Mary C. Gentile, PhD, Director
www.GivingVoicetoValues.org

Giving *Voice* to Values

Discussions about Ethics in the Accounting Classroom: Student Assumptions and Faculty Paradigms[1]

The following essay was based on extensive classroom observation in graduate accounting classrooms and was written to enable faculty to better understand the needs and assumptions of their students with regard to the link between ethics and accounting, as well as to better recognize their own impacts on student learning and attitudes.

However, the assumptions, expectations and intentions of students and faculty described herein are just as relevant for managers who wish to find effective ways to frame and express their values-based responses to frequently heard workplace rationalizations for less than ethical accounting practices.

Reframing discussions of accounting practice around the question of "purpose" is just as critical (if not more so) in the workplace as in the classroom. The section on "Teaching Pitfalls" describes frameworks and attitudes experienced just as often in the workplace as in the classroom. And the section on "Red Flags" just as easily applies to warning signs in the manager's organizational experience as it does to the classroom experience. Finally, the suggestions for educators enumerated in the "Conclusion" are also useful for managers who want to guide and mentor their employees.

Typically when educators set out to introduce ethical issues into existing courses in the management curriculum, they use the "add and stir' approach. First, they try to identify ethical issues that are especially prevalent in the particular field — say accounting; then they try to find appropriate places within the syllabus to raise these issues for discussion. In accounting, this often translates into case discussions about the temptations of fraudulent financial reporting or more subtly, all the ways in which earnings can be massaged, smoothed, enhanced and hurried by managers at various levels within a firm.

While this strategy may succeed in setting some less suspicious students on their guard about questionable practices they might encounter, it often does little in the way of arming students with a clear sense of how to resist such temptations or even whether or not it makes sense to try. Faculty sometimes nervously worry that they may actually be providing recipes for "cooking the books" rather than proscriptions against such practices.

[1]An earlier version of this note was developed while the author was a Senior Research Fellow at Harvard Business School.

Actual classroom discussions of typical financial reporting and managerial accounting case studies reveal a set of student needs and assumptions, as well as a set of conceptual paradigms implicit in the curriculum design that inhibit effective ethical discussion from surfacing and often render it unsatisfying when it does manage to erupt. The following paper, based on extensive MBA classroom observations, will share some actual classroom exchanges, identify the student assumptions and the conceptual paradigms that stifle the integration of ethical analysis into the discussion, and provide some suggestions on how these barriers might be overcome.

Student Expectations: Truth, Purpose, Mastery

Students approach a course on Financial Reporting and Managerial Accounting (FRMA) with certain baggage. Unfortunately some students come in with the complete Samsonite European Tour Set, while others carry nothing but a backpack. Those students with no background in the field are keenly aware of its specialized language and its standards and rules. They have a sense of an exclusive and specialized realm to which they are seeking entry. Their lack of familiarity encourages the belief that insiders have access to business insight and control which they also can have if they are smart enough and if they learn the right rules. They are seeking truth and a sense of mastery.

On the other hand, those students who have prior experience in the field come to the course with the confidence born of familiarity, but they also know the limits of this special knowledge. They may have seen accounting used as a tool for a variety of ends. For some, this experience leads to an acceptance that the rules of accounting are just like the rules of any other "game;[2]" the trick is to make them work for you. Others still hope that the field's standards can be perfected so as to serve as guidance and even an enforcer. These students don't experience the anxiety and blind faith of the outsider. Rather they are insiders, some of whom are seeking a sense of purpose for their expertise and others who have already defined that purpose, but rather narrowly.

Differing expectations exist not only between different groups of students, but also within the same student. Students bring conflicting assumptions to the study of accounting. For example, they bring a simultaneous belief and disbelief in "the numbers:" on the one hand, they see managers (i.e., themselves) as governed by the rules of accounting and GAAP, unable to act without a version of the numbers to back them up; on the other hand, they see themselves as autonomous agents who manipulate the tools of accounting to their own ends. This contradiction is succinctly summed up in the often-heard query: "Can you make the numbers work?" Implicit in this question is the assumption that the numbers are manipulable, as well as the assumption that they are the ultimate arbiter. The students' desire for control over their experience causes them to want to believe that they can 'make the numbers work." However, their feelings of powerlessness in the face of a highly technical, exclusive realm and their discomfort in the face of organizational pressures to "play the game," cause them to prefer to abdicate

[2] Use of the "game" metaphor for accounting or any other business activity can be dangerous. There are ways in which business activities and games are similar but there are very important ways in which they are different. For example, it can be useful to ask "what is the time frame for the activity?": an hour's game is very different from an ongoing business activity. Similarly, asking "what is at stake?" can emphasize the distinctions between a business and a game of entertainment. Additional important questions that can emphasize the limits of the "game" metaphor include: What are the goals? Do all the participants know the rules? Is participation in the activity freely chosen? Are third parties (people not directly involved in the activity) affected?

their sense of responsibility for their actions to an external rule-giver: ‘It must be OK because GAAP allows it.”

It is this confusion/ambivalence over the degree of control or power the manager actually possesses, and the nature of that control, which is at the heart of the pedagogical challenges faced in accounting ethics discussions. The students accept that managers do have power, but only within a bounded realm of action, the limits of which have been externally given. This complex belief system allows them to feel simultaneously empowered to “make the game work for them and their companies,” as well as feeling excused from ultimate responsibility, since they believe the rules so limit their options and serve as surrogate for a broader accountability.

