JOURNAL OF LEGAL, ETHICAL AND REGULATORY ISSUES

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# TABLE OF CONTENTS

EDITORIAL REVIEW BOARD.................................................................iii

PAY SECRECY: LEGAL, POLICY, AND PRACTICE ISSUES FOR EMPLOYERS..........1
    Gerald E. Calvasina, Southern Utah University
    Richard V. Calvasina, University of West Florida
    Eugene J. Calvasina, Southern University

RELIGIOUS ORGANIZATIONS AND THE ANNUAL COMPLIANCE REPORTING
EXEMPTION .............................................................................................11
    Raymond J. Elson, Valdosta State University
    Maurie Tarpley, Valdosta State University

CHEATING: STUDENTS AND FACULTY’S PERCEPTION ON POTENTIAL
CHEATING ACTIVITY ..............................................................................21
    Laurent Josien, SUNY Plattsburgh
    Eugene Seeley, Utah Valley University
    James Csipak, SUNY Plattsburgh
    Rohit Rampal, SUNY Plattsburgh

HARMONIZING COMPETING LEGAL THEORIES IN PATENT LAW, ANTITRUST
LAW AND THE FIRST AMENDMENT .........................................................39
    Michael O’Brien, Saint Mary’s College of California

CORPORATE SOCIAL RESPONSIBILITY AND CONFLICTING STAKEHOLDER
INTERESTS: USING MATCHING AND ADVOCACY APPROACHES TO ALIGN
INITIATIVES WITH ISSUES........................................................................55
    Zinaida Taran, Penn State Harrisburg
    Stephen Betts, William Paterson University

SUSTAINABILITY IS APPLIED ETHICS.......................................................63
    Sharon S. Seay, University of West Georgia

THE TALE OF TWO CFOS: THE BANALITY OF WRONGDOING AT HEALTHSOUTH
CORPORATION .......................................................................................71
    Robert W. Armstrong, University of North Alabama
    Dennis R. Balch, University of North Alabama

THE EFFICACY OF VOLUNTARY DISCLOSURE: A STUDY OF WATER DISCLOSURES
BY MINING COMPANIES USING THE GLOBAL REPORTING INITIATIVE
FRAMEWORK ..........................................................................................87
    Philip Dennis, University of Idaho
    Heidi Connole, Eastern Washington University
    Marla Kraut, University of Idaho
ACCOUNTING MAJORS’ PERCEPTIONS OF THE ADVANTAGES AND DISADVANTAGES OF SUSTAINABILITY AND INTEGRATED REPORTING

Marianne L. James, California State University

AN INVESTIGATION OF MANAGEMENT ACCOUNTANTS’ EXPERIENCE WITH ETHICAL DILEMMAS INVOLVING FINANCIAL REPORTING AND EMPLOYEE SUPERVISION

Timothy L. McCoy, Lamar University
PAY SECRECY: LEGAL, POLICY, AND PRACTICE ISSUES FOR EMPLOYERS

Gerald E. Calvasina, Southern Utah University
Richard V. Calvasina, University of West Florida
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ABSTRACT

On April 8, 2014, President Obama issued an Executive Order amending Executive Order 11246 of September 24, 1965 prohibiting federal contractors from retaliating against employees for disclosure of compensation information (Obama, 2014). Executive Order 11246 covers employees who work for service and supply contractors and construction companies covered by Office of Federal Contract Compliance Programs (OFCCP) regulations that apply to federal government contracts. The Executive Order was heralded by organizations like the National Women’s Law Center as “an end to pay secrecy gag rules for employees of federal contractors” (Watson, 2014). It was characterized by others as “unnecessary” given long standing protection afforded to employees covered by the National Labor Relations Act (NLRA) (Smith, 2014, A). Pay secrecy has often been characterized as a “contentious” issue in many organizations and President Obama’s recent executive order has rekindled the debate as to the utility of pay secrecy policies and rules in organizations. This paper examines recent legal, policy, and practice issues for employers covered by the National Labor Relations Act regarding the use of pay secrecy policies and, recommendations to reduce employer exposure to litigation.

INTRODUCTION

President Obama’s amending of Executive Order 11246 in April of 2014 continued to stoke the long running debate over the use of pay secrecy policies by organizations. The pay secrecy issue has been often characterized as “contentious” (Colella, Paetzold, Zardkoohi & Wesson, 2007) and (Gely & Bierman, 2003) and the long run nature of the debate surrounding the issue has been traced back to Matthew 20: 1 – 16 and the parable involving laborers complaining about their rate of pay (Gely & Bierman, 2003). The long debate over the utility of the issue has come from many different perspectives. In the review by Colella et al. the authors identified “arguments” based on management, economics, psychology, and cultural perspectives. They also noted that there has been limited empirical and scholarly research on pay secrecy and “that most of what we thought we knew about pay secrecy was anecdotal” (Colella, Paetzold, Zardkoohi, and Wesson, 2007, p. 67). There does seem to be consistent survey research supporting the reported wide spread proliferation of both formal and informal pay secrecy policies in the private sector of the economy (Gely & Bierman, 2003 and Hayes & Hartmann, 2011). Hayes and Hartman reported on the Institute for Women’s Policy Research/Rockefeller Survey of Economic Security in 2010 that “about half of all workers” reported “that the discussion of wage and salary information is either discouraged or prohibited and/or could lead to punishment” (Hayes & Hartmann, 2011).

Colella et al. in their review of the literature identified negative and positive aspects associated with pay secrecy policies. On the negative side, citing limited empirical research, Colella et. al. reported that pay secrecy is generally “bad for organizations, also
demonstrating lowered motivation” (Colella, Paetzold, Zardkoohi & Wesson, 2007). Another often heard negative aspect associated with pay secrecy is that it may facilitate employers’ efforts to conceal discriminatory pay practices (Colella, Paetzold, Zardkoohi & Wesson, 2007; Obama, 2014). If “employees are prohibited from inquiring about, disclosing, or discussing their compensation with fellow workers, compensation discrimination is much more difficult to discover and remediate, and more likely to persist” (Obama, 2014).

With respect to positive aspects associated with pay secrecy, Colella et al. identify survey efforts “asking how people feel about pay secrecy” reporting that “the majority of U.S. workers are in favor of it” (Colella, Paetzold, Zardkoohi & Wesson, 2007, p. 56). They also noted that organizations are aware of the potential illegality of pay secrecy, that many organizations still utilize both formal and informal methods to promote it, and that “individual employees and many organizations find pay secrecy useful and desirable” (Colella, Paetzold, Zardkoohi & Wesson, 2007, p. 56).

