Excellence through Ethics

JA Titan

Junior Achievement®

ETE 2005 CONTENT.V8 4/26/05 10:09 AM Page 24

Ethics Activity 1

Overview

Students examine the accounting practices of businesses and learn why ethical standards are important for business people.

Objectives

Students will:

- review how businesses account for income and expenses.
- analyze ethical and unethical accounting practices.
- identify the consequences of unethical accounting practices for a business and its investors.
- recognize the importance of accurate financial reports.

Preparation

Student understanding of the concepts and skills found in *JA Titan*, is critical to the success of this activity. Review Activities 1-5 of *JA Titan*.

Review the activity and the list of materials, then discuss the activity with the teacher. Explain that the activity will involve small groups. Ask the teacher for help in dividing the class into groups of three. Note any modifications to the activity on the outline that follows it.

You will need to make 32 copies of Student Handouts 1 and 2. Students will need copies of their most recent round of *JA Titan* Company Reports. If your company or profession has a set of written ethical guidelines, bring enough copies for each of the students.

Write all key terms on the board.

Time

45 minutes. Ask the teacher to help you keep track of time.

Materials

- 32 Student Handout 1 (master included on Page 5)
- 32 Student Handout 2 (master included on Page 7)
- *JA Titan* Company Reports (ask the teacher to provide)
- 32 company ethical guidelines (optional, not included)

Presentation

Introduction

Greet the students. Tell them that today they are going to digress from the business simulation to examine some corporate activities related to financial reports.

Explain to the class that the vast majority of corporations and business executives engage in ethical or legal practices. However, there are some corporations that engage in unethical or illegal practices that have made the news because their activities were unusual.

Tell students that sometimes honest accounting mistakes can happen. Companies that make accounting errors are generally not engaging in practices established to intentionally mislead. There is a difference between honest mistakes and intentional fraud. Examples discussed in this activity are not the norm.

Ask students to name the two most important financial reports that a public corporation must periodically produce. Answers: balance sheet and income statement. What does the balance sheet show? Answer: It is a statement of financial position as of a particular date, showing assets (what it owns) and liabilities (what it owes). What does the income statement show? Answer: How much a business has made or lost over a period of time.

Ask students if they have heard about any large corporations accused of misleading the public about their income and expenses. Use your own professional knowledge to prompt or address student responses. They might also have heard of business leaders who allegedly redirected company money for their private use.

Ask what word we could use to describe business practices that mislead and perhaps harm others. Answer: Unethical, illegal. Remind students that unethical behavior is not always illegal behavior. For example, it is not illegal, while playing *JA Titan*, to shut off all expansion and research when you know the game is about to end. In a real business situation, however, such behavior is not advisable for the long term due to its impact on workers, managers, and investors.

Ask students if they know what was allegedly unethical about the activities of some companies in the news recently? Answer: Their financial reports did not present the complete picture of profits and losses to investors and employees. Ethical reporting must include any bad news along with the good. If honest mistakes are made on a financial report, one of the ethical things to do is issue a restatement.

What general criterion can we use to decide if an action is unethical? Answer: It’s meant to mislead or harm others who depend on its truthfulness or accuracy.

Activity

Separate the class into groups of three. Distribute Student Handout 1 and ask the groups to read the first three scenarios. The groups should keep the question, What's Wrong with That? in mind as they read each scenario. (Note: The correct answer may be that nothing is wrong.) Students should focus on who is hurt by the actions outlined in the scenarios, i.e., stockholders, employees, customers, the business, etc.

Walk around the room to help keep the groups on task and to answer any questions. When it seems that most of the groups have responded to three of the scenarios, call the class to order. Ask each group to select a spokesperson to report their decisions of why the actions described in the first three scenarios are ethical or unethical.

Now, distribute Student Handout 2. Explain that ethical decisions can be made by using ethical decision-making guidelines such as:

1. contrasting good character traits with self-awareness questions
   - good character traits are ethical values that guide choices in the search for what is good, right, and proper.
   - two questions help remind us that we are accountable for our actions.
2. using an ethical construct, a method that provides questions students can ask themselves when faced with an ethical decision:
   - Is your action illegal or unethical?
   - Are you being fair and honest?
   - Would you be unwilling or embarrassed to tell your family, friends, or co-workers?
   - Will you sleep soundly tonight?
   - Would you want to see it reported on the front page of a newspaper?
   - Could someone's life, health, or safety be endangered by your action?
   - Could the intended action appear inappropriate?

Have students use the guidelines in discussing the remaining scenarios. Walk around the classroom to make sure students are on task and using the ethical guidelines. Fifteen minutes before the end of class, or sooner if all the groups appear finished, call the class to order. Ask students if the activity was easier by using the guidelines. Ask them to explain why.

If time allows, discuss with the class whether the actions of the remaining scenarios were ethical or unethical.

Summary and Review

Ask students why they think a company would want to hide its true financial situation. Possible answers include the following:

- to attract investors and stock analysts and drive up stock prices
- ego gratification, life style maintenance, or résumé building for the firm's leaders
- once begun, hiding the truth becomes an end in itself to avoid detection

- to attract lending institutions

Remind students that good financial reports can tell a management team where their company stands. When these reports are published, investors, employees, customers, and potential investors count on them to be accurate so that they can make wise decisions.