Student Expectations and Faculty Assumptions

Now if educators take a look at the student needs or expectations that have been identified above, and match them up with certain faculty assumptions about the proper conceptual approach to FRMA, they can pinpoint the obstacles to accounting ethics discussions. First of all, as noted above, students experience an expectation or need for truth, for the sense that accounting knowledge will enable them to see and understand the actual state of a firm’s operations. They want clarity and the ability to evaluate information as true or false.

Faculty, on the other hand, approach the FRMA course with the expectation, indeed the intention, to undermine the student’s too simple belief in the validity of the numbers. Cases are designed to illustrate the latitude of managerial discretion, as well as the limitations of any reporting system in capturing the complex and varied “reality” of a particular business enterprise. For example, in introductory discussions of inventory reporting, students explore the different advantages and disadvantages of LIFO and FIFO, from perspectives internal and external to the firm. Later in the course, an examination of different methods of product cost accounting reveals that each method captures different information but no system is completely “true.”

Faculty intend to initiate students into the complexities of financial reporting and to communicate the degree to which students have control or power over the reality they choose to construct and convey, both within and outside of the firm. As Gareth Morgan argues:

> Accountants often see themselves as engaged in an objective, value-free, technical enterprise, representing reality “as is”. But in fact, they are subjective “constructors of reality”: presenting and representing the situations in limited and one-sided ways....By appreciating and exploring this dimension of the accounting process, accountants have a means of developing a new epistemology of accounting that will emphasize the interpretive as opposed to the supposedly ‘objective” aspects of the discipline, perhaps in a way that will help broaden and deepen the accountants’ contributions to economic and social life (Morgan, 1988).

Ironically, in an effort to be more “truthful” with their students about the nature of accounting, faculty may actually undermine the student’s expectation of truth from the tools of the discipline. The message that students take away from the class discussion deconstruction of “reality,” as presented in a particular set of financial reports, is that “truth” does not exist ... or at least it is not what accounting is about. As several students put it at different times during an FRMA course: "Accounting is just a way to make things look good." No matter that faculty may actually intend to convey that truth is complex; that it is a matter of balance and negotiation between different perspectives; and that although a single, completely accurate reporting of a firm's activity may never be achieved, it is still worthwhile and necessary to strive to approach it.

The costs of this student misunderstanding are high. In his book, *The Corning Crisis in Accounting,* Belkaoui comments on fraudulent financial reporting as follows:

> [Fraudulent financial reporting] results from a number of documented dysfunctional behaviors: smoothing, biasing, focusing, gaming, filtering and illegal acts. Such behaviors generally occur when managers have a low belief both in the analyzability of information and in the measurability and verifiability of data (Belkaoui, 1989). (Emphasis added)

That belief in the verifiability of data begins to be undermined when students see the complexity of financial reporting as a reason to abandon altogether the struggle for responsible accounting practices.

In addition to the students' desire for truth, they require a sense of purpose for their accounting expertise. Some hope to find this in an external source: the standards of GAAP and FASB. Faculty, however, hold it as their responsibility to clarify the limitations of these guidelines: they are sometimes too general; they are an evolving and often reactive framework; and they, too, represent a limited perspective. Given these limitations, accounting standards are a poor surrogate for purpose: they tend to be more a set of "thou shalt not's" than a guide for managerial meaning.

Other students look inward for a sense of purpose for their accounting knowledge and find it in a commitment to individual career goals. Faculty may inadvertently reinforce this rather narrow definition of purpose by omitting the assertion of a broader conception of managerial purpose on the one hand, and by accepting students' assumption of case protagonists' narrowly personal motivations, often served by unethical behavior, on the other.

Without a belief that some form of truth is a possible goal, and without a sense of broader purpose than one's personal career success, students are left with the drive for technical mastery as the motivating force in FRMA. Placing this drive for mastery within the context of students' confusion/ambivalence about the degree of control or power the manager actually possesses over "the numbers," it is no wonder that ethical imperatives seem misguided, beyond the manager's ability, or both. For example, ethics-related case studies in FRMA often deal with some aspect of truthful disclosure (i.e., "Harnischfeger Corporation," "R. J. Reynolds Tobacco Company," "Scovill Inc.: Nutone Housing Group." -- See Appendix for case summaries). If students have come to accept that the accounting "truth" is impossible to define — if it exists at all — how can these cases generate moral commitment, much less a practical action plan for pursuing it? And if students imagine no sense of purpose beyond individual career success, is it any wonder that their sense of mastery is defined without reference to ethics — sometimes in fact, in contradiction to it?

The Assumption of Unethical Behavior

So faculty and students appear to possess a reciprocally reinforcing set of assumptions which undermine an ethical perspective toward case material. The assumption of unethical behavior on the part of managers is particularly problematic in the classroom (Tyson, 1990) and it surfaces frequently. For example:

- In a class discussion of a typical corporate annual report, students commented that they found the report's emphasis on "corporate citizenship" surprising;
- In classes on inventory reporting, students routinely talked about managers "playing hide and seek with the IRS" or using accounting "to just make themselves look good on paper;"
- In a discussion of depreciation schedules at two different airlines, a student commented that "I'd like to think that the airline extended plane life in their depreciation in order to be more accurate, but it made their earnings go up;"
- In a discussion of accounting for leased assets, the instructor asked: "Are we arguing for this method of accounting because it looks good and smoothes our earnings, or because it most closely reflects the underlying economics of the leasing situation?" The students responded: "It depends on who you are" and "Sometimes we may want things to look bad for the purpose of tax breaks."

