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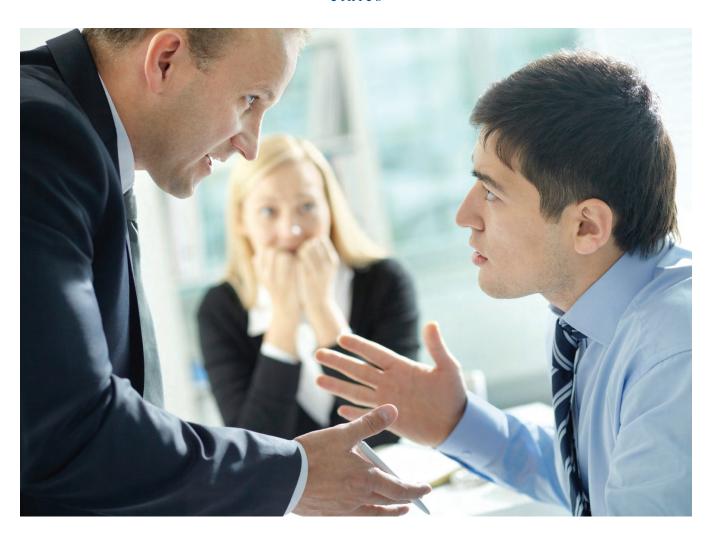Follow this and additional works at: http://ir.stthomas.edu/ocbacctpub

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Staff Auditors' Observations of Questionable Peer Behavior

The View from the Other Side

By Eileen Z. Taylor, Mary B. Curtis, and Lawrence Chui

Violations of audit standards threaten audit quality and increase litigation risk, while violations of workplace behavior lead to demoralization and employee turnover, a significant threat to CPA firms focused on attracting and retaining qualified and talented professionals. Identification of these activities can help managers understand which types of activities employees consider unethical. Knowledge of these activities can help management address employee concerns and work toward developing a positive organizational culture.

The study described below reported and classified public auditors' observations of unethical behavior within their offices. Of the 238 survey respondents, 66 reported observing 80 instances of unethical behavior. The majority of these behaviors were related to audits, but many were related to the workplace.

Observations

A second-year staff auditor—a new CPA—looks around to see who is watching before placing a page of uncleared review notes

in a client's shredder. Back at the office, a senior auditor receives an e-mail from a colleague containing a sexually offensive joke. Another staff person, working toward a promotion to manager, is staying late again; however, she won't record those extra hours because she has to come in under budget or risk a poor evaluation.

These examples are actual behaviors observed by audit staff in their workplaces. As members of a profession that has a primary responsibility to protect the public, auditors have an obligation to behave with the utmost integrity. But as employees working in a for-profit business, they are also subject to company pressures, organizational politics, and individual moral values. Violations of professional standards or company policies reduce effectiveness and efficiency and threaten a company's overall success. In addition, violations of professional standards reduce audit quality and increase litigation risk. Violations of company policy might lead to employee demoralization and increased turnover in the organization; this, in turn, drives up recruiting, training, and salary costs. Creating and maintaining an ethical workplace is critical, especially at a time when executives at large firms state that attracting and retaining talented professionals is what keeps them up at night (Ira Solomon, "Conversations with the Big 4 Accounting Firms' Chief Executives," *Current Issues in Auditing*, vol. 2, pp. C13–C27, 2008). In a recent ethics and compliance report, accounting firm partners and executives stressed the importance of integrating ethics in training and practice in order to attract and retain the best employees (*Speaking of Ethics: Ethics and Compliance Report 2010*, KPMG).

The sections below present practicing staff auditors' observations on behavior that they considered unethical—also called workplace deviance—within their own offices. For the past three years, this article's authors used an open-ended survey to ask 238 in-charge auditors to provide information about any unethical or questionable acts they witnessed within their firm. Of the participants, 66 (27.7%) reported 80 instances of unethical behavior, which fall into two broad categories: those related to audits and those related to the general workplace environment. While inappropriate audit behaviors were the most common issues identified (57.5%), workplace environment issues were also a major concern.