Gely and Bierman also cited survey data from a variety of sources that support the wide spread use of pay secrecy rules by a “significant number of private sector employers in the United States” (Gely & Bierman, 2003, p. 122). They also noted that pay secrecy and confidentiality rules are “quite prevalent despite the fact that they have consistently been held by both the National Labor Relations Board (“NLRB” or “Board”), and the federal courts as violations of Section 7 of the National Labor Relations Act (“NLRA” or “Act”)) (Gely and Bierman, 2003, p. 123). Section 7 of the National Labor Relations Act (NLRA) applies to employers engaged in interstate commerce.

The National Labor Relations Board (NLRB), the federal agency that enforces the NLRA, has adopted a dollar amount of business standard to determine which employers are covered by the statute. For example, employers in retail business that have a gross annual volume of business of $500,000 or more are under the NLRB’s jurisdiction (NLRB, 2014, A). Employers excluded from the NLRB’s jurisdiction by statute or regulation include federal, state and local governments, including public schools, libraries, and parks, employers who employ only agricultural laborers, and those engaged in farming operations that cultivate or harvest agricultural commodities or prepare commodities for delivery (NLRB, 2014, A).

Employers subject to the Railway Labor Act including interstate railroads and airlines are also not subject to NLRB jurisdiction. While most employees in the private sector are covered by the NLRA, the Act specifically excludes individuals who are:

- employed by Federal, state, or local government
- employed as agricultural laborers
- employed in the domestic service of any person or family in a home
- employed by a parent or spouse
- employed as an independent contractor
- employed as a supervisor (supervisors who have been discriminated against for refusing to violate the NLRA may be covered)
- employed by an employer subject to the Railway Labor Act, such as railroads and airlines
- employed by any other person who is not an employer as defined in the NLRA (NLRB, 2014, A)

The purpose of this paper is to examine recent legal, policy, and practice issues for employers covered by the National Labor Relations Act regarding the use of pay secrecy policies, and recommendations to reduce employer exposure to litigation.
LEGAL

Pay secrecy and pay confidentiality rules ("PSC rules") that both generally prohibit employees from discussing their wages with coworkers have created legal problems for employers (Gely & Bierman, 2003). PSC rules have been found to violate Section 8(a)(1) of the NLRA. Section 8(a)(1) makes it an unfair labor practice for an employer to interfere with employees Section 7 rights to engage in protected concerted activity (Gely & Bierman, 2003). Survey data previously noted has reported the wide spread use of both of these types of policies over the years by employers either in employment manuals or through direct communication by supervisors to employees, generally early in an individual’s employment with an organization.

“Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all such activities” (Sec. 7, NLRA).

The NLRB has long held that Section 7 “encompasses the right of employees to ascertain what wages are paid by their employer, as wages are a vital terms and condition of employment” (Jones & Carter, Inc. & Lynda A. Teare, 2012). The NLRB has also noted that “in fact, wage discussions among employees are considered to be at the core of Section 7 rights because wages ‘probably the most critical element in employment,’ are the ‘grist on which concerted activity feeds.’ (Jones & Carter, Inc. & Lynda A. Teare, 2012). In the Jones & Carter, Inc. case decision, the Administrative Law Judge (ALJ) further noted that over the years, the NLRB has consistently ruled that “an employer violates the Act when it maintains a work rule that reasonably tends to chill employees in the exercise of their Section 7 rights” (Jones & Carter, Inc. & Lynda A. Teare, (2012).

Gely and Bierman’s article details the three-part test applied in Section 8(a)(1) cases involving PSC rules.

First, it must be determined that the PSC rule adversely affected the employees' Section 7 rights. Second, the employer must advance a "substantial and legitimate business reason" for her conduct if the rule adversely affected the employees' rights. Third, the Board must then apply a balancing test to determine whether the employees' Section 7 rights outweigh the employer's business justification. Such a finding will require the Board to conclude that the PSC rule and its application have violated Section 8(a)(1) (Gely and Bierman, 2003, p. 126-127).

Employer’s may be able to defend their PSC rules if they can establish “a legitimate business justification for the rule” (Gely and Bierman, 2003). Gely and Bierman concluded that employers “have been rather timid in advancing possible justifications for the adoption of PSC rules” and have primarily argued that “PSC rules are necessary as a way of limiting jealousies and strife among employees” (Gely and Bierman, 2003, p. 129). Gely and Bierman concluded that reviewing courts and the NLRB have “consistently rejected this argument” (Gely and Bierman, 2003).

Gely and Bierman also provided a detailed review of cases where PSC rules were not contained in published documents but were orally and sometimes only informally communicated to employees. Their review included decisions from several appeals court decisions that “regardless of whether found in employment manuals or informally communicated to employees” PSC rules have been held to “inhibit employees” Section 7 rights to engage in
concerted activities for mutual aid and protection” (Gely and Bierman, 2003, p. 128).

The NLRB v. Main St. Terrace Care Center case cited by Gely and Bierman, provides further details on how the courts have dealt with informally stated PSC rules:

the employer contended that comments made by a manager to two employees that employees were not allowed to discuss their paychecks with anyone, nor disclose the pay raises that the employees were receiving, did not establish a rule sufficient to trigger a NLRA violation. The employer's argument was threefold: 1) the rule was not written or acknowledged; 2) the manager who made the comment did not have the authority to promulgate such a rule; and 3) the rule was not enforced. Id. at 538. The Sixth Circuit rejected all three arguments. Id. Regarding the first argument, the Court held that whether the rule is oral rather than in writing made no difference to the 8(a)(1) analysis. Id. The Court noted that "any rule prohibiting wage discussions, whether written or oral, has a tendency to discourage protected activity, and is thus potentially illegal under Section 8(a)(1). Id. Similarly, the fact that the rule was not enforced was irrelevant, since in 8(a)(1) cases, "the actual effect of a statement is not so important as is its tendency to coerce."' Id. at 539 (quoting NLRB v. Okun Bros. Shoe Store, Inc., 825 F.2d 102, 107 (6th Cir. 1987). (Gely and Bierman, 2003, p. 128).