With no alternative perspective, repeated comments like these serve to construct a context inhospitable to ethical considerations. An assumption of unethical managerial behavior deprives students of positive managerial models; it presupposes that the world of professional management — the world students have targeted — is a realm where individuals thrive, or at least cope, by unscrupulous means; and it hinders ethical discussion by casting it as unrealistic and naive. After all, the MBA classroom is a place where pragmatism is valued. Even when students <u>want</u> to consider the ethical implications of a managerial decision, they need to believe those implications are actionable in the real world and to feel confident that they can express them as such.

In their explication of the mutual trust perspective on morality, Dees and Crampton describe how the assumption of others' unethical behavior can affect individuals. They posit a three part classification of human behavior: opportunists, moral idealists, and pragmatists:

> Most [people] are pragmatists, concerned with their own material welfare, but also with moral ideals....Pragmatists are looking for reciprocal moral commitment. They behave like opportunists in the state of nature, not because they are inherently egoistic, but because they cannot trust others to constrain their opportunistic behavior. Pragmatists will gladly do their fair share to create a civil society, but not place themselves at a systematic disadvantage (Dees & Crampton, 1991).

Consider students as such pragmatists for a moment. Similarly, they do not want to place themselves at a systematic disadvantage by restricting their action plans with ethical considerations, if they believe that their classmates and more importantly, real managers, would not do so.

Classroom Example

A classroom discussion of trade loading at R. J. Reynolds illustrates this phenomenon. The case was written specifically as an effort to integrate attention to ethical issues into the FRMA curriculum. In this case, R.J. pads end-of-period cigarette shipments to distributors to increase reported income. Faculty opened the discussion by analyzing the impact of trade loading over time on income, and by asking whether there was a real problem ("Is this material?") and who, if anyone, was hurt by this practice. Casting the question in terms of materiality, to begin with, shifts responsibility for decisions away from the manager and onto a set of external guidelines. In addition, the analysis that faculty and students displayed at the start of the discussion illustrated that materiality depends upon the method of analysis used. Therefore, managerial purpose is limited to compliance with external guidelines and the accounting "truth" is once again shown to be a moving target.

As explained above, students' drive for learning is therefore limited to a desire for mastery: how can a manager make this situation work for them? Accordingly, attention shifts to the intentions and the tactics of R. J. Reynolds managers. Faculty and students then focused the discussion on the individual character of chief executive Ross Johnson. Faculty called attention to the KKR takeover of R. J. Reynolds and then asked:

> Faculty: "Would Ross Johnson have the obligation to tell KKR of problematic income projections due to trade loading practices?"
>
> Student: "Yes."
>
> Faculty: "Would he do so?"
>
> Student: "No."
>
> Faculty: "So he should do the deal fast and blame the trade loading on the next guy? What kind of guy is Ross Johnson? Would he misrepresent to KKR?"
>
> Student: "Yes."

After this exchange and others like it, despite faculty efforts to encourage students to examine the deleterious effects of trade loading on the quality of the firm's information, or to question the role and responsibility of the auditor in this situation, or even to raise questions about the impact of trade loading on distributors and customers, students remained focused on the motives and assumed character traits of Ross Johnson. The tone of the discussion was cynical, as they built a sort of "conspiracy theory" wherein the managers were consumed with the idea of "cashing out on the company" and "getting their parachutes." As one student put it: "Cash is king...This product [cigarettes] is a cash cow, but it's a declining industry — a declining industry with huge margins. They're going to soak up as much as they can." When faculty asked if anything was wrong with the firm's practices, another student replied, presumably with an intention to shock: "No one is getting hurt....A manager here ought to consider whether his job is long term or short term in deciding whether to try to make any change."

Finally, the faculty ended the class with a brief summary, drawing a comparison between "operating manipulations" and "accounting manipulations," commenting that; "1 don't know if you consider operating manipulations unethical, but think about it. You probably would think it was unethical if they had played with the accounting." And then a reprint of the Bruns/Merchant article, "The Dangerous Morality of Managing Earnings," *(Management Accounting,* August 1990, pp. 22-25) was distributed to students, presenting survey results where managers report a high level of tolerance for just such "operating manipulations."

Reframing the Argument: Purpose

The above case discussion illustrates how faculty's concern for intellectual integrity may be experienced by students as a lack of concern for honesty. For example, the demonstration of the many ways in which the cumulative impact of trade loading may be calculated can leave students with the conclusion that any approach is equally appropriate, as long as they can justify their choices within the constraints of GAAP. Similarly, any notion of managerial purpose is limited by a narrowly individualistic analysis of motives and responsibilities. For example, the pragmatism and self-interest of Ross Johnson are explored in much greater depth than the pragmatism and even self-interest of a manager defining his or her purpose more broadly. Students are left with a quest for mere technical mastery in the service of individual career goals, and the assumption of unethical behavior on the part of "the other manager" -- an assumption that can lead to their own lack of ethics as a defensive maneuver.

Now the case discussion described above was not without its usefulness. Students were made aware of the less obvious costs of operating manipulations like trade loading, and of how quickly they can compound. They became aware of managerial incentives for such behavior and of the disincentives for addressing the problem. Nevertheless, the net impact of this class may have been substantially different from what was intended.

Given that some of the apparent barriers to serious, rigorous discussions of ethical issues in this field appear to be built into the conflict between student needs/assumptions and faculty intentions, how can these conversations be restructured so as to realign the goals of these two groups?

