

PAC INVITED CONFERENCE
CORPORATE MISCONDUCT, FRAUD &
WHISTLEBLOWING

June 3, 2022

CEO Oath and Corporate Misconduct

Discussant: Kyle Welch

George Washington University



Professional Accounting Centre

UNIVERSITY OF TORONTO

MISSISSAUGA

When Executives Pledge Integrity: The Effect of the Accountant's Oath on Firms' Financial Reporting

Kyle Welch

George Washington University



Dutch News Pre 2016

- Royal Ahold 2003
- Vestia 2012
- DSB 2010
- Weyl 2013
- SNS Reaal 2015
- Imtech Ballast Nedam 2015

COMPANY NEWS MAY 12, 2014 / 9:18 AM / UPDATED 8 YEARS AGO

Royal Ahold settles accounting fraud lawsuit for \$297 million

Published May 21, 2014



Dutch head of KPMG resigns amid criminal investigation



AUDIT & ACCOUNTING TAX TECHNOLOGY PRACTICE MANAGEMENT MORE
INTERNATIONAL ACCOUNTING

Voices Dutch Accounting Firms Look to Improve Tarnished Rep

By [Michael Cohn](#) August 28, 2015, 3:35 p.m. EDT 2 Min Read

European companies + Add to myFT

FINANCIAL TIMES

Bank's downfall opens old Dutch wounds

Matt Steinglass in Amsterdam and Alex Barker in Brussels FEBRUARY 21 2013

A Dutch crown jewel tarnished

The accounting scandal at Royal Ahold, a giant Dutch food retailer, further undermines the idea that continental European capitalism is more reputable than the transatlantic variety

Feb 28th 2003 (Updated Feb 27th 2010) |

The Economist

The FCPA Blog

News and commentary about white-collar crime, enforcement, and compliance
KPMG pays €7 million to settle Dutch bribery case

Geert Vermeulen January 13, 2014 8:58 am



MERGERS & ACQUISITIONS | INVESTMENT BANKING | PRIVATE EQUITY

DSB Bank Goes Bust

BY DEALBOOK OCTOBER 19, 2009 6:42 AM

Dutch Response (1 of 2)

- *“In spring 2014, as a result of these scandals, the Dutch parliament conducted a debate on accountancy and audit. There was a lot of anger: the view was that the profession was motivated by profits alone, to the detriment of their duties. “It was front-page news. The Minister of Finance at that time said: ‘this has to stop’. During a public Finance Committee meeting, the Minister of Finance addressed attendees from the profession and told them they had five months to come up with a reform plan.”* <https://www.icaew.com/insights/viewpoints-on-the-news/2021/april-2021/how-the-profession-won-back-trust-in-the-netherlands>
- Dutch Minister of Finance delivered an ultimatum to the audit profession that they needed to improve their business practices. *“You reform your profession or we will do it for you.”*

Dutch Response (2 of 3)

- Reform plan created by Nederlandse Beroepsorganisatie van Accountants (NBA) and accounting firms



- “And where in the first instance [of accounting professional problems] this appeared to be a case of isolated incidents, the linking together of these indicated a structural problem. This assumption was emphatically confirmed by the AFM reports of recent years, in which sector-wide shortcomings in audit quality were discovered.”
- In a 2014 Authority of Financial Markets (AFM) report *45% of audits reviewed were inadequate*—insufficient documentation of audits, insufficient collection of audit evidence, insufficient audits of internal controls, insufficient examination of accounting fraud red flags, and insufficient skepticism towards management’s reporting choices.

Dutch Response (3 of 3)

IN THE PUBLIC INTEREST

MEASURES TO IMPROVE THE QUALITY AND
INDEPENDENCE OF THE AUDIT IN THE NETHERLANDS

- Proposed **53 measures** in the Autumn of 2014.
 - 1.1 *"The profession is introducing a professional oath for accountants. The oath will be taken at the time of registration in the accountants' register."*
 - Silvia Gawronski calls it a [finishing touch](#) *"an oath can be useful in this respect, but as part of a broader context. This was lacking in the bankers' oath, whereas the accountants' oath is not an end in itself, as can be seen, for instance, in the sector plan of September 2014 containing 53 proposed measures, of which the oath is only one."*
- Measures were accepted by the profession and parliament. Some of them were transferred into legislation, with a period of three or four years to implement.
- Several monitoring groups were put together to keep track of progress, both inside the profession and from the Dutch regulator.