In March of 2014, the United States Court of Appeals for the Fifth Circuit issued its Flex Frac Logistics v. the NLRB decision. The decision was on Flex Frac’s appeal of an NLRB order holding that Flex Frac’s employee confidentiality policy “stymied employee discussions of wages” and was an unfair labor practice in violation of Section 8(a)(1) of the NLRA (NLRB, 2014, B). The NLRB found that Flex Frac Logistics confidentiality policy “was facially unlawful because employees would reasonably interpret the ban on disclosing personnel information and documents to prohibit discussing their salaries and wages with coworkers or non-employees (NLRB, 2014, B). While the case began with the 2010 firing of Flex Frac employee Kathy Lopez, the Fifth Circuit decision did not address her termination but focused on the confidentiality clause in a document that all Flex Frac employees were required to sign (Exhibit 1).

Exhibit 1

<table>
<thead>
<tr>
<th>Confidential Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employees deal with and have access to information that must stay within the Organization. Confidential Information includes, but is not limited to, information that is related to: our customers, suppliers, distributors; Silver Eagle Logistics LLC organization management and marketing processes, plans and ideas, processes and plans, our financial information, including costs, prices; current and future business plans, our computer and software systems and processes; personnel information and documents, and our logos, and art work. No employee is permitted to share this Confidential Information outside the organization, or to remove or make copies of any Silver Eagle Logistics LLC records, reports or documents in any form, without prior management approval. Disclosure of Confidential Information could lead to termination, as well as other possible legal action (Flex Frac Logistics v. NLRB 2014).</td>
</tr>
</tbody>
</table>

Another interesting point of law contained in this decision dealt with the issue of the employer’s enforcement of the rule. In the Flex Frac Logistics decision the court, citing the 1998 NLRB decision in Lafayette Park Hotel, concluded that the employer’s enforcement of the rule is not determinative and that the appropriate inquiry is “whether the rules would reasonably tend to chill employees in the exercise of their Section 7 rights” (Flex Frac Logistics v. NLRB, 2014).

The Flex Frac Logistics case is “the latest in a string of cases in which the NLRB is challenging company policies that it claims have a chilling effect” on employee Section 7 rights (Leonard, 2014). A series of cases associated with employer social media policies led to the
issuance of three special reports by the NLRB on employer policies and rules that inhibit employee Section 7 rights. The third report, issued in May of 2012, focused on policies governing the use of social media by employees. In six of the seven cases examined in the report, the NLRB found a variety of provisions that were determined to be unlawful (Smith, 2012).

OTHER RECENT CASES

In another recent NLRB case, a Hooters employee initiated a complaint after allegedly being terminated after complaining about a bikini contest. The investigation and hearing associated with the employees complaint eventually led to a detailed review of the restaurant’s mandatory arbitration agreement and other handbook policies (Smith, 2014, B). The initial complaint alleged that the company “maintained certain rules in an employee handbook and, a confidential information agreement, that infringed upon the employees Section 7 rights in violation of Section 8(a)(1) of the Act” (Hoot Winc, LLC and Hanson, 2014). In challenging the employee’s contention that she was terminated for alleged violation of her Section 7 rights, the employer alleged that the employee was terminated for allegedly violating various sections of the Hooters employee handbook including engaging in acts of violence, insubordination to a manager, off-duty conduct that negatively affected the company’s reputation, and other activity that “Hooters reasonably believes represents a threat to the smooth operation, goodwill, or profitability of the business” (Hoot Winc, LLC and Hanson, 2014). The Administrative Law Judge assessed the following rules from the Hooters Handbook that allegedly interfered with, restrained, and coerced employees in the exercise of their Section 7 rights:

(a) Remember: NEVER discuss tips with other employees or guests. Employees who do so are subject to discipline up to and including termination.
(b) Insubordination to a manager or lack of respect and cooperation with fellow employees or guests [might result in discipline up to, and including immediate termination.]
(c) Disrespect to our guests including discussing tips, profanity or negative comments or actions [might result in discipline up to, and including immediate termination.]
(d) The unauthorized dispersal of sensitive Company operating materials or information to any unauthorized person or party [might result in discipline up to, and including immediate termination.] This includes, but is not limited to, recipes, policies, procedures, financial information, manuals or any other information in part or in whole as contained in any Company records.
(e) Any other action or activity which Hooters reasonably believes represents a threat to the smooth operation, goodwill or profitability of its business [might result in discipline up to, and including immediate termination.]
(f) Any off-duty conduct which negatively affects, or would tend to negatively affect, the employee’s ability to perform his or her job, the Company’s reputation, or the smooth operation, goodwill or profitability of the Company’s business [might result in discipline up to, and including immediate termination.]
(g) Employees shall not discuss the Company’s business or legal affairs with anyone outside of the Company. Information concerning claims or lawsuits brought by the Company or against the Company shall be treated as confidential. Employees shall not discuss matters related in any way to litigation or claims. Any employee who violates this rule shall be subject to discipline up to and including termination of employment.
(h) Information published on your social networking sites should comply with the company’s confidentiality and disclosure of proprietary information policies. This also applies to comments posted on other blogs, forums, and social networking sites.
(i) Be respectful to the Company, other employees, customers, partners, and competitors. Refrain from
posting offensive language or pictures that can be viewed by co-workers and clients. Refrain from posting negative comments about Hooters or co-workers. In all cases, NEVER publish any information regarding a co-worker or customer (Hoot Winc, LLC and Hanson, 2014).

The ALJ found that all of the rules in the handbook where either “overbroad” or “invalid” and forbidding employees ability to exercise their Section 7 rights. With respect to the rule forbidding employees from discussing tips with each other, the ALJ ruled that “discussing tips between employees is essentially discussing wages” and that nothing is more basic “terms and conditions of employment than wages” and is unlawfully over broad (Hoot Winc, LLC and Hanson, 2014).

Policies designed to prohibit employees from engaging in “gossip” involving the personal lives of their co-workers or making negative remarks about their co-workers have also come under recent scrutiny of the NLRB (Gold and Lebel, 2014). In two cases, Hills and Dales General Hospital and Laurus Technical Institute, the NLRB administrative law judges concluded that the organization’s no-gossip policies interfered with their employees Section 7 rights (Gold and Lebel, 2014).

In the Hills and Dales General Hospital case, three-member panel of the NLRB reviewed an NLRB Administrative Law Judge’s decision regarding portions of the Hospital’s Values and Standards of Behavior Policy. The “relevant part” of the policy that came under NLRB scrutiny stated that “employees will not make negative comments about our fellow team members, including coworkers and managers” and that “employees will represent [the Respondent] in the community in a positive and professional manner in every opportunity” (Hills and Dales General Hospital and Danielle Corlis, 2014).

