmas, because no company is immune to ethical scandals.

**Historical Accounting Fraud Cases**

When one thinks of an unethical situation causing trouble in a company, there are often two examples that come to mind-- Enron and WorldCom. These were two companies in the early 2000’s that were doing incredibly well in their industries, until they were both exposed for major financial fraud and eventually collapsed entirely. While these are of course great examples of the disasters that financial corruption can cause, these types of stories are nowhere near the “norm” when it comes to unethical behavior in companies. These are the extremes that do sometimes happen, but not nearly as frequently as other types of unethical acts. WorldCom and Enron are
important stories to know, however, because it can provide concrete evidence for why companies and individuals should act ethically.

*Enron*

Enron began as a pipeline company in the 1980s and transitioned to energy trading after that. At its peak in the 1990s, the company was valued at approximately $70 billion, with its stocks trading at $90 each (NPR). This large company collapsed in 2001 due to unethical business practices, specifically related to accounting. The scandal began to unfold after a rival company, who was going to purchase Enron for $9 billion and all its debt which was valued at $13 billion, backed out of the deal after learning about the accounting fraud that the company was committing. As the deal was being finalized, Enron disclosed more debt, including a credit downgrade that meant Enron had to pay or refinance $690 million. They also had less cash on hand than stated, and the SEC discovered that the company had misrepresented nearly $600 million in earnings over five years. The company ultimately collapsed entirely, and 21,000 employees of the company lost their job (Oppel, Sorkin, 2001). Companies often face pressures both externally and internally that lead to scandals such as this. Externally, management wanted the company to look profitable to shareholders in order to continue to receive financial support and confidence of the public. Internally, upper management encouraged the accountants to misuse accounting procedures to benefit the company. If the CEO had followed the proper accounting procedures, and held to a high ethical standard even if that meant admitting when the company needed help, or not being able to aggressively pursue some goals, the company most likely would have been able to avoid complete collapse.
WorldCom

WorldCom was a long-distance telephone provider that grew rapidly throughout the 1990s. It began slowing down and experiencing financial difficulties in the early 2000’s, but the CEO refused to let the public know about the company’s financial situation. Despite the internal struggles happening to the company, the CEO, Bernie Ebbers, told the Committee on Financial Services of the House of Representatives at a hearing that WorldCom was doing extraordinarily well. He said that WorldCom received revenues of $30 billion per year, served over 20 million customers, and provided internet services to over 100 countries. Ebbers made as many acquisition and merges as he could, completing 75 mergers in total, including his largest, MCI (Zekany, 2004). In a time when telecom services were decreasing, WorldCom appeared to be thriving, which was appealing for stockholders and future investors. However, this success was not as true as it appeared on paper.

WorldCom was under intense pressure both externally from investors and analysts, and internally from the CEO, whose financial status was dependent on WorldCom’s stock price. Ebbers had pledged his enormous holdings of WorldCom’s stock as collateral for loans to finance the purchase of his personal interests (Zekany, 2004). This kind of strategy poses an enormous conflict of interest for the CEO, because he wants to see the company do well in order to benefit his own personal endeavors, meaning he may be willing to do unethical things to protect his own investments and income. One strategy that WorldCom practiced was known as the “Close the Gap” exercise that happened at the end of every quarter. Upper management was intensely focused on recognizing double-digit growth, and in order to meet these aggressive targets, the final revenue numbers were altered to be closer to the budgeted numbers rather than the actual numbers. These adjustments were sometimes in the millions to tens of millions dollars,
and were booked to the “Corporate Unallocated revenue account.” This was justified by labeling the exercise as keeping a running tally of accounting “opportunities” that could later be exploited (Zekany, 2004). In other words, the company was listing potential revenue-generating events as actual revenue. Perhaps if the CEO had a higher personal ethical standard, he could have realized this dilemma between the aggressive goals and the actual results and stopped himself before he became too involved with it. Furthermore, the internal auditors had a dual-reporting role, reporting on the completed projects for the year, as well as reporting directly to the CFO, Scott Sullivan, who controlled their promotions, salary increases, bonuses, and stock options (Zekany, 2004). Essentially, the auditors, who were supposed to be uninfluenced by the company, had to report their findings to the same supervisor that controlled their pay and bonuses. Again, there is a conflict of interest, as the employees may misrepresent reports in order to gain favor with their supervisor and obtain raises or bonuses. For both Enron and WorldCom, the unethical decisions made by upper management not only caused their stock prices to completely crash, but led to the complete collapse of both companies.