Furthermore, participants rarely reported their observations to firm management, despite the availability of an anonymous hotline. This lack of reporting is a concern, especially given the recent revisions to the NYSSCPA Code of Professional Conduct, which elevate integrity and due professional care of CPAs (Joanne S. Barry, "A Revised Code of Conduct for the New Law," *The CPA Journal*, September 2010). Unless managers make a concerted effort to identify these behaviors by encouraging auditors to report them early on, they might miss the opportu-

nity to address employees' concerns. With knowledge of the specific activities employees have identified, managers can more adequately address those concerns and build a positive organizational climate. In addition, management can implement more effective governance tools in order to reduce unethical behavior before it becomes an established norm in the organization.

On Ethics and Audit Firms

Within an audit firm, management is rightly concerned by the presence of dysfunctional or (audit) quality-threatening behaviors (QTB). These include, but are not limited to, insufficient audit evidence, inadequate documentation and review, violations of U.S. generally accepted auditing standards (GAAS) and U.S. generally accepted accounting principles (GAAP), truncating of small samples, false or premature sign-off, failure to do adequate research, and underreporting of time (Jean Bedard, Donald Dies, Mary Curtis, and J. Gregory Jenkins, "Risk Monitoring and Control in Audit Firms: A Research Synthesis," *Auditing: A Journal of Practice and Theory*, vol. 27, no. 1, pp. 187–218, 2008). In a 1990 survey of practicing auditors in the United States, Tim Kelley and Loren Margheim found that 54% of staff

auditors reported engaging in at least one of five QTBs on a specific, recent audit. The two most frequently reported acts were the acceptance of weak client explanations (33%) and the reduction of the amount of work performed on audit to below a reasonable level (31%) ("The Impact of Time Budget Pressure, Personality, and Leadership Variables on Dysfunctional Audit Behavior," *Auditing: A Journal of Practice and Theory*, vol. 9, no. 1, 1990).

QTBs are undoubtedly harmful. Lawsuits accusing CPA firms of violating professional standards negatively impact those firms—directly, via defense costs and fines, and indirectly, via reputation damage and time spent preparing a defense. Managers must realize that they significantly influence staff members' behavioral choices. Several research studies have found that auditors underreport time when pressured by management and also sign off on materially misstated financial statements to demonstrate their obedience to managers (Michael D. Akers and Tim V. Eaton, "Underreporting of Chargeable Time: The Impact of Gender and Characteristics of Underreporters," *Journal of Managerial Issues*, vol. 15 (spring), 2003; Lawrence A. Ponemon, "Auditor Underreporting of Time and Moral Reasoning: An

Experimental Lab Study," *Contemporary Accounting Research*, vol. 9, no. 1, 1992).

While management plays a role in perpetuating or preventing QTBs, a deficient workplace environment can also result in employee QTB. Employees who are satisfied with their work environment exhibit high organizational commitment, which results in belief and acceptance of the organization's values and willingness to work hard for the organization. Workplaces that contribute to low organizational commitment might result in auditors shirking audit steps or putting forth reduced effort on audit engagements. U.S. accounting professionals' organizational commitment is positively related to a principled ethical climate, one in which members look to rules and codes for guidance when faced with an ethical dilemma (John Cullen, K. Praveen Parboteeah, and Bart Victor, "The Effects of Ethical Climates on Organizational Commitment: A Two-study Analysis," *Journal of Business Ethics*, vol. 46, 2003). Thus, because workplace behavior can impact QTB, it is important to be aware not only of audit-related unethical behaviors, but also of workplace-related behaviors that might be perceived as unethical.

This study examined ethics in audit firms from the perspective of staff and senior-level auditors. By being aware of the concerns of those at the staff level, management can develop improved strategies for addressing such issues before they become part of the firm's culture.