In the Laurus Technical Institute case, another three member panel of the NLRB found that an employee’s termination for violating the company’s no gossip policy for discussing with other employees concerns about job security was interference with the employee’s Section 7 rights (Laurus Technical Institute and Joslyn Henderson, 2014). In the decision, the panel, citing its decision in Hoodview Vending Co., ruled “that an employee’s conversations about job security with another employee, like those about wages, are inherently concerted” and that Laurus must “cease and desist” from maintaining or enforcing its overly broad no gossip policy and rule (Laurus Technical Institute and Joslyn Henderson, 2014).

RECOMMENDATIONS

Employers in all private sector workplaces, with or without unions, should be alert to the NLRB’s focus on protecting employee Section 7 rights. Policies and rules, whether published or unpublished that can be reasonably construed to prohibit protected Section 7 activity, are promulgated in response to union activity, or have been applied to restrict Section 7 activity may run “afoul of the NLRA” (Gold and Lebel, 2014). With the continued escalation of NLRB efforts to enforce Section 7 of the National Labor Relations Act, all private sector employers should be engaging in proactive measures to make sure that policies and rules, whether published or not, are ready to withstand what one law firm called the NLRB’s continued “interventionist trend in invalidating work rules” (Winston & Strawn, 2014). Winston & Strawn, in addition to citing the NLRB’s Administrative Law Judge decision in the Hoot Winc, LLC case, detailed other “recent developments” initiated by the NLRB that are designed to “expand its influence” (Winston & Strawn, 2014). Winston & Strawn described an NLRB agreement with the Occupational Safety and Health Administration (OSHA) that will allow OSHA to refer “time-
barred complaints under the Occupational Safety and Health Act (OSH Act)” to the NLRB (Winston & Strawn, 2014).

While employers are wise to periodically review their policies and rules to make sure they are in compliance with new court decisions and new law, in light of the proactive approach to enforcement at the Federal level, employer efforts to maintain compliance are more important than ever. The range of policies and rules that have come under scrutiny in addition to pay secrecy policies, include confidentiality agreements, no-gossip policies, and attempts by employers to limit employee use of social media. A consistent problem for employers in regard to all of these that have come under NLRB scrutiny has been the use of overly broad wording in the construction of policies and rules that employers have created. Employers that want to draft policies and rules in these areas must start with an understanding of the basic NLRA prohibition that “employers can’t maintain a rule or policy that reasonably tends to chill employees’ ability to exercise their Section 7 rights” (Guiltinan, 2013). Employers are advised to remember the NLRB test utilized to determine whether a rule or policy “impermissibly chills” employee ability to exercise Section 7 rights - does the rule explicitly restrict Section 7 activity? Could it reasonably be construed to prohibit Section 7 activity; was the rule or policy developed in response to union activity; or was the rule or policy applied to restrict the exercise of Section 7 rights (Guiltinan, 2013). Employers should also remember that it is irrelevant as to whether the rule or policy that prohibits covered employees from discussing their pay has been formally or informally published. Whether it is an off the cuff remark by a supervisor or a CEO, if it could be construed by employees to not talk about any aspect of their compensation it could run afoul of the NLRA. Given the current approach of current federal regulators, if the employer’s policies and or rules come under NLRB scrutiny, the chance that an NLRB ALJ or the full board will determine that it restricts employee Section 7 activity is very high. For Federal government contractors, the OFCCP is currently developing regulations to implement President Obama’s amendments to Executive Order 11246 prohibiting contractors and subcontractors from retaliating against covered employees who inquire about or discuss their compensation with fellow workers. Current and potential Federal government contractors are strongly advised to be alert for their publication and to prepare accordingly.

One final option to avoid coming under NLRB scrutiny with respect to a pay secrecy policy is to adopt an open pay policy. Two companies that have taken that approach are supermarket chain Whole Foods, and Buffer a new firm that develops apps for social sharing. Whole Foods is a large publicly traded firm (78,400 team members as of September 2013) and adopted their open pay policy in 1986 (Whole Foods, 2013). In addition to opening up salary data, Whole Foods gives “high-level access to the company’s financial data” to all employees (Griswold, 2014). The objective of Whole Foods open policy is to help “create a high-trust organization, an organization where people are all-for-one and one-for-all” (Griswold, 2014). Whole Foods has been a member of Fortune magazine’s “100 Best Companies to Work for in America” for 16 consecutive years, all “team members” are non-union, and the company considers their “team member” relations to be very strong (Whole Foods, 2013).

Buffer, a 15 employee start-up firm, publishes the “salaries of every employee as well as the formula they’ve devised for determining employee pay” (Johnson, 2014). Buffer’s management believes that their open pay policy, referred to as “radical transparency”, has been instrumental in attracting an increase in the supply of high quality applicants for the growing firm (Johnson, 2014).
The Whole Foods and Buffer approach to the pay secrecy issue are currently unique. As regulators, especially at the NLRB, continue to increase their scrutiny of pay secrecy policies and rules, employers are advised to assess their objectives regarding such policies. Employers may want to consider adopting the Whole Foods or Buffer solution to this problem considering the cost of complying given the current regulatory environment.

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Hoot Winc, LLC and Hanson (2014). Hoot Winc, LLC and Ontario Wings, LLC d/b/a Hooters of Ontario Mills, Joint Employers, and Alexs Hanson, Jamie West, and Chanelle Pantich.


RELIGIOUS ORGANIZATIONS AND THE ANNUAL COMPLIANCE REPORTING EXEMPTION

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ABSTRACT

Religious organizations receive the most charitable contributions of all public charities. However, unlike other public charities, they are automatically exempt from the annual IRS compliance reporting via Form 990. This is based on the protection of religious freedom which exempted such organizations from government scrutiny. Religious organizations are becoming more complex, and are growing exponentially especially in the ‘mega church’ sector. Perhaps it is time to re-examine the compliance reporting exemption. The paper discusses the positions of those who support and oppose this federal exemption and concludes with the authors’ viewpoint.

INTRODUCTION

There are approximately 2.3 million nonprofit organizations (NPO) in the United States in 2010 (most recent year available), and 1.6 million were registered with the Internal Revenue Service. One million of these are 501(c) (3) public charities, the most common NPO (Blackwood, Roger & Pettijohn, 2012). According to Giving USA, a public service initiative of The Giving Foundation, Americans contributed approximately $335 billion to charitable organizations (public charities) in 2014, and religious organizations received 31% of the funds, by far the largest benefactor. However, this contribution rate is slowing as a result of declining religious affiliation and attendance and increased giving to religious-oriented charitable organizations.