To begin with, faculty can reframe the debate. One lesson that has been illustrated time and time again is that one cannot reverse the tone and thrust of an entire class period with a pious commentary at the close of the hour, regardless of how sincere or articulate. Unless students feel the urgency of the ethical imperative, just as they feel the urgency of the market's imperatives and of their own career aspirations, these comments will carry little impact. It becomes crucial, right from the start of the class period, to position the managerial decisions under examinations within a context of broader business purpose and managerial responsibility.

For example, the purposes of accounting tend to be discussed in only the most limited and often cynical a fashion (e.g., student comments from students that accounting is really only about "making yourself look good on paper.") In one classroom, the faculty opened the semester with a brief reference to the historical origins of double-entry bookkeeping. This opening session would be an ideal opportunity to take the topic further, to address the roles that the accounting and financial reporting function have played historically and the ones they currently play for the contemporary manager.

Faculty might open the course with some questions like:

- What is the function of accounting and of financial reporting within the organization? Outside the organization?
- Who are the stakeholders affected by managerial choices around accounting and financial reporting practices?
- What purposes should drive the manager's decisions around accounting and financial reporting practices?

One of the first things that become apparent when individuals take the time to try to answer the above questions is that accounting and financial reporting are merely tools or means to other ends. There certainly are rules and guidelines for the legitimate use of these tools but as noted above, these rules are open to differing interpretations and they can be circumvented if one's motive is strong enough. Learning how to do accounting does not teach one for what purpose to do accounting. Similarly, the eleven concepts[3] governing the practice of accounting and typically presented to students in the first class sessions, rely upon the manager's responsible exercise of judgment, and judgment requires a sense of direction. Without a clear conception of the purpose for which one wants to use this powerful tool of accounting, these concepts become meaningless as guidelines and function only as rationalizations or excuses. An extreme example of this phenomenon is the student who attempts to justify fraudulent activity by claiming it was not "material."

So if accounting and financial reporting are only tools, albeit very powerful ones given the force of the seeming objectivity of quantitative measures, how does one begin to answer the questions listed above? What are some of the responses students may discuss, or that faculty may hope to elicit?

When asked, "What is the function of accounting and of financial reporting within the organization and outside the organization?" student responses are likely to fall into four areas:

- Control function: monitoring activity in order to assure compliance with goals and standards;
- Communication function: internal and external reporting;
- Historical function: recording the financial history of the organization;
- Decision-Making function: creating opportunity/need for dialogue and relationship-building around organizational goals and strategy.

The first three of these responses "beg the question" of purpose. They are based upon the assumption that the managers already know their organizational purpose (i.e., how the reporting will help them assure compliance with standards, or what messages their reporting will help them communicate to which audiences). As noted, the existence of rules like GAAP help to give the illusion that these "standards" and these "messages" are already given. It is really only the last of these functions – decision-making – which positions accounting and financial reporting as tools to determine purpose, as well as to serve it.

Students often tend to focus on the control and communication functions, but it is the discussion of the decision-making function of accounting and financial reporting which makes their potential power and

[3] The eleven concepts as presented in Robert N. Anthony and James S. Reece's *Accounting Principles* (Homewood, Illinois: R.D. Irwin, 1983) are money measurement, entity, going concern, cost, dual aspect, time period, conservatism, realization, matching consistency, and materiality.

their accountability as managers visible. Focus on the decision-making function of accounting reveals that the collection, analysis and presentation of information reflect many prior choices: Who will collect the data? What sources of data will be accepted? What reporting methods will be used? How and to whom will data be presented? Who will make these decisions? Whose voices will be heard in the decision-making process?

Viewing accounting and financial reporting as a dialogue and a relationship-building process precludes the narrow application of rules and guidelines as mere rationalizations. Accounting becomes a reciprocal discussion of ends, as well as means. Once this question of ends or purpose has been broached, students may be asked "what purpose drives the manager's decisions around accounting and financial reporting practices?" Answers may include:

- To insure the firm's financial survival;
- To stay within the law and regulations;
- To satisfy the financial market's need for information and/or to convince the market of the firm's continuing profitability;
- To generate information for internal evaluation, planning and performance review purposes;
- To maximize reported short term performance;
- To maximize reported long term performance;
- To manage reported performance to the benefit of individual career goals or performance-based compensation;
- To clearly disclose financial information to certain stakeholders;
- To manage information in a fashion to build and support the case for a desired outcome (i.e., desired impact on share prices, reassurance of bankers and other creditors, argument for annual performance goal setting and/or budget allocations).

Once such a list is generated, a number of observations become apparent. Many of these purposes contradict each other. Commitment to some of these purposes varies depending upon the point of view adopted: internal vs. external, lower vs. higher in the organization. And a fundamental conflict is revealed between a view of accounting and financial reporting as a tool for managing appearances as opposed to a tool for managing the substance of the firm's activities.

Because, as noted earlier, students' notion of "truth" is shaken by the complexity to which they are exposed in the course and because they see that appearances can often drive substance, students often retreat to the notion that appearances are all that one can control. However, by raising these conflicting notions of purpose at the start of the course, faculty can suggest a preemptive perspective, one that neither over-simplifies the notion of "truth" nor surrenders it altogether. That is, the very fact that the purposes of accounting may contradict each other, depending upon one's perspective and position, suggests the importance of viewing it as a dialogue and a decision-making process that is and must be continually questioning and remaking itself. This perspective underscores the role of openness and shared responsibility.