Data Collection

Over a three-year period, the authors surveyed 238 senior-level auditors at various continuing professional education (CPE) and training sessions held by the Big Four, representing CPA offices located throughout the United States. Session topics primarily focused on audit and financial accounting issues. Participants did not receive compensation for completing the paper-based survey, and all responses were anonymous. Participants answered the following open-ended question, and provided demographic data at the end of each CPE session:

Have you ever faced a situation at work in which you observed unethical behavior? If so, please write a few lines describing the situation and the

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EXHIBIT 1
Descriptive Statistics

Panel A: Continuous Variable:

	Mean	Std. Deviation	Range
Age	27.20	3.00	21–41

Panel B: Dichotomous Variables:

	Male	Female
Gender	57%	43%
	U.S.	International
Birthplace	84%	16%
Education	94%	6%
Ethics Training:	Yes	No
CPE	83%	17%
College Section	66%	34%
College Course	68%	32%
CPA Certified	55%	45%

actions you did/did not take. (Remember, this survey is anonymous so please do not include any identifying information, especially the names of clients or individuals.)
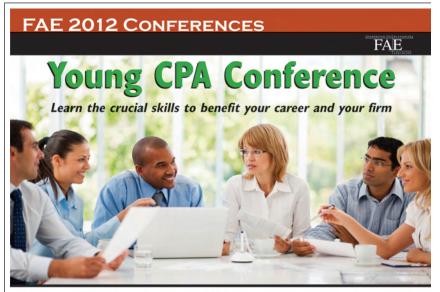
As shown in *Exhibit 1*, the average participant was 27.2 years old, which indicates that respondents have pursued a traditional career path, entering public accounting directly after college. The sample was 57% male. For the most part, participants were either born (84%) or educated (94%) in the United States, eliminating the ability to investigate cultural differences in this study.

Nearly all participants (94%) indicated that they previously had some ethics training. The most common form of ethics training was CPE (83%), followed by a college course (68%) and a section of a college course (66%). CPAs comprised a slight majority of participants (55%); one was a certified management accountant (CMA), and no respondents were certified internal auditors (CIA) or certified financial examiners (CFE). With respect to the low percentage of respondents with a CPA license, the authors have observed that many accountants who graduated in the years following the Sarbanes-Oxley Act of 2002 (SOX) delayed taking the CPA exam because they had such a high workload. In more recent years, more students appear to be taking the exam earlier. Over the three-year period, the percentage of auditors reporting observations of unethical behavior increased. In the first year, 24% of participants reported observing unethical behavior; reports increased to 28% and 36% in the second and third years, respectively. This trend could indicate that unethical behavior is increasing, but it could also suggest that more auditors are less willing to overlook unethical behavior in the workplace. (For an in-depth discussion about the potential causes of workplace deviance in public accounting, see Ronald Jelinek and Kate Jelinek, "Auditors Gone Wild: The 'Other' Problem in Public Accounting," *Business Horizons*, pp. 223–233, 2008.)

Based upon an analysis of the reported observations, the authors identified two distinct categories of behavior: audit-related and general workplace environment. These behaviors were then grouped into several distinct types. The first category, audit-related behaviors, includes behaviors that directly influence audit quality—that is, they violate audit standards, company policies or procedures about auditing processes, or the AICPA Code of Professional Conduct. The two types within this category are audit steps and auditor review. Audit steps are nonsupervisory actions undertaken by an audit team member, such as skipping or falsifying audit steps, or other activities that endanger audit quality, such as violations of independence. Auditor review violations relate to supervisory activities completed on the audit and include actions of in-charge individuals, managers, and partners in assigning tasks, supervising staff, and reviewing audit workpapers.