**Non-Accounting Unethical Behavior**

Aside from accounting fraud involving poor ethical decisions, there have also recently been two famous scandals in the manufacturing and retail sector of the market—Volkswagen and BP. These are two well-established companies that have a large market presence and, before their disastrous scandals, had a good reputation in their respective markets. The companies had reputations for providing good quality products and acting legally and ethically. BP accidentally spilled over one billion gallons of oil from a broken under-water pipe into the Gulf of Mexico, killing large amounts of wildlife in the ocean. Volkswagen deliberately lied to the EPA and their consumers about the vast amounts of Nitrogen oxides that their vehicles were releasing into the
atmosphere. While these two cases are not related to accounting, both of these companies violated ethical principles before their mistakes were brought to the public’s attention. This can be interpreted by the average person as a more direct deception to the public than an accountant who misrepresents expenses to receive a tax break, because Volkswagen produces tangible goods that are used daily by consumers, and BP harmed or killed innumerable amounts of wildlife and polluted the Gulf where people frequently swim. The stock market reacted more strongly to these ethical violations than most of the accounting-based fraud, which agreed with my hypothesis that investors view unethical accounting as less serious that non-accounting fraud. Perhaps this type of thinking is pervasive in businesses also, which is why accountants and management continue to commit fraud. Accountants should view unethical accounting as being equally as wrong as consumer-related problems, and that can be achieved by incorporating a high standard of personal ethics with business ethics.

**Volkswagen**

In September of 2015, the Environmental Protection Agency (EPA) declared that beginning in 2009, Audi and Volkswagen diesel vehicles were releasing up to 40 times the amount of the legal limit of Nitrogen oxide emissions (Krall, 2015). Not only were the vehicles releasing this astronomical amount of gas, but the cars were equipped with software specifically meant to trick emissions-testing machines. The EPA reported that approximately 482,000 vehicles in the United States had been equipped with the software meant to deceive emissions testing. On September 22, Volkswagen revealed that as many as 11 million vehicles worldwide could have been equipped with the malicious software, and they set aside $7.4 billion to prepare for returns and further reparations (Krall, 2015). Volkswagen was then forced to recall these defective diesel vehicles, and many people simply got their money back and bought other cars.
Volkswagen’s stock also plummeted due to the fraudulent act, and their reputation was irreversibly tarnished.

*BP*

While BP did not intentionally spill oil into the Gulf of Mexico, it was the failing of one of their oil rigs that caused the release of the oil. On April 20, 2010, a cement seal of the Macondo oil well one mile below the surface in the Gulf of Mexico broke, causing oil to spew out uncontrollably. Oil and methane gas poured out of the well for 87 straight days before it was repaired. The government estimated that 4.2 million barrels (1,764,000,000 gallons) of oil was released into the Gulf. BP argued that it was less, and it was eventually agreed that they were responsible for 3.1 million barrels (1,302,000,000 gallons). In addition, 11 workers on the rig lost their lives (Griffin, 2015).

The project that I conducted is an attempt to determine quantitatively the consequences of a company committing an ethical breach. Of course, not all companies completely collapse such as Enron and WorldCom, but they are examples for future accountants and managers of what unethical behavior can cause. For this project, I began with the assumption that examining a company’s stock prices would be an adequate way to show the market’s reaction to this phenomenon, because the stock prices are a reflection of the public’s trust in the company. I assumed that the stock of companies that had scandals related to consumer products (such as BP or Volkswagen) would decrease farther than accounting-related fraud. I also hypothesized that the stock prices of the consumer-related cases would remain low longer than accounting-related cases. In the cases of BP and Volkswagen, the stories were all over the media, which likely aided to the public’s reaction to the companies. In order to test this hypothesis, I wanted to compare the stock data between these two types of violations.
Methodology

The companies that I selected were from the Security and Exchange Commission’s (SEC) website. The SEC is a group that investigates and reports ethical violations committed by publicly-held companies as well as making sure that the companies’ financial statements are in compliance with U.S. GAAP. The SEC then often assesses monetary fines to the companies based on the degree of their violation. They also grant the Financial Accounting Standards Board (FASB) the authority to create U.S. GAAP. I selected thirty companies for this experiment, because I felt that would be a fair estimation of how the market reacts to most of these types of violations. I found the companies under the SEC’s “enforcement” section of their website, under the “accounting and auditing” tab. Each year, the SEC releases all of the companies and individuals that they have investigated and found to have committed violations of business or accounting laws. I selected thirty public companies from this list, so that I could easily access their stock prices, starting from 2017 and going back as far as 2013. I also selected two companies that had problems with their products, not related to accounting procedures, such as BP Amoco who spilled oil in the Gulf of Mexico, and Volkswagen, who deliberately lied to the EPA and their customers about the emissions of their vehicles. This was to examine the difference in the reaction of the stock market between accounting-based fraud and product-related violations. I assumed that these types of unethical behavior would have a larger impact on stock prices than accounting-related fraud, because accounting could seem like more of an abstract concept rather than concrete examples of deliberate deception or colossal failure of equipment.