Religious organizations are charitable organizations and are exempt from taxation under Section 501(a) of the Internal Revenue Code (IRC) and specifically Section 501(c) (3). Tax-exemption is automatic if an organization meets five general requirements outlined in the IRC, including not intervening in political campaigns or attempting to influence legislation (McNair & Pryor, 2006). Also, religious organizations are exempt from paying property taxes in all states plus the District of Columbia.

Charitable and other tax exempt organizations are required to file an information (compliance) return annually with the IRS. The form and complexity depends on the level of support or revenue received by the charitable organization. The ultimate goal of reporting is to ensure effective management and fiscal oversight of the organization’s resources. Large charitable organizations file the complex Form 990; medium ones file Form 990EZ; and smaller organizations (less than $25,000) file Form 990N or e-postcard. It is worth noting that only 40% of registered NPOs were required to file an information financial return with the IRS in 2010 (Blackwood et al, 2012).

This paper will explore whether religious organizations should be exempt from the annual federal compliance reporting requirements. It discusses religious organizations in general and various the positions in support for and against reporting and concludes with the authors’ call for action.
RELIGIOUS ORGANIZATIONS

Churches and certain church-affiliated organizations receive special exemptions from the federal government that are not available to other charitable organizations. For instance, they receive automatic tax exemption without the need to file the appropriate forms, they do not need to file annual information returns, and they are protected from IRS examination though a special law passed by Congress (IRS, 2012).

The law, the Church Audit Procedures Act or CAPA, impose special limitations in IRS Section 7611 on how and when the IRS may conduct civil tax inquiries and examination of churches. Specifically, it requires a high ranking Treasury official’s approval when the IRS demands a church’s records. However, this particular individual is not specified and so; there is no one in the government to authorize a church audit. Clearly, churches (and other religious organizations) are placed in favorable situations since many of their activities are not subject to review by external parties.

Religious organizations, like other nonprofit organizations, must pay taxes on unrelated business income. They could also lose their tax exemption if they are engaged in certain non-permissible activities such as political campaigning. The motivation for the favorable tax treatment is the first Amendment passed in 1789 which promotes and protects religious freedom. Clearly, the founding fathers wanted to ensure that people were able to worship as they choose without interference from the government. History shows that Americans enjoy more religious freedoms than any other people in the world. For the most part, various religious organizations exist harmoniously in the United States with limited discord.

For purposes of our paper, the term church is used as a synonym for religious organizations although the former and not the later, is the one defined in the IRC (McNair & Pryor, 2006). Since churches do not have to formally register with the IRS, it becomes difficult to quantify the number of such organizations that are operating in the US. The Urban Institute publishes data on the nonprofit sector. Its detailed information on 501(c) (3) organizations includes a category for ‘religion related, spiritual development,’” presumably the category for churches. This category, the largest of the 501(c) (3) organizations reported 222,144 of such entities and only approximately 14% file reports with the IRS (Blackwood et al, 2012). Another report noted that there are 321,839 congregations in the US (nces, 2014).

One thing is certain, religious organizations are a diverse group consisting of congregations, mosques, temples, Buddhist centers, among others. They include the Lakewood Church in Texas with its approximately 38,000 members; World Changers International with approximately 20 fellowship centers across the country and growing; Westboro Baptist Church known for its extreme ideologies; the Islamic Center of America in Michigan, the largest and oldest Shia mosque in the country; and the Park Avenue Synagogue in New York with approximately 1,500 families with a top membership dues of $5,520 per family (of two) per year.

SUPPORT FOR TAX REPORTING

Requiring churches to file annual reports with the IRS could be explored on many different levels. However, the paper limits the discussion to a review of current oversight bodies if any, the potential for fraud and abuse, and any violation of the constitution.

Current State
The Evangelical Council for Financial Accountability (ECFA) is at the forefront of helping churches and religious organizations (herein categorized as churches) improve transparency and accountability in their activities. Churches can become accredited through the organization by complying with its seven standards on responsible stewardship. These standards include governance; financial oversight such as the preparation and publication of audited (or reviewed) financial statements; and compliance with applicable laws. A number of main stream religions/denominations such as the Episcopal Church, have their own internal oversight bodies.

The ECFA is a third party peer accountability organization that confirms that churches are operating with integrity, accountability and transparency. ECFA’s website noted that 21 of the largest churches in America are ECFA accredited (although the churches’ names were not easily accessible). It did note recent accredited churches such as Mariners Church in Irvine, Ca; Mars Hill of Seattle, WA; and Free Chapel of Gainesville, Ga.

Another watchdog group is the Trinity Foundation, a religious, charitable and educational nonprofit, which monitors and investigates religious fraud. To understand the current state of tax reporting if any, the group compiled a list of the nation’s 30 leading religious broadcasters (or televangelists). The goal was to determine which ones disclosure their finances, file information return with the IRS, hold regular services, are accredited by ECFA, and/or consider themselves churches. This list is provided in Appendix I.

There is some interesting information that can be obtained from reviewing the information provided in the referenced table. In general, the entities identified as religious organizations elect to file information returns. The key highlights include:

- Eight of the 30 are categorized as religious organizations, and they all file information returns with the IRS.
- Six are accredited by the ECFA but only one is a church.
- Seven of the churches (total of 22) do not hold regular services.
- Eleven, including three churches, disclosed some level of financial information (income or net assets) to the public.

**Fraud and Abuse**

Another watch dog group, taxthechurches.org, believes that churches are easily abusing their tax exempt status by not reporting annually to the IRS. Certainly there are many reported cases of abuse which suggest that it might be happening in organizations of all sizes. The group reported many examples such as a brothel “church” where sisterly love is being offered to male parishioners in exchange for donations. In a small, rural town in New York State, 98% of the land owners were exempt from taxes because their land was branches of a mail order church. In Wisconsin, hotels, pay parking lots, farms, and communion wafer bakeries are among church holdings that are tax-exempt. Overall, at least $4.2 billion in tax-exempt, religious property exists in that state. (taxthechurches, 2012).

Taxthechurches also points to the moral corruption of the Catholic Church as evidence by the many sexual scandals as another example of routine scandals in churches. A more recent scandal facing the Catholic Church is the lifestyle of its retired or retiring archbishops. The Newark, NJ archbishop was recently criticized for the three-story, 3,000 square feet addition to an already 4,500 square feet retirement home. This addition was estimated at approximately $500,000 (Mueller, 2014), and was in sharp contrast to the schools being closed in the diocese due to the lack of funds (Powell, 2014).
The Catholic Church is only one example. Others examples of exploitation by churches include claims of torture and abuse by dissenting members of the Church of Scientology (Barajas, 2012), the Church of Latter Day Saints in its support of California’s Proposition 8 initiative (Galle, 2009), and Mars Hill Church diverting donations received for international purposes to expansion in the United States (Throckmorton, 2014). Most recently, faith based organizations are demanding exclusion from an executive order by the President of the United States that would bar discrimination against gay men and lesbians by companies doing business with the government (Hirschfeld & Eckholm, 2014).