Perhaps an analogy may be useful here. One might reflect upon the changing role of physicians in the United States. Not too many years ago, the doctor was viewed as the revered and wise expert, with access to specialized knowledge and breadth of experience that the patient could not expect to fathom. The doctor's opinion was sought and followed, often without undue questioning. Times are changing, and individuals today often seek second opinions. They request and expect the doctor to share their information and experience, but to leave the final decision as to treatment up to the afflicted individual. The very fact that there are more options available to treat illness, as well as the increased sophistication of the consumer, has changed the way a responsible decision can be made. A careful and empathetic treatment is no less the physician's responsibility today than it was twenty or thirty years ago, but the method for achieving that end has changed.

The goal or purpose of the physician's interventions may be ambiguous: is it to maximize the length or the quality of the patient's life? And as the patient becomes more sophisticated, he or she expects to determine that purpose. Nevertheless, the physician's greater knowledge and insight allows a measure of control -- and therefore responsibility -- over the determination of the treatment's purpose. The physician may respond to this principal/agent dilemma in a number of ways:

- Controlling the patient's information so as to assure a certain outcome, thereby implicitly, if not explicitly, assuming primary responsibility for the choice of treatment;
- Doing a "core dump" of information on the patient and leaving him or her to sort through it and come up with a decision about treatment options, thereby attempting to transfer responsibility for treatment choice onto the patient;
- Attempting to build an honest, reciprocal dialogue with the patient, sharing options, learning of the patient's priorities and fears, and sharing responsibility for the final decision.

Just as the last of these approaches most closely reflects the reality of the physician/patient relationship (responsibility is shared whether the physician likes it or not), it also offers an analogy to the manager's responsibility toward the accounting and financial reporting function. Few managers would adopt the second approach described above -- providing all data available to them to the firm's various stakeholders (bankers, shareholders, outside auditors, vendors, customers, etc.) -- for it represents a complete abdication of power and control. Many, however, attempt to take the first approach described, carefully monitoring and controlling the amount and form of information disseminated to each constituent, especially if the manager views his/her purpose as narrowly defined (i.e., individual career success, short-term profitability). The third option, however, may represent the most appropriate meshing of the shared responsibility and rights of managers and stakeholders.

If this reciprocal dialogue between manager and stakeholder is accepted as an appropriate and more realistic representation of the function of accounting and financial reporting, it becomes more possible for students to seriously propose and consider longer term considerations and fuller disclosure as reasonable decision-making criteria. The idea of establishing a constructive dialogue between manager and outside auditor, or between the firm and market analysts, becomes a viable option for discussion.

For example, take a look at a classroom discussion of "First National Bank Corporation," [See Appendix] a case study about a New England bank's effort to set the "right" Provision for Credit Loss in a climate of failing real estate loans. Students were torn between their sense that the real number was a good deal higher than the anticipated allowance, and their concern that reporting this figure would send negative signals to regulatory bodies and the market. A few brave souls tried to suggest that discussion with the auditing team, with the SEC, and with analysts might be the best way to address the conflict, but their comments ran counter to the prevailing conviction that information is to be held closely and that open communication leads inevitably to a loss of power, not a sharing of responsibility.

At the close of the class, the instructor did share with students some data revealing the actual size of the bad loan problem among New England banks at the time of the case – very large – and she noted that many banks did indeed step up to the line to report their concern. As she put it, "this was not a routine audit," indicating that this was not the problem of an individual bank and that therefore the consequences and the managerial options were broader than many students had realized. Nevertheless, the prevalent mood of the class had been one that emphasized the "risk" of open communication more heavily than the necessity.

If a context had been set from the beginning of the course in which accounting and financial reporting were seen as tools for building reciprocal dialogue, students may have been freer to seriously entertain an alternate vision of this case decision. Without this perspective, students are ultimately training themselves to limit their creativity, to distort their inventiveness, applying it in an effort to manage "appearances" in the service of a narrow definition of purpose.

The assumptions behind the reciprocal dialogue are useful within the firm as well. Rather than simply assuming that each manager will use whatever means necessary to advance his/her individual career potential (Dees and Crampton's "opportunists") at the expense of the firm and its other stakeholders, or that each manager will sacrifice his/her own aspirations for the good of the whole ("moral idealists"), this view of the accounting and reporting process assumes that most individuals are "pragmatists," who will behave in a morally desirable fashion if they believe that they are not being "suckers" by doing so. Reciprocal dialogue means that managers can name the mixed messages they may be getting from a corporate headquarters that says that, "We expect you to obey the rules, but remember that the most important thing is to make goal." The results of such a dialogue may be the redesign of the firm's incentive program, or the rethinking of the firm's budgeting process.

In other words, viewing accounting and financial reporting as a decision-making function which creates the opportunity/need for reciprocal dialogue and relationship building, makes it possible for students to conceive of their purpose in broader terms. They can begin thinking of this activity as more than just "window dressing" -- as one student termed it, and as serving ends more far reaching than their individual careers.

Teaching Pitfalls

In addition to narrow assumptions concerning the purpose of accounting and financial reporting, there are other common student assumptions that often undermine serious attempts at ethical discussion:

- **Competitiveness:**

For example, the definition of competitiveness as assumed by many students seems to follow the old joke about two lawyers pursued by a bear in the woods. One lawyer says to the other, "We'll never be able to outrun that bear," and the other replies, "1 don't have to outrun that bear; I just have to outrun you."