Of course, there are other variables that I cannot account for that could impact the stock prices, such as the company’s financial performance, a decrease in a competitor’s stock price that
may cause an investing company to move their stock, or other reasons that individuals or large investing firms may pull out of the company’s stock. However, I felt that the ethical violation and corresponding release from the SEC is the biggest factor in comparison to these other variables that would cause individuals or large investing firms to withdraw their stock. My hypothesis was that, immediately after the SEC released their investigation’s findings about the company, that their stock prices would decrease. I also hypothesized that this decrease in stock price and volume would only be temporary, and that the stock would return back to its normal level after the original reactions had worn off. I had hoped that, in addition to the financial penalties issued by the SEC, that investors would punish the companies by withdrawing their stock. By comparing the accounting cases with the non-accounting cases, I could see the difference in duration of the decrease, if it happened at all, and how much the stock decreased following the publication by the SEC. If there was a large difference between the reactions of the stock market, this would imply that investors found accounting-related fraud less alarming than unethical behavior not related to accounting.

This project is a simplified version of an event study, which is a common practice in accounting and other financial disciplines. I follow the basic steps of the event study, which include determining the event, selecting the time period of study, and selecting sample size (MacKinlay, 1997). I did not use the formulas that traditional event studies use to examine results quantitatively. Instead of purely empirical data, I examined the trends in stock price related to the event. Once I determined what companies I wanted to examine, I found their historical stock data on Yahoo Finance’s website. I searched one year before and after the SEC publication, in order to get a large sample size of stock data to see what impact the fraud made. This would show the trends in the companies’ stock in order to see the impact that the breach of
ethics made. Of course there are other variables that can affect stock prices, but an ethical infraction about which the SEC reported would damage the public’s trust in the corporation and likely cause investors to remove their stock from the company for fear of its collapse or impairment from the fine or other consequences.

**Results**

Figure 1 is a sample of one graph that I made on Excel, the highlighted date is the date of the infraction. This is The St. Joe Company, which is a New York Stock Exchange (NYSE) listed real-estate company. This company violated GAAP by materially overstating earnings and assets, and they improperly used assumptions to benefit their company on conditions that did not exist (SEC, 2015). The graph indicates that the stock price fell on the date the infraction was published, and continued to fall until February of the next year. This implies that the public, specifically investors, removed their stock from the company and caused the price to fall, damaging the equity and value of the company. This is a good example of the public adding further punishment to a company for an ethical infraction. However, within approximately one year, the company had recovered from the initial decrease. This case supports my hypothesis that companies will see an immediate decrease in stock price following the release by the SEC, but that the stock price will increase in a short time.
Of course, not all companies followed my hypothesis. Many of the companies’ stock prices did not noticeably fall following the date of the violation. One example of this is Bank of America, who violated the federal securities law by not accurately and fairly reporting transactions in which they engage. Bank of America (Figure 2) did not faithfully recognize the structured notes and other financial instruments they received upon acquisition of Merrill Lynch & Co., understanding the portfolio by approximately $45 billion, among several other infractions (SEC, 2014). The SEC released this filing on September 29, 2014 which I have highlighted in Figure 2. The graph indicates that the stock prices did not decrease sharply as was the case with The St. Joe Company. The stock began to decrease dramatically two weeks after the event, though this may not be at all related to the infractions. The stock then grows rapidly very shortly after the decrease. Unfortunately, this was the case with many of the companies that I analyzed. I found this discouraging because the stock market, apparently, is less alarmed by accounting-
related fraud than product-related issues. The complete list of companies that I analyzed can be found in the appendix following the bibliography.