Congress is also concerned about the lack of financial reporting and the potential of abuse in this area. As a result, Senator Grassley of Iowa investigated six prominent televangelist ministries for possible financial misconduct, specially the use of their tax exemption as churches to shield their lavish lifestyles. The six are Paula White, Joyce Meyer, Creflo Dollar, Eddie Long, Kenneth Copeland, and Benny Hinn (Strickler, 2007). These names are included in the top 30 televangelist in Appendix I. Of course, the ministers denied the alleged charges.

The senator’s staff also investigated the broader issue of whether churches should file Form 990 or not (Kasper, Ziel, and Johnson, 2012). The final report insisted on greater accountability and more transparency so that the government has a better picture of the workings of churches and concluded that churches should no longer be exempt from filing Form 990.

**Constitutional and Filing Issues**

A broad view of the U. S. Constitution shows that it its intent is to have separation of church and state the government should not show partiality to any one group. The government should not establish the religion or interfere with religion according to Walz v Tax Commission of City of New York (1970). On the other hand, culture has indeed changed since the writing of the Bill of Rights and the U.S. Constitution. It seems a bit contradictory that Congress is allowed to make a law saying churches are exempt, but it is not allowable for Congress to make a law saying Form 990 must be filed by churches and/or religious organizations.

Cole (2012) noted that requiring churches to file Form 990 does not necessarily violate the U. S. Constitution. The author believes that people and not churches have constitutional freedoms. The church is an organization made up of people who have the right to choose and exercise their religion. Cole (2012) believes that tax filing could be limited to certain organizations such as churches with income and assets greater than $1 million and $5 million respectively. A new information return, such as Form 990-CH would be created for these churches meeting the filing threshold. An alternative is to ensure that all churches are members of an accreditation organization such as ECFA.

Gaubatz (2012) reviewed Supreme Court decisions relating to tax reporting by churches and concluded that the IRS would be legal to require churches to file Form 990 because this information is necessary to validate tax-exempt status and to verify that churches are complying with all federal laws. Ideally, churches should file Form 990-N since it would not create a substantial burden to them. Churches already file other forms with IRS (e.g., payroll tax information) so answering the eight questions on Form 990-N would not impose any more of an unlawful burden than is already imposed when churches complete forms that are required.

Gaubatz (2012) further noted that by filing Form 990-N churches would simply be providing assurance that they are complying with all federal tax laws. Thus churches with nothing to hide would be glad to file Form 990-N.
SUPPORT AGAINST TAX REPORTING

There are many proponents against any potential requirements of having religious institutions file annual information returns with the IRS. The themes are similar as the supporters, but the outcomes are different. Some of the rationale for maintaining the status quo is discussed in this section.

Constitutional Issues

Some writers explain that it is unconstitutional for churches to file IRS form and that the IRS must follow the U. S. Constitution. Thus, the IRS automatically exempts churches from filing Form 990. The founding fathers diligently studied history of other countries as they created the doctrines for America. Historical documents show the desire for Americans to have freedom of religion and separation of church and government. Their belief that there must be a strong separation of religion and government ensures that religion does not become entangled with government and that people have religious freedom (taxthechurches.org, 2012).

The Commission on Accountability and Policy for Religious Organizations, another oversight organization, published numerous position papers on potential reporting by religious organizations. In one paper, Kasper, Ziel, and Johnson (2012) concluded that having churches file Form 990 is severe and unconstitutional. After reviewing numerous Supreme Court cases, they believe that the court has established precedence relating to the issue of tax and religious institutions supports Form 990 being illegal. Perhaps the most significant finding is that the IRS already has measures in place to determine if churches are engaged in fraudulent abuse; therefore, there is no need to have churches also file Form 990.

Kasper et al. (2012) also noted that filing Form 990 is indeed a burden for churches. The U. S. Constitution states that there is not to be a national church (such as the Church of England). Since then, court decisions have endorsed the practice that religion is to be free from government interference and Americans are free to practice their faith without such interference. The practice of gathering information from churches through Form 990 constitutes the government being entangled with religion. After reviewing the information that is gathered on the full Form 990, they concluded that this form requires much more information than the IRS (government) needs in order to impose a tax. It is possible that mandatory taxation will soon follow if Form 990 is required.

Mosher and Wagenmaker (2012) acknowledge that American life is different, in many respects, from when the U. S. Constitution was written. The Tax Reform Act of 1969 first required nonprofit organizations to apply to the IRS for official exemption status, but this same law stated that religious organizations do not have to file the new annual information return (Form 990). Obviously, a law created as recently as 1969 is based on modern American society rather than life in 1789.

Mosher and Wagenmaker (2012) also agreed that requiring Form 990 of churches would violate the First Amendment. Changing the law to allow this filing would contradict longstanding social policies in that church and government would no longer be separate. Filing Form 990 is in conflict with the basic nature of religious organizations.

According to Winters (2012), the action of imposing on churches annual disclosures through the Form 990 will inherently result in the opposite reaction, a loss of religious liberties and surrendering a measure of control over our religion. The motives of those championing additional regulation of churches may be pure, but liberty must yield for the government to gain
ground. Moreover, submission of churches to any annual Form 990 filing requirement unavoidably involves First Amendment violations of the Free Exercise Clause and the Establishment Clause, as it would unduly burden churches and promote excessive entanglement with church affairs. The imposition of Form 990 reporting requirements upon churches, in any manner, should be soundly rejected.

**Monitoring and Reporting**

Kasper et al. (2012) noted that if Form 990 were required, the IRS would be forced to implement detailed monitoring. Consequently, the IRS would have tremendous power of discretion over religious organizations; this, in itself, opens the door for more government entanglement with religious organizations. Trying to decrease fraud within religious organizations does not justify requiring filing of Form 990.

According to Mosher and Wagenmaker (2012), the purpose of the IRS is to supervise commercial activities and make certain that the country has money to operate. They identify additional implications if the current law is changed. The government would have to determine the penalty for not filing Form 990 if it were required and be able to enforce it. Certainly, this would result in more entanglement with religion by the government. If all churches were required to file, the IRS would be in a position to abuse its power and discriminate more in reference to religion. This could, in time, lead to religious persecution as the idea would be that only government-approved churches are allowed.