First Concern—Diff-in-Diff (1 of 3)

Regulation is not created in a vacuum

- Variable of interest is **one of 53 measures** used to reform the profession implemented over the same period.
 - This is a period of hyper reform in the culture of accounting and the oath is not the only event happening.
 - Many additional efforts implemented around the same time, likely to impact dependent variable in the same way.
- Use of SPE or accruals after Enron and WorldCom
- Do auditors taking the oath not matter? If oaths matter, we might not see any response because of auditors. “That’s why we do a diff and diff?” My point is the Auditors are part of both subgroups being tested, an odd situation for a diff and diff because it is accounting CEO+CFO+Auditor vs. Auditor taking the oath. Would an oath have prevented ArthurAndersen?

First Concern—Diff-in-Diff (2 of 3)

CEO and CFO that don't take the oath as a control

- These are the CEOs and CFOs less likely to know and navigate the widespread accounting reform. They are also those whose vocational reputation is not being attacked.
- Those with an accounting background have an accounting identity that are likely wanting to be favorable—thus they are likely to be impacted by this WAVE of reforms—not just the oath.

Placebo test & Abnormal discretionary accruals

- Doesn't solve this problem

Propensity score matched sample

- Doesn't solve this problem as currently constructed.
- There are only 3 Inactive CPAs + 15 with “business background” in control
- I would say an “C” suite exec would have a “business background.” This measure is not well defined and has questionable assumptions. Does Bill Gates, Steve Jobs, or Elon Musk not have a “business background”?

First Concern—Diff-in-Diff (3 of 3)

Solutions:

- Creative cross-sectional tests
 - Detail of variation in oath ritual (think weddings)
 - Compensation or wealth
 - Age, culture, religiosity, tenure
 - Accounting instruction/inactive
 - Was there an increase in lapsed license because of oath?
- Supplement with other oath opportunities
 - Dutch banker oath?
 - Get data from MBA Oath movement
 - Philippines and Singapore
 - Reach out to National Association of State Boards of Accountancy
 - <https://nasba.org/stateboards/>
 - North Carolina CPA <https://www.ncacpa.org/cpa-oath/>
 - Maryland CPA <https://www.macpa.org/oath-an-exclamation-point-on-new-cpas-milestone/>

Academic Push for Vocational Oaths

Make sure you are very clear about what has been done and what you are doing.

Use precise words and clear description of what we know.

Calls for vocational oaths

- MBA Oath movement (<http://mbaoath.org/>)
- Khurana, R., Nohria, N., 2008. It's time to make management a true profession. *Harvard Business Review*.

Claims about vocational oaths

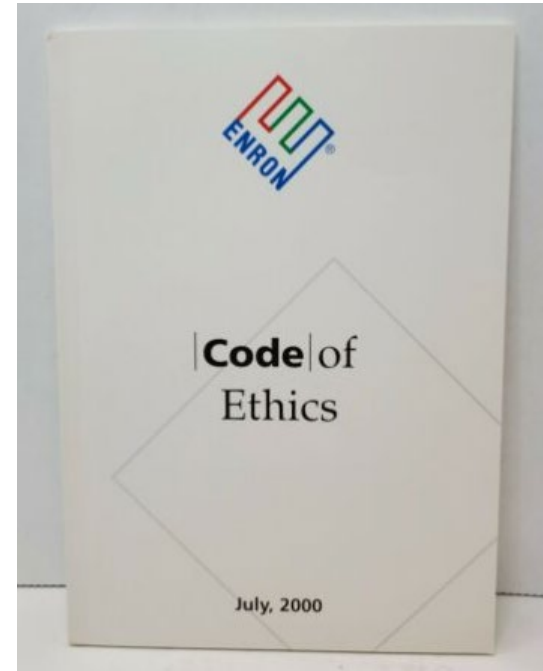
- Cialdini, R. B. and Trost, M. R., 1998. Social influence: Social norms, conformity and compliance. In D. T. Gilbert, S. T. Fiske, & G. Lindzey (Eds.), *The Handbook of Social Psychology*, 151–192. McGraw-Hill.
- Gino et al. 2009?