![Figure 2](image)

I believe that it is valuable to compare these two graphs of accounting-based fraud to the reactions of the two most recent consumer-related frauds. Figures 3 and 4 are the respective graphs of the stock data for Volkswagen and BP, and the date of the infraction is highlighted in the same way the two graphs above are formatted. I also followed the same formula for the data below, finding stock data one year before and after the event. Before collecting the data, I speculated that the stock price would plummet more rapidly and stay low longer than almost all other accounting-based fraud cases. Volkswagen deliberately lying to consumers about their vehicle emissions, or BP accidentally spilling over a billion gallons of oil into the Gulf of Mexico, may seem more personal to the consumer and more tangible than misrepresenting income or under-reporting assets. Even though both accounting-based and consumer-related violations are unethical, perhaps the consumer-related fraud seems “more” unethical. If a person
is unfamiliar with accounting and its regulations, the concept of violating accounting standards may seem abstract in comparison with problems that one can physically see. It may also seem that accountants or managers are not hurting anyone by violating accounting principles, whereas the consequences of BP’s spill are much more severe. This is why accountants and managers must be held to a high standard of ethics, because violating laws and regulations is still wrong even if the consequences do not seem as extreme.

In the case of Volkswagen, the EPA first noted the malicious software on September 18, 2015. By September 21st, the stock had fallen from $36.31/share to $30.1/share. Next, Volkswagen revealed the number of vehicles potentially affected worldwide (11 million) on September 22, which brought the stock down to $25.68 by September 25. As the graph shows, the stock price stayed below $35 even a full year after the initial incident, indicating that investors continued to punish Volkswagen far longer than most accounting-based scandals.

![Figure 3](image-url)
Regarding BP, the initial spill happened on April 20, 2010, and the stock price began to fall quickly as one week later. Between the day of the initial spill and the price one week later, the stock price had fallen $4. As the graph shows, the stock price continued to consistently fall for over two months before it began to steadily increase again. Between April 20 and June 29th, the stock price fell $33.54, from $60.29/share to $26.75/share. Even after the steady decrease had ended, one year after the spill it was still approximately $15 less than its highest price before the accident.

![BP Stock Price Graph]

**Conclusion**

In conclusion, based on the data from the stock prices, it appears that the public reacts far more strongly to non-accounting related issues rather than ethical violations in accounting. Many of the graphs of the stock data indicate that many companies do not see much of a decline in their stock prices around the time the SEC releases the information about their infraction, especially compared to consumer-related scandals. If there is a decrease near the date of the
infraction, most of the companies recover quickly from the decline in stock value. Based on this information, I believe that fear of punishment is not enough to keep accountants from acting unethically. It seems that in order to maintain the public’s trust, which is fundamental in accounting, there must be a different source of motivation for accountants to act ethically at all times.

Based on this information, a direction for further study would be analyzing the impact of ethics requirements at school and continuing ethics education at work for newly trained accountants. Given the rise of ethics education in college accounting courses, professionals must see some value in attempting to instill ethical values in aspiring accountants. I believe that ethics requirements in accounting degrees and CPA licensure is the key to mitigating accounting fraud in industry. There will always be ways to hide fraud or find loopholes in regulation, and if management or an accountant wants to exploit it, fear of punishment is clearly not enough to stop them. Furthermore, upper management often places pressure on accountants or other finance employees within a company to not follow GAAP or other standards in order to meet performance goals, appear more profitable than the company truly is, or attempt to avoid high taxation. Without a strong ethical standard, it is easy to succumb to these pressures and not consider all the factors and consequences related to acting unethically. I believe the best way to lower the frequency of future fraud is for accounting students to adapt a strong ethical standard within themselves as early as possible. To aid in the retention of this personal ethical standard, I believe that it is important for companies to implement ongoing ethics education for employees and management. This education will help reinforce the code of conduct among employees and also give them a guideline to use when faced with ethical dilemmas at work. With the help of ethics requirements in college, ongoing ethics education at work, and the ethics requirements of
the CPA exam, accountants will at least be forced to know what the ethical expectations are in the profession. If accountants can adopt these ethics personally, they will be able to face dilemmas in their careers, and choose the right decision simply because it is the right thing to do. College-aged accountants are the future of the accounting profession, so adopting a strong ethical guideline at that age is paramount for keeping the public trust in accounting in the future.

Works Cited


APPENDIX

This appendix contains the graphs of the stock data from the thirty companies that I analyzed for this project. I have also included a short description of the fraud that was committed by each company. The date of the statement from the SEC about the fraud is noted on each graph. As the data shows, some companies experienced a reduction in stock prices shortly after the announcement, while others did not.