Implicit in this view of competitiveness is the assumption that the point of business is conquest, narrowly defined as outrunning the competitors. This model often results in the same kind of short-sighted, narrow conceptions of managerial purpose discussed above. For example, this line of thinking would argue that it is not necessarily important for R.J. Reynolds to deliver a quality product or to maintain good relationships with distributors, if they can manipulate the process of trade loading to record ever higher sales and revenues each quarter -- and thereby outperform their competitors.

It can be valuable to suggest an alternative model for competitiveness: that is, one based upon sustainability and/or excellence rather than merely "outrunning" the competition. An example which surfaced in an operations management discussion revolved around the issue of plant and process safety. Some students pointed out that the best safety record in a particular industry might be 80% safety or 20% injury rate over a specific span of plant operation; therefore, their performance benchmark could be 80% safety. But a senior executive who was a guest speaker in the class asserted that his goal would be 100% safety, because otherwise management was making plant injuries acceptable and actually limiting the imaginations of their workforce.

Naming that a more narrow definition of competitiveness prevents students from recognizing the broader consequences of their actions and from exercising their full potential for creativity and performance, is a useful corrective to this more "blindered" view. An instructor might ask: "If performance goals are defined narrowly, how many managers will think broadly about impact and innovation?" In the case of "R.J. Reynolds", an instructor might ask: "What kinds of performance measures and goals would encourage managers to think more broadly about the consequences of trade loading?"

- **False Dichotomies:**

One of the most stubborn underlying assumptions in student rationalizations of ethically questionable behavior is that their reasonable (and "pragmatic") aversion to self-destructive behavior serves as a justification for any behavior. For example, students will often cite an unforgiving market as the reason for all sorts of distortions in reporting and operating manipulations. If the market does not tolerate the trade-off of short term profits for long term gain in one instance, then this becomes an excuse to abandon the attempt to forge open, honest communications in any instance. This kind of false dichotomy -- between unquestioning moral idealism (e.g. total disclosure) and a suspension of any obligations at all is often the subtext behind student justifications for unethical behavior. However, these false dichotomies usually obscure a more complex reality (Martin, 1990).

For example, in the discussion of "First National Bank Corporation" mentioned earlier, some students pointed out that if the bank reported too large a provision for credit loss, they would call themselves into question by the bank regulators. Therefore, many students concluded that the "truth" just couldn't be told, and that was that. Somehow the potential shortage of assets and the impact upon all customers, as well as the bank in the longer term, just disappeared. A false dichotomy had been established: "tell the truth" and the bank is closed OR minimize the provision for credit loss and the bank survives. There was no sense that this was an inadequate resolution of an admittedly difficult dilemma. But the instructor was able to question this false resolution by naming the reality that was hidden by the false dichotomy: she simply but repeatedly asked, "So you would limit the credit loss provision to the number which would avoid scrutiny -- but what if it's really worse than that?" This comment suggested a "reality" beyond the reported numbers; it began to shake loose the rationalization that "we have no choice but to distort our reporting." It opened the door to further discussion of the consequences of this decision upon a wider group of stakeholders over a longer time period.

- **Myth of Objectivity:**

As mentioned earlier, quantitative data carries with it the aura of "objectivity" and the greater credibility that this aura brings. Although faculty strive to make visible the ways in which "the numbers" represent just as many subjective choices and interpretations as any qualitative argument, the numbers still do have a way of settling an argument. And educators still give off a lot of mixed messages. For example, when teaching the "R.J. Reynolds" case, the first ten or fifteen minutes of the class are spent laying out the quantitative mechanics of trade loading, illustrating how it affects the bottom line and how quickly its impact grows. There is a perfectly sound pedagogical reason for this strategy. Students have to understand the phenomenon before they can intelligently evaluate it. However, this exercise is often immediately followed by a discussion of materiality: is the effect of trade loading material or not? Implicit in this discussion, which takes considerable class time, is the assumption that materiality is an entirely objective question and that it alone is the key factor in determining the acceptability of this practice. If the discussion of materiality were preceded by a discussion of the impacts of trade loading on all stakeholders, the motives that drive it and the far and near term costs, materiality would be placed in a very different context when it was raised.

- **Disaggregation of Responsibility:**

In a case discussion of control systems for managing plant costs ("Worldwide Motor Company: Budgeting and Cost Control at the Chicago Engine Plant") [See Appendix], one student suggested that since his performance evaluation was based on cost variance, he would send his excess scrap to another product center so its cost would be held against her budget rather than his. The next student replied that although the prior student may not be concerned about the impact of costs upon her center or upon the firm as a whole, his plant manager certainly would be. Putting aside for a moment the questionable feasibility of such a scheme, it is useful to examine the underlying assumption of disaggregated responsibility (Reidenbach & Robin, 1990).

Commonly, when case issues become excessively complex, students will quite reasonably attempt to break the decision down into its component parts (Gambling, 1987). However, there is a tendency to limit one's focus of attention to those areas over which one has the most immediate control and by which one's career and compensation will be most directly affected. This is quite understandable: when circumstances feel overwhelming, people strive to simplify, and often (unconsciously or consciously) block out constituencies or factors which will not fit into their models.