Furthermore, recent federal budget cuts, including the automatic spending cuts known as sequester, as hindered the IRS’s ability to fulfill its mission (Hicks, 2014). The cuts amounted to approximately $900 million since 2010, with a proposed $1.2 billion reduction in the enforcement budget (Calabresi, 2014). So asking it to do more oversight and monitoring with fewer resources seem onerous.

Kasper et al. (2012) explains that contributions to churches from donors are reflected on each donor’s individual tax return. Therefore, the IRS is able to follow the source of funds to religious organizations through this avenue. Clearly, this only applies to individual tax payers who itemize and claim charitable contributions on their tax returns. Also, donors themselves are often the best control for preventing fraud if they insist on accountability.

**Fraud and Abuse**

Kasper et al. (2012) provides current IRS practices which are available for use in preventing fraud. For instance, churches are required to report unrelated business income from a business not closely related to its exempt purpose. Thus, if it does not want to be required to report unrelated business income, a church can simply stop the activity that would generate the income. Mosher and Wagenmaker (2012) describe various IRS laws and practices that result in oversight of churches so there is no need for mandatory filing using Form 990. State governments also have authority to investigate churches if they are suspected of wrongdoing.

**CONCLUSION**

The growth in the number of religious organizations has created the need for oversight to ensure that they are fulfilling their mission. As noted in the paper, the IRS is experiencing budget restrictions which impact its ability to perform current duties. Therefore, giving the IRS
additional responsibilities without new funding is a recipe for disaster. Appendix I provide examples of institutions that are considered churches but hold no regular services, and others defined as religious organizations that elect to file annual reports (Form 990) with the IRS. This suggests that some religious organizations are willing to open their records to external parties in order to ensure transparency and accountability, and that doing so does not create excess burden for them.

The authors believe that churches and other religious organizations should file annual reports with the IRS on a voluntary basis. The preferred document is Form 990-N since it is short and would not create a burden. Another option is to develop or adopt Form 990-CH proposed by Cole (2012) which would limit reporting to the largest organizations. Since the IRS allows the electronic filing of tax forms, allowing churches to use this filing option should not increase its workload. These recommendations are consistent with the new Form 1923-EZ which was recently introduced by the IRS to streamline the tax exemption approval process. We believe that churches will comply with this requirement is order to assure their stakeholders of their transparency and accountability.

Religious organizations received approximately $104 billion in contributions from taxpayers in 2014, the largest recipient of all NPO. In an evolving and complex world, asking them to comply with federal filing requirements that are applicable to other charitable organizations is not excessive and will not impact their constitutional rights. Certain religious organizations are already performing this task so churches and similar institutions should follow their lead. This action might lead to increase donations since donees are more confident in the management and oversight of the organization’s resources.

REFERENCES


### Appendix I - Top 30 Leading Religious Broadcasters

<table>
<thead>
<tr>
<th>Organization</th>
<th>Affiliation</th>
<th>Type</th>
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<th>Files IRS 990s</th>
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<td>☑</td>
<td></td>
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<td>James Robison</td>
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<td></td>
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<td>Religious organization</td>
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<td>$21 million</td>
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<tr>
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<th>Accredited</th>
<th>Industry</th>
<th>Notes</th>
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<td>Church</td>
<td>✔</td>
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<td></td>
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<td>Church</td>
<td>✔</td>
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</tr>
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<td>Evangelism</td>
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<td>TD Jakes Ministries</td>
<td>Church</td>
<td>✔</td>
<td></td>
<td></td>
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<td>Peter Popoff Ministries</td>
<td>Breakthrough Ministries, World Harvest Church</td>
<td>Church</td>
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<td></td>
<td></td>
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<td>Potters House Church</td>
<td>Rockwealth International Ministries &amp; Church Online</td>
<td>Church</td>
<td></td>
<td></td>
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<td>Rod Parsley</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
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<td>Todd Coontz</td>
<td></td>
<td></td>
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<td>✔</td>
<td>$177 million</td>
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**Notes**

1. Accreditation by the Evangelical Council for Financial Accountability. The ECFA was founded in 1979 to help Christian ministries earn the public’s trust through principles such as board governance, financial transparency and proper use of charity resources.
2. Assets, from court documents
3. Assets

Sources: Trinity Foundation, Guidestar, ECFA, NPR
CHEATING: STUDENTS AND FACULTY’S PERCEPTION ON POTENTIAL CHEATING ACTIVITY

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Eugene Seeley, Utah Valley University
James Csipak, SUNY Plattsburgh
Rohit Rampal, SUNY Plattsburgh

ABSTRACT

Cheating has permeated many facets of our daily life. Reports on cheating are found in business (Enron, Tyco ...), in sports (baseball, athletics...), and in the classroom, which make this topic relevant for scrutiny. The paper examines academic dishonesty among college students to ascertain whether faculty has a different perception on what constitutes cheating than students. A survey presenting 16 different scenarios was submitted to students and faculty alike asking them whether the action of the imaginary students in the scenario constituted cheating or not. The analysis of the results showed that there were some significant differences between faculty and students in their perception on whether or not their actions established cheating.

INTRODUCTION

In the academic world, a cancer exists. That cancer has a name and is called cheating, Pullen, Ortloff, Casey, and Payne (2000) refers to it as the “bane of higher education” (p.616), and Moffatt advance that “the university at the undergraduate level sounds like a place where cheating comes almost as naturally as breathing, where it’s an academic skill almost as important as reading, writing, and math” (in Whitley, 1998, p.2). However, how many students cheat is hard to precisely figure since most data come through self reporting and it is likely that students do not want to advertise their cheating, making measurement difficult.

Nevertheless, several studies tried to establish a baseline on how many students engage in deceitful activities. One of the first studies (Baird, 1980) found that 75.5% of undergraduates from several majors had cheated while in college. In 1992, Meade reported a rate of cheating of 87% in various majors in top universities. McCabe and Trevino (1997) reported a range of 13% to 95% of student whom at one point had cheated. In his research, Park (2003) advanced that a minimum of 50% of students are cheating, others studies put that percentage at 63% (Nonis and Swift, 1998) or even up to 75% (Kidwell, Wozniak, and Laurel, 2003; Chapman, Davis, Toy, and Wright, 2004). Moreover, Whitley (1998) reviewed 46 studies conducted from 1970 to 1996, the range of the numbers of students engaging in academic dishonesty was from 9% to 95% across the different samples. The mean across the samples was 70.4%.