The second category, general workplace environment, includes all activities that do not directly affect audit quality, such as interpersonal issues, violations of company policies related to general business activities, and official or nonofficial norms that could create a hostile work environment or lead an individual to violate standards, procedures, or codes. This study identified three types: gossip/morale, employee fraud, and sexual harassment. Gossip/morale issues include interpersonal events or activities that influence the morale of an audit firm's members. Employee fraud includes actions that arise from intentional dishonesty for personal gain, such as misappropriation of assets, stealing, fraud, or lying about activities not directly related to audit quality. Sexual harassment is defined as "unwelcome sexual advances, requests for sexual favors, and other verbal or physical harassment of a sexual nature" (U.S. Equal Employment Opportunity Commission, http://www.eeoc.gov/laws/types/sexual_harassment.cfm).

Findings

The authors reviewed auditors' responses to the open-ended question that asked them to describe any "situation at work in which you observed unethical behavior." The responses were independently coded according to the mutually exclusive categories described above.

Audit-related behavior. Panel A of *Exhibit 2* includes frequency counts by category; respondents identified audit-related issues most frequently, accounting for more than half of the reported observations (57.5%). Panel B provides frequencies by type. The majority (58.7%) of reported audit-related behaviors were classified as skipping audit steps. Audit review violations accounted for the remaining 41.3% of audit-related behaviors.

The excerpts below provide additional details about the observed audit-related behaviors. The quotes are generally representative of comments made; to avoid applying their own value judgments, the authors used no materiality or weighting standard in their choices.

The following comments are examples of issues related to audit steps:
■ "On a senior/manager/partner level, I have noticed some rare instances where a senior/manager needs to make a deadline and will skip procedures detailed in the audit program."

■ "I feel that at times employees have [recorded] procedures that were not performed."
■ "I've seen some people add documentation to a file post-filing the binders, but it was nothing unethical, just late documentation on audit work performed prior to issuing the reports."
■ "If you consider employees soliciting job offers from clients unethical, then yes. If not, then no."

The following comments are examples of issues related to auditor review:
■ "Managers/partners indirectly encouraging people to 'eat time' by not charging hours."
■ "Manager prepared a document and asked associate to sign off as if she were the preparer."

Gossip/morale. In the general workplace environment category, the most commonly identified issue was gossip/morale, representing over half (55.9%) of all responses. Several responses related to affairs between co-workers; the authors classified such affairs as gossip/morale because the responses suggested that they were perceived as such by observers. Although not prohibited by most firms' policies and not a violation of professional standards, auditors perceived these affairs (or their related effect) as unethical behavior. As before, comments were chosen based on general representativeness, without consideration of materiality.

The following comments are examples of issues related to gossip/morale:
■ "The married partner and the engaged manager were obviously having an affair, which was affecting team morale."
■ "This person appears to have [been] seen having a relationship with a co-worker."
■ "I noticed that if one gets a bad assessment, immediately all the people in the office talks and knows about it, although it should be kept with some kind of privacy, and it starts a snowball because people already have a bad opinion about you, and they won't give you fair chance, while they're also not helping."
■ "I have witnessed prejudicial behavior amongst co-workers (i.e., racist comments, etc.)."

Employee fraud. Employee fraud represents 20.5% of general workplace environment issues reported by participants. These issues relate to falsification of training, expense reports, and time reports. The

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EXHIBIT 2
Frequency of Observed Unethical Behavior by Category and Type

Panel A: Category

	Count	Percentage of Total
Audit-related	46	57.5%
General Workplace Environment	34	42.5%
Total	80*	

Panel B: Type

	Audit-related	General Workplace Environment
Audit Steps	27	
Auditor Review	19	
Gossip/Morale		19
Employee Fraud		7
Sexual Harassment		8
Total	46	34

* Note: There were 66 respondents but 80 total responses because some individuals provided multiple responses.

following comments are examples of issues related to employee fraud:

■ "Other than minor incidents of skimming through [training assignments] and other training things. No big deal breakers."