Ethical discussions (because they frequently involve boundary spanning concerns and impact stakeholders beyond the borders of the function, division, or firm) often trigger this retreat to 'blindered" thinking. Everyone retreats to managing just that piece of the world that they believe they can control. It becomes the challenge for faculty to reveal the practical, as well as ethical, limitations of this approach and to provide a motive and a process for moving beyond it. In the case described above, the practical problems with the student's proposal, as well as the costs to the firm, are fairly easy to uncover. What may be more challenging and more motivating to this student, however, is to point out the flaws in his general approach. By attempting to control the cost management/performance system, he is in fact controlled by it. He has limited himself to a purely "reactive' stance, as opposed to a "learning" stance. So, for example, if the instructor attempted to raise this discussion of cost control systems to the level of purpose once again ("Why was this system designed? What behaviors are managers trying to encourage?"), students could look at the system as a tool for organizational learning and reciprocal dialogue, as opposed to simply a tool for monitoring and compliance.

- **Cynical = Smart:**

This assumption is often communicated through subtle signals of tone and humor. In a classroom environment where practicality and effectiveness are prized, ethical questions are often presented as constraints on action, a dreary list of "thou shalt not's." Thus it becomes important to counter these subtle messages in a variety of ways.

First, as mentioned earlier, the assumption of unethical behavior can be countered by sharing examples of effective managers who have made choices influenced by their sense of obligation and ethics. For example, in the discussion of the "First National Bank Corporation" case, some faculty made a point of sharing the fact that numerous banks in similar situations had, in fact, stepped up to the line and raised their provisions for credit loss when they recognized that their loan portfolios were in trouble.

Second, students don't have to "close their eyes" to the reality of "perverse incentives" that encourage behaviors that benefit an individual in the short term but harm the firm in the long term. Instead they can probe the motives for less than responsible managerial action in a particular case, but from the perspective of one who is motivated to design systems that will correct for these incentives.

For example, if control systems are to be viewed as a tool for organizational learning and reciprocal dialogue, managers require a willingness to adopt multiple perspectives. Take the case discussion of product cost control systems mentioned above: from the firm's perspective, the purpose of these systems is to control actual production processes, but from the individual manager's perspective the purpose may feel as if it is merely to manage the information reported to his/her best advantage.

Students can use these insights to design a control system that sends the most realistic and effective mix of signals. It becomes very important for instructors to take the discussion beyond the diagnosis of why managers behave in a short-sighted and even unethical manner to the question of "how can this be changed?" Asking this question allows the student to identify with a position of efficacy and action again, rather than with a stance of sanctimonious inaction. Additionally, it allows students to experience their recommendations of responsible and ethical management choices as deriving from savvy intelligence and an understanding of how the "real world" works, rather than from naiveté.

Red Flags

In the previous section, certain prevalent assumptions that tend to inhibit inquiry around ethical issues were identified, as well as some questions that can help to push past these barriers. What follows is a list of "red flags," behaviors that often trigger or announce the opportunity for unethical activity. By naming these behaviors when they arise in discussions and using the same language to refer to them each time they surface, faculty and students – and managers – can construct an explicit or implicit list of warning signals, indicators that extra caution and reflection may be required.[4]

[4] This approach is based upon a teaching plan designed by Thomas Bonoma, former professor of Marketing at the Harvard Business School.

Some of the "red flags" most commonly found in accounting and financial reporting situations include:

- **Addictive Cycles:**

There are reporting manipulations that, once accepted, become difficult to abandon because they create an ever escalating need to disguise the initial distortion. The trade loading in the "R.J. Reynolds" case is an example of such a behavior. People who may never have chosen or agreed to such actions initially may feel trapped into avoiding embarrassing consequences if the behavior is terminated.

- **Management by Exception:**

In the evaluation and discussion of management outcomes, there can be a tendency to limit oneself to the data most accessible and to be influenced by the format in which it is presented. Discussions of cases like "Worldwide Motor Company" can reveal the dangers of evaluating performance based solely upon comparisons with and divergence from the past performance or the projections for current performance (Cohen &Pant, 1988/89). Not only is the practice shortsighted from a competitive perspective, it provides opportunities and incentives for distorted reporting. The incentive to manage cost variances at any expense, cited above, is one example. The subtle encouragement to shift sales from one period to another, chronicled in the "Heinz" case, [See Appendix] is another.

- **Political Nature of Budgeting:**

An awareness of the accounting and financial reporting processes as a reciprocal dialogue helps to make more visible their political reality (Chua, 1986; Cohen & Pant, 1988/89). For example, the "First National Bank Corporation" case provides an opportunity to understand the pressures upon the outside auditors to please their client, as well as the pressures upon the internal controller to please the CFO. As noted in the discussion of cynicism above, it is essential to take this realization the next steps and ask, "What are the internal and external costs of ignoring this reality?" and "Given the political nature of this process, what steps can manager take to encourage and reward open dialogue?"

- **Short Term vs. Long Term:**

An obvious "red flag" for responsible and effective managers is short term thinking. The problem is that students will often note that there is little motivation to take the long view, if the immediate consequences will be negative and the decision-makers may well be long gone before the positive impact of their decision manifests itself.

There are several potential directions to take in response to this reasoning. One is to appeal to the broader definition of purpose which, by now, has been established through initial discussion and ongoing references as described above. A habit of looking at issues beyond individual career success is being established.

The other response is to once again break the frame of the assumed status quo, and ask, "How can this "perverse incentive" be changed? Are there rewards for effective long term management? Are there ways to effectively communicate one's reasoning and to enlist the intelligence and foresight of one's audiences?" In other words, examine the assumption that long-term management is not rewarded and that short-term management is not punished. Is this always true? Are there ways to break free of this constraint?

Conclusion

The fundamental challenge for faculty of financial reporting and managerial accounting is to communicate the degree to which accounting truth is constructed, without undermining the student's sense of responsibility for their role in that process. The challenge is to engender a constructive self-awareness rather than a destructive cynicism, a collective sense of responsibility rather than an individual retreat to manipulation.