SciClone was found in violation of anti-bribery, books and records and internal accounting controls provisions of Foreign Corrupt Practices Act of 1977. Employees of SciClone subsidiaries gave money, gifts and other things of value to foreign officials, including healthcare professionals. Schemes were known and condoned by managers within SciClone’s China-based corporate structure. Transactions were falsely recorded as legitimate business expenses.
United Continental Holdings is one of the largest airlines in the U.S. The company was found in violation of books and records and internal accounting controls provisions of the SEC Act of 1934.
JP Morgan Chase & Co. provides banking and investment services worldwide. The company was found in violation of anti-bribery, books and records, and internal controls provisions of Foreign Corrupt Practices Act. Chase provided valuable jobs and internships to relatives and friends of certain key executives of its clients as a personal benefit to obtain or retain investment banking business or other benefits of the firm. The company provided valuable jobs and internships to the relatives and friends of certain key executives of its clients, prospective clients, and foreign government officials in the Asia-Pacific region as a personal benefit to the requesting officials in order to obtain or retain investment banking business or other benefits for the firm.
AstraZeneca (AZN) is a global biopharmaceutical company. The company was found in violation of internal controls and recordkeeping provisions of the foreign corrupt practices act by both AZN and its wholly-owned subsidiaries in China and Russia. AZ failed to maintain sufficient system of internal accounting controls relating to the interactions of its China and Russia subs with government officials. Employees made improper payments of gifts, travel, cash and other benefits to influence health care providers to purchase AZN pharmaceuticals.
Park National is a bank holding company in the U.S. and practiced improper accounting for its Allowance for Loan Losses relating to certain impaired loans, the largest of which were construction real estate land and development loans at its Vision Bank subsidiary. Park National understated its reported allowance by not properly using impairment analyses.
Weatherford International is a large multinational provider of oil and gas equipment and services. The company issued false financial statements that inflated its earnings by over $900 million in violation of GAAP.
GlaxoSmithKline (GSK) is a global provider of pharmaceutical and consumer health care products. GSK was found in violation of internal controls and recordkeeping provisions of Foreign Corrupt Practices Act of 1977. Employees and agents of GSK’s China-based subsidiary engaged in various transactions and schemes to provide things of value to foreign officials in order to improperly influence them and increase sales of GSK in China.
General Cable Corporation is a global manufacturer of copper, aluminum, fiber optic wire and cable products. The company was found in violation of improper inventory accounting and disclosure violations that caused the financial statements to be materially misstated at its Brazil subsidiary that went undetected due to the company’s internal accounting controls failures.
Ocwen is a provider of residential and commercial mortgage loan servicing. The company lied about having policies and procedures that required its executive chairman of the board be recused from approving transactions with two other companies on which he was also on the board. Ocwen also incredibly over-valued its financing liability on certain mortgage servicing rights which led to materially misstating its financial statements.
Monsanto is an agricultural seed and chemical company that manufactures and sells glyphosate, an herbicide, under the trade name “Roundup.” Monsanto improperly accounted for millions of dollars of rebates offered to Roundup distributors in the U.S. and Canada and retailers to incent them to purchase Roundup.
Bankrate owns and operates an Internet-based consumer banking and personal finance network. The CFO, VP and director of accounting, and VP of finance intentionally manipulated financial results for one quarter in order to meet or exceed analyst consensus estimates for key financial metrics. Materially overstated its financial results.
The Bank of New York Mellon (BNY) violated anti-bribery and internal accounting controls provisions of the Foreign Corrupt Practices Act. Employees of BNY tried to corruptly influence foreign officials in order to retain and win business managing and servicing the assets of a Middle Eastern sovereign wealth fund. They gave internships to family members of the officials as well.
GoodYear Tire and Rubber Company was found in violation of books, records and internal control provisions of the Foreign Corrupt Practices Act. Goodyear subsidiaries in Angola, Kenya routinely paid bribes to employees of government-owned entities and private companies to obtain tire sales. Also bribed police, tax and other local authorities. These subsidiaries made over 3.2 million in illicit payments between 2007-2011. All bribes were falsely recorded as legitimate business expenses.
The St. Joe Company is a real estate developer, timberland owner, and resort operator. This company violated GAAP by materially overstating earnings and assets, and they improperly used assumptions to benefit their company on conditions that did not exist.
Avon is a global beauty products manufacturer and seller, failed to institute controls that could have detected and prevented payments made to Chinese government officials by employees and consultants at Avon Chinese subsidiary which violated the Foreign Corrupt Practices Act. The Chinese subsidiary made approximately $8 million worth of payments to officials.