What are the advantages of the ethical reporting of business and economic activity? Possible answers:

- an ethical company attracts investors
- an ethical company encourages favorable reports from stock analysts
- high ethical standards in a business attract and keep the best employees
- an ethical company enhances its brand and reputation in the marketplace
- managers and employees know the true condition of the company and can do what it takes to improve it
- an ethical company need not fear having its financial condition scrutinized

Presentation

Introduction

Review the functions of a corporation's balance sheet and income statement.

Discuss the unethical financial reporting of several major corporations in the news recently.

Remind students that the vast majority of corporations are ethical.

Activity

Distribute Student Handout 1; have students work in groups of three to answer, "What's Wrong with That?" for the first three scenarios.

Have each group explain whether the actions of the first three scenarios were ethical or unethical.

Distribute and discuss Student Handout 2. Have students review and discuss the remaining scenarios using suggested ethical decision-making guidelines.

Discuss the scenarios as a class; be sure to refer to Student Handout 2.

Summary and Review

Have students surmise why companies would choose to hide their true financial situation.

Emphasize the benefits to presenting an honest financial picture.

Student Handout 1

What's Wrong With That?

1. Your company signs a contract to provide a service. Though it has neither performed the service nor received any money from the contract, your company reports income from the contract to show investors higher earnings for this quarter.

2. Your company serves as a broker (similar to Telecharge) for tickets to entertainment and sporting events, for which it is paid a 15% commission on every ticket it sells. On its income statement, however, your company reports as income the full price of all the tickets it sells.

3. Your company appears to you to be overstating its profits. As Assistant Chief Financial Officer you know that your boss and the President probably do not want to hear it and that you may lose your job if you tell them the bad news. Then again, you might be able to persuade them to issue a restatement.

For the rest of these scenarios, your company creates other companies that are separate from (but still controlled by) your company. For convenience, let's give all of these newly created subsidiaries the same name: SUBCO (sub company)

4. Your company forms a partnership with another company to provide a service and agrees to a 50-50 split of the profits from the deal. Your company then creates SUBCO-1 to perform your company's end of the partnership and gets a bank to lend SUBCO-1 a lot of money based on the hoped-for future earnings. To get the loan, your company guarantees that the bank will get all its money back, even if SUBCO-1 and the partner are unsuccessful. Now, your company reports the entire amount of the SUBCO-1 loan as profit from its partnership.

5. Your company creates a company called SUBCO-2 and owns all of its stock. Your company also has a contract with SUBCO-2, saying that if SUBCO-2 stock prices fall, then SUBCO-2 will reimburse your company for the amount of the loss. If SUBCO-2 stock prices increase, your company reports a profit from the increased value of the SUBCO-2 stock it owns. If SUBCO-2 stock prices fall, your company reports a profit from its reimbursement contract with SUBCO-2 (without, of course, mentioning that it's your company's money that SUBCO-2 is using to reimburse your company).

6. Your company creates a company called SUBCO-3 and gives it an amount of your company's stock. In exchange for the stock, SUBCO-3 gives your company a "note receivable" (an IOU) for the value of the stock. Without mentioning the stock deal, your company records the full value of the "note receivable" as an "asset" on its books.

7. Your company has 10 obsolete PCs. It sells them to its own company, SUBCO-4, for $3,500 each and then decides to report the $35,000 as profit to your company. As a junior employee

in the accounting department, you bring this seeming error to the attention of your boss.

8. Your company encourages its employees to invest in company stock for their retirement. The company's financial reports look so good that many employees do so. Their purchases cause the company's stock prices to rise.

With the exception of scenarios 1 and 3, all of these scenarios are adapted from a PBS NewsHour with, Jim Lehrer report about Enron, "Accounting Alchemy," by Paul Solman (January 22, 2002).

Student Handout 2

Guidelines for Ethical Decision Making

Ethical decisions can be made by contrasting good character traits with self-awareness questions as you go through the steps for ethical decision making.

Good Character Traits in Ethical Decision Making:

1. Trustworthiness. People learn to believe in and admire us if we have such qualities as
   a. honesty in communication and conduct.
   b. integrity – we keep our word.
   c. reliability – we are consistent and dependable.
   d. loyalty to certain people or organizations.
2. Respect. We do unto others as we would have them do unto us.
3. Responsibility. We are accountable for what we do and who we are.
4. Fairness. We follow a balanced standard of justice without reference to our own biases or interests.
5. Caring. We have concern for the welfare of others.
6. Citizenship. We follow the law and do more than our "fair share" to make society work.

*The above guidelines were adapted from Making Ethical Decisions, by Michael Josephson, and Auditing and Assurance Services, by Dr. Jack C. Robertson and Dr. Timothy J. Louwers.

Self-Awareness Questions for Ethical Decision Making:

- What written or unwritten rules should determine my behavior?
- What are the possible consequences of my choices? *

Another method that can be used to make ethical decisions is called an ethical construct. This method provides you with questions you can ask yourself when faced with an ethical decision.

- Is you action illegal or unethical?
- Are you being fair and honest?
- Would you be unwilling or embarrassed to tell your family, friends, or co-workers?
- Will you sleep soundly tonight?
- Would you want to see it reported on the front page of a newspaper?
- Could someone's life, health, or safety be endangered by your action?
- Does the intended action appear inappropriate?