Hundreds of hours of classroom observation have revealed a number of tactics that appear to satisfy this goal. Many of them have been discussed above and can be summarized as follows:

1.) Explicitly discuss and name the PURPOSE toward which the responsible and effective manager will apply the tools being taught. This discussion can occur at the broadest level at the start of the course, establishing a framework and a vocabulary (i.e.,"reciprocal dialogue") which can be echoed throughout the course.
2.) Explicitly name and QUESTION THE ASSUMPTIONS that underlie the most frequently heard rationalizations for ethically questionable behavior (i.e., disaggregated responsibility, false dichotomies). Asking students to name and prioritize the criteria they used to draw a certain conclusion, or to unpack the decision criteria embedded in a variety of student-generated plans-of-action can help to get at these assumptions.
3.) Develop a working list of RED FLAGS or dangerous situations where unethical behavior may be most likely to surface.[5] These situations or conditions can be noted, and followed with questions like: "Can this situation be avoided?" or "How can these conditions be changed?" or "What would it take for someone to make the 'right' decision under these conditions?" It is important to take students past the diagnosis to potential treatments, in an effort to leave them with a sense of empowerment rather than fatalism.
4.) Share POSITIVE MODELS of managerial decision-making, both in cases and in classroom summaries.
5.) Rather than focusing teaching plans around the question "to lie or not to lie" (with all the endless variations: "to smooth or not to smooth," "to disclose or not to disclose," etc.), the emphasis might be better placed upon examining complex managerial <u>motivations</u> and developing <u>implementation</u> plans to foster incentives for effective and responsible decision-making.

One of the most compelling observations taken from student discussions of ethical issues in the financial reporting and accounting field is the recognition that many students want to find ways to behave responsibly and ethically. They look to the class discussion and to the faculty member to be honest with them and to avoid facile sermonettes, but they also hope to find intelligent and savvy ways to begin to look beyond the past rationalizations for unethical behavior with which they are already only too familiar. Anticipating and recognizing the familiar forms that these rationalizations take is the best first step to deconstructing them.

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[5] "Appendix H: Good Practice Guidelines For Assessing the Rash of Fraudulent Financial Reporting" of the *Report of the National Commission on Fraudulent Reporting* (Exposure Draft, April 1987), includes a thorough list of factors in the internal and external environment of a firm which place it at risk for fraudulent financial reporting.

Appendix

First National Bank Corporation (A), #9-192-042 Barth ME, Nichols CA
First National Corporation, a major regional bank in the Northeast, must decide how large a provision for credit losses to accrue in its 1990 financial statements. The recession in New England has caused serious problems in its loan portfolio. Teaching Objective: Introduce concepts of allowance and provision for bad debts; present manager/independent auditor relationship; raise ethical issues about accounting judgments without clear answers and with important social effects.

First National Bank Corporation (B), #9-192-043
Barth ME, Nichols CA
Describes recent proposals to change bank credit loss accounting rules.

Harnischfeger Corporation, #9-186-160 Palepu KG
Presents an analysis of Harnischfeger's quality of earnings, and the investment potential of the company's stock in light of the company's turnaround strategy.

R.J. Reynolds Tobacco Company, #9-191-038 Bruns WJ Jr, Nichols CA
Following the company's purchase as a part of a leveraged buy-out, the new management team of R.J. Reynolds Tobacco Co. had to decide what to do about the build-up of excess inventory of its independent wholesale customers. The case introduces students to the problems that changing inventory levels can create in interpreting financial results. Also raises ethical issues about the effect of such practices on company management, investors, wholesalers, and ultimately customers.

Scovill, Inc.: Nutone Housing Group, 19-186-136 Merchant KA, Ferreira L
Describes a conflict between the corporate controller and a division president about labor standards which the division purposefully overstates so as to protect its margins. Illustrates the multiple roles of standards, and the roles of controllers and line management in resolving such conflicts.

Worldwide Motor Co.: Budgeting and Cost Control at the Chicago Engine Plant, #9-190—069 Dearden J
Describes the budgeting and cost control system that is used by an engine plant of a major automobile company.

H.J. Heinz Co.: The Administration of Policy (A), #9-382-034 Goodpaster KE, Post RJ
Relates the April 1979 discovery of improper income transferal practices used at the H.J. Heinz Co. Background data on the company is presented, along with a detailed description of the organizational practices, the management incentive system, and the corporate ethical policy then in use. Also contains an organization chart and financial data for the 1972-78 fiscal years.

H.J. Heinz Co.: The Administration of Policy (B), #9-382-035 Goodpaster KE, Post RJ
Summarizes the investigation conducted by outside legal and accounting firms under the Heinz audit committee. Improper practices were found at three of the five Heinz domestic divisions and at a number of foreign operations. Presents restated financial data for the period, filed by Heinz with the SEC. Summarizes the committee's assessment of contributing factors and its conclusions.

H.J. Heinz Co.: The Administration of Policy (C), #9-382-036 Goodpaster KE, Post RJ
Presents a condensation of the audit committee's recommendations for organizational and policy changes to help prevent a recurrence of improper income transferal practices used at the H.J. Heinz Co. The Supplement, H.J. Heinz Co., The Administration of Policy (D), presents a brief discussion of disciplinary action taken by Heinz with respect to personnel involved in improper income transferal practices.

Source: *Harvard Business School 1991-92 Catalog of Teaching Materials.*

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