■ "Roommate at training a few years ago charged through cab fare for a ride he did not take to pay for a more expensive dinner."

Sexual harassment. Sexual harassment issues represent 23.5% of general workplace cases and relate directly to unwanted conduct based on gender. While these incidences can certainly affect morale, they can also subject the firm to legal liability and regulatory action. Issues included sending inappropriate e-mails, viewing sexually explicit websites at work, and sexually harassing a female co-worker. The following comments are examples of those related to inappropriate behavior:

■ "Individual viewing inappropriate email/Internet content."

■ "Yes, a partner has hit on an associate of mine and said inappropriate things."

Recommendations

This study identified two types of unethical activities occurring within public accounting firms that accountants viewed as unethical. In a survey of public accounting audit seniors over a three-year period, approximately 28% reported observations of workplace wrongdoing. Behaviors ranged from the objective (e.g., excluding sample items) to the subjective (e.g., sexual harassment). Behaviors also differed in their potential effect on the firm's reputation and liability risk. Audit-related behaviors increase the risk of professional liability litigation, while general workplace environment behaviors lead to employee dissatisfaction and turnover, and possibly workplace rights litigation. In addition, workplace violations could ultimately lead to audit-quality problems because poor morale might lead to poor performance, and thus to increased risks of liability and regulatory action.

Public accounting firm managers can gain insight into these issues by identifying the types of questionable activities identified by their employees. Although confidentiality constraints render research on workplace wrongdoing difficult to perform, the available research suggests that audit firm managers can make a difference in the incidence and severity of such wrong-

doing by paying careful attention to policies and procedures for assessing, monitoring, and controlling the risk of violations of professional standards and human resource policies (Bedard 2008). Although not permitted by the limitations of this study's data, comparing observations across levels, geographic areas, firms, and client types might have provided greater insights.

> Clear policies, clear communications, and available reporting mechanisms should reduce unethical behavior over time.

Managers can also lower the negative impact of workplace wrongdoing by taking swift action when they become aware of wrongdoing and by clearly communicating to all employees the actions that were taken. Lastly, exit interviews, an often overlooked avenue for detective and corrective action, could provide an additional confidential information-collection point. These data could be the most effective method of identifying behaviors that have become entrenched; some behaviors become embedded in an organization's culture, which reduces the likelihood that normal governance measures will reduce the occurrence of those behaviors. Additional recommendations include developing and implementing a comprehensive training program for new and current employees that clarifies and provides examples about what behavior the organization considers wrong, and what to do if an employee observes those behaviors.

This study found that participants reported few of these activities to their firms' management and did not mention firm hotlines as an alternative for internal reporting, even though the participant firms' policies recommended these two solutions. By not reporting these activities, auditors can contribute to the creation of a new social norm within the firm, providing tacit acceptance of unethical behavior and reducing the likelihood that others will report observations of these activities. If these behaviors shape the firm negatively, high-quality auditors might choose to leave, rather than work in an organization whose professional values conflict with their own.

To address underreporting of observations, management must clearly communicate its expectations regarding the reporting of unethical behavior. To appeal to auditors with a strong professional identity, they can frame reporting as a professional obligation, rather than a disruptive action that results in retaliation or "bad feelings." Some research has found that hotlines do not need to be anonymous; as long as they protect the whistleblower's identity, auditors are as likely to report using an anonymous or protected hotline (Mary B. Curtis and Eileen Z. Taylor, "Whistleblowing in Public Accounting: Influence of Identity Disclosure, Situational Context, and Personal Characteristics," *Journal of Accounting and the Public Interest*, vol. 9, no. 1, 2009). Further study of the effectiveness of hotlines and employees' perceptions of them might provide greater insight into what encourages or discourages individuals from using them.

Clear policies, clear communications, and available reporting mechanisms should reduce unethical behavior over time. Swift and consistent responses will detect and correct unethical behavior before it becomes the norm, reducing firm risk and improving the workplace overall.

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