Very little can be said about the impact of vocational oaths—that is great for your paper. Any result you get matters! I.e., If an oath doesn't work—that is also important to know. Embrace descriptive nature.

Why an Oath

Why not a code of conduct?—not much showing that codes of conduct work

- Companies have values posted on the walls. They talk about them, use them in training.
 - Kaptein, Muel, and Mark S. Schwartz. "The effectiveness of business codes: A critical examination of existing studies and the development of an integrated research model." *Journal of Business Ethics* 77, no. 2 (2008): 111-127.
- Companies have values posted on the walls. They talk about them, use them in training. Verbalize them.



Zingales (2015) Gary Becker on amoral students. "He attributed this to the fact that—in spite of the teacher's intentions—they took Becker's (1968) descriptive model of crime as prescriptive. We label as "irrational" not committing a crime when the expected benefit exceeds the expected punishment. Most people call this behavior moral. Is being agnostic subtly teaching students the most amoral behavior, without us taking any responsibility?"

The Dutch Oath

of I am aware that as a professional accountant I am bound to act in the public interest. I will exercise my profession with an attitude of professional skepticism. When exercising my profession as a professional accountant I am guided by fundamental principles of Integrity, objectivity, professional competence, and due care and confidentiality. I will comply with the laws and regulations applicable to my profession. My professionalism implies that I will not execute any acts of which I know or ought to know that these could bring the accountancy profession into disrepute. **So help me God / I promise / I declare.**

- Large meeting with multiple people making a promise
- Done once

What Makes an Oath Different?

- What is it about an Oath that could make it more powerful? Why is it different from corporate ethics or values? Sense of identity? Deity involvement?

- Boy Scout Oath



- Religious rituals

- Also leveraged against religious groups

- Bosley, S., & Knorr, M. (2018). Pyramids, Ponzis and fraud prevention: Lessons from a case study. *Journal of Financial Crime*.
- Levi, M. (2008). Organized fraud and organizing frauds: Unpacking research on networks and organization. *Criminology & Criminal Justice*, 8(4), 389-419.

Second Concern/Solutions—Oath (1 of 3)

What do we know about people that commit accounting crimes

They typically don't see what they are doing as wrong?

Especially in Accounting.

- <https://www.youtube.com/watch?v=qo5SJgKdkBQ>

Second Concern/Solutions—Oath (2 of 3)

How does oath help? Nature of an oath. What is causal? Individual demographics

Motivated by unwritten contracts and eternal truth (i.e., not relative truth or relative values)

Is there anything that would make it more significant? Is there a way we could measure the significance of the oath by individuals?

- Nature of ritual (think wedding)
- Distance to travel for ritual (think pilgrimage to mecca)
- Location of ritual (conducted in a location of significance)
- Time taken to complete oath (3-year window)
- How busy are they

Second Concern/Solutions—Oath (3 of 3)

Current evidence does not convince me that a one-time oath would impact this behavior as the single causal factor as this paper argues.

Especially since the Dutch oath is not that significant of an oath

Solutions:

Creative cross-sectional tests that line up with understanding of rituals and oaths

- Nature of ritual (how grand is it? “So help me God / I promise / I declare”)
- Distance to travel for ritual
- Location of ritual
- Time taken to complete oath (3-year window)
- How busy are they when they take the oath (i.e., M&A deals)

Third Concern Capturing Accounting Fraud

What is the moral view of aggressive accounting accruals?

What is the moral view of real-activities management?

Performance pressure is most likely to be captured in a meet or beat measure or with close covenant violations

- The current measure (Negative ROA or loss) could be doing the opposite by having accountants have a big bath during times of pressure.



Thank You