Great Lakes operates a dredging segment with both U.S. and foreign operations, which was responsible for 85% of the company’s revenues; and a demolition segment with only U.S. operations, which was responsible for the remaining 15% of revenues. Great Lakes overstated revenue in its demolition segment, by recording revenue for pending change orders even though it did not have sufficient proof of customer acceptance of the orders.
Bank of America did not faithfully recognize the structured notes and other financial instruments they received upon acquisition of Merrill Lynch & Co., misunderstanding the portfolio by approximately $45 billion.
Mercantile Bancorp failed to recognize in financial statements a probable loss on one of the bank’s largest troubled loans. In other words, Mercantile knew they were not going to get the loan repaid but did not report it, which overstated their assets.
Diebold is a global provider of ATMs and bank security systems. The company violated the Foreign Corrupt Policies Act for bribing foreign officials with trips, entertainment and other gifts in order to obtain and retain business with government owned banks in China and Indonesia. Diebold paid approximately $3 million in illicit payments from 2005-2010.
Chase did not maintain a system of internal controls sufficient to provide reasonable assurances that transactions are recorded as necessary for financial statements, violated Sarbanes-Oxley Act of 2002.
Medifast manufactures, distributes, and sells weight loss and other health and diet products and supplements. The company improperly accounted for its income tax provision for three years, resulted in material understatements of its income tax expense and material overstatements of its net income after tax. Deficient system of internal controls that failed to ensure appropriate recording and reporting in conformity with U.S. GAAP.
Anchor Bancorp and its CFO intentionally or recklessly made material misstatements in Anchor’s quarterly report on Form 10Q. The CFO also manipulated an estimate to offset an accounting adjustment required by external auditors.
Parker Drilling Company provides worldwide drilling services and is a project management firm. Parker violated the Foreign Corrupt Policies Act by paying a third-party intermediary retained to assist the company in resolving customs disputes. Parker authorized payments to a Nigerian agent totaling $1.25 million.
Capital One materially understated its provision for loan and lease losses. The understated amount was approximately 51 million, which overstated its assets.
Volt Information Sciences is a global staffing, managed services, infrastructure support, customer care, and technology solutions and services company. The CFO participated in a scheme to materially overstate revenue by $7.55 million. This resulted in the net income being materially overstated.
Over a three year period, First Bancorp failed to disclose related party transactions involving family members of the company’s former chief operating officer, chief loan officer, and a member of its board of directors. By failing to make these disclosures in its Forms 10-K, First Bancorp violated SEC disclosure rules requiring public companies to disclose such relationships if the amounts involved exceeded $120,000.
Key Energy Services, which provides rig-based well services, was found in violation of books and records and internal control provisions of the Foreign Corrupt Practices Act. Key Energy’s Mexican subsidiary made improper payments to a contract employee of a Mexican state-owned oil company to bribe him to provide inside information about the company.
L3 Technologies, which provides technology for the U.S military, failed to maintain books, records and accounts that accurately reflected the transaction and dispositions of its assets, and for failing to maintain a sufficient system of internal accounting controls. L3 Improperly recorded $17.9 million in revenue based on invoices associated with unresolved claims against the U.S. Army that were created in L3’s internal accounting system but not delivered to the customer. Employees even mentioned it to internal control personnel but the review of the problem was not conducted properly and therefore left it unresolved.
PTC, Inc. designs, manufactures, and sells Product Lifecycle Management Systems software (i.e., software that manages a company’s products from design through manufacturing and distribution) and maintains operations in the Americas, Europe, and Asia Pacific, including China. PTC violated anti-bribery, books and records and internal accounting controls provisions of Foreign Corrupt Practices Act. Two wholly-owned subsidiaries provided improper payments totaling nearly $1.5 million to Chinese government officials who were employed by Chinese state owned entities that were clients of PTC. Payments were made to obtain or retain business from the entities. PTC earned approximately 11.85 million in profits from sales contracts with entities whose officials were bribed.
Orthofix International is a diversified medical device company that develops and sells surgical and non-surgical medical products to medical professionals in various market sectors, including orthopedics. Orthofix used at least four schemes, with third-party commercial representatives and distributors, to make improper payments to doctors employed at government-owned hospitals to induce them to use Orthofix’s products, thereby increasing sales. The improper payments to doctors employed at government hospitals were improperly recorded as legitimate expenses and generated illicit profits to Orthofix of approximately $2,928,000.