Also, there is a developing body of evidence that academic dishonesty is increasing; with the increase in tuition, the advance in technology, and the increase in online class offerings, new ways to engage in academic dishonesty are available for potential cheaters (Born, 2003; Park, 2003; Scanlon, 2004; Eastman, Iyer, and Eastman, 2006; Brown, McInerney, 2008). Indeed, Brown and McInerney found significant increases in 7 of 16 cheating practices between a 1999 and a 2006 sample using the same questionnaire, with an average usage increase of these 7
practices of 19.2%. Finally, one of the latest studies confirms this trend, Jones (2011) found that 92% of her students surveyed indicated that they had or they knew someone that cheated.

The only conclusion that one can have is, therefore, that cheating does take place in higher education and that the number of participants is significantly high. This is a very important issue as Nonis and Swift (2001), based on the study of 1,051 business students, reported that the frequency of cheating in college was highly correlated with cheating at work. Also, Lawson (2004) found that business school students who cheat are more likely to be accepting of unethical workplace behavior and there is a growing body of evidence that a positive correlation between cheating while in college and behaving unethically while at work exists (Brown & Choong, 2005; Nonis & Swift, 2001; Sims, 1993; Hilbert, 1985).

In addition, academic dishonesty has several impacts on students that do not engage in cheating. First of all, many firms that engage in on-campus recruiting require a minimum grade point average for students who sign up for interviews. Thus, students who engage in academic dishonesty may gain an unfair advantage that goes well beyond the higher grade earned through cheating. GPA is also typically considered an important selection criterion for hiring purposes. Finally, another way in which peers of the cheaters may be harmed is the potential backlash and scrutiny that may be implemented once a cheater has been caught, as well as the potential for distrust and poorer interpersonal relationship between students and faculty.

**LITERATURE REVIEW**

Most studies on academic dishonesty focused on situational and individual factors that may contribute to cheating behavior (McCabe and Trevino, 1993, 1997; Straw, 2002; Eastman, Iyer, Eastman, 2006. More specifically, McCabe and Trevino (1997) found that cheating was influenced by age, gender, grade point average, peers, and Greek membership.

The literature found that younger, immature students cheat more than older, more mature students (Choong and Brown, 2007); upper division classes encounter less cheating than lower division classes and unmarried students cheat more than married ones (Whitley, 1998; McCabe and Trevino 1997; Park, 2003; Straw, 2002).

Crown and Spiller (1998) looked at 16 previous studies on the relationship between gender and academic dishonesty, and found mixed statistical results. Klein, Levenburg, McKendall, and Mothersell (2006) established the same inconsistency regarding gender and cheating. They reported that about half the studies analyzing gender and academic dishonesty showed that males cheat more often than females, while the other half found no relationship. However, McCabe and Trevino (1997) found men to be more involved than woman in academic dishonesty. The same tendency was found by Buckley, Wiese, and Harvey (1998) and Chapman and Lupton (2004), who also reported a higher probability of males engaging in academic dishonesty than females. On the other hand, Leming (1980) reported that under a low risk condition, woman cheated more than men, but that a higher risk of punishment reduced the risk of cheating only for women. More recently, Anitsal, Anitsal, and Elmore (2009) found that both genders are engaged in cheating behaviors, but that their approaches to cheating were different.

Regarding grade point average, Crown and Spiller (1998) analyzed 14 studies focusing on grade and academic dishonesty. They established that the majority of the studies found that students with lower GPAs cheat more than students with higher GPAs. Straw (2002), also reported that students with a lower GPA are more likely to cheat as they have more to gain and less to lose than students with a higher GPA. Finally, Choong and Brown (2007) reported that GPA is inversely related to flagrant cheating, but found no significant difference in other type of
cheating among brighter students and their counterparts.

On the subject of peers, McCabe and Trevino (1997) found that “the most powerful influential factors were peer-related contextual factors… Academic dishonesty was lower when respondents perceived that their peers disapproved of such misconduct, was higher among fraternity/sorority members, and was higher when students perceived higher levels of cheating among their peers” (page 391). In a similar manner, results from student samples suggested that they cheat less when they feel that they are more likely to get caught (Corcoran and Rotter, 1989) and when their college has a known honor code (May and Lyod, 1993; McCabe and Trevino, 1993).

Regarding Greek membership, several studies advance that students involved in Greek life are more likely to cheat (McCabe and Trevino, 1997; Straw, 2002; Park, 2003). One of the main reasons for such behavior is grounded in the fact that fraternities are environments where norms, values, and skills associated with cheating can easily be shared as they provide access to resources (e.g. old test files) that facilitate academic dishonesty (McCabe and Trevino, 1997, page 383).

However, what constitutes cheating? As with many ethical issues, it is somewhat hard to ascertain for sure, what constitutes cheating. For instance, Lambert, Nicky, and Louise (2003) defined academic dishonesty as behavior that breaches “the submission of work for assessment that has been produced legitimately by the student who will be awarded the grade, and which demonstrates the student’s knowledge and understanding of the context or processes being asserted” (page 98). Others define academic dishonesty by the action that the students engage in; where the most common forms of cheating are plagiarism, “literary theft, stealing (by copying) the words or ideas of someone else and passing them off as one’s own without crediting the source” (Park, 2003, p. 472), working on individual assignment with others, having someone check over a paper before submitting it (if it is not permitted by the instructor), and getting questions/answers on a test from someone else (Brown 1996; Kidwell et al. 2003).

Our study is looking at academic dishonesty from a different angle. Each one of us has a personal definition of “where the line is” as far as cheating is concerned, and what is acceptable or not. Could it be that students, in general, have a different point of view than faculty? In the same manner, do faculty members all agree on what constitutes cheating? One can easily see that if faculty members are not aligned that it may create confusion for students about what is acceptable or not, indeed, Kessler (2003, p.60) writes that some students find that –…it’s sometimes hard to tell if the teacher specifically wants you to not work with other people, “and that they were often “afraid to ask.”

For instance, if we refer to the Lambert et al. (2003) definition above, what “behavior” is acceptable for a student? Is getting someone else’s notes to review for a test cheating? One could say that this behavior would enhance the grade of the borrowing student based on an effort from someone else, which would then be a violation of the Lambert et al.’s definition and thus make the borrower a cheater. However, someone else’s perception could be that the borrower learned from his or her friend’s notes and that the borrower’s grade is the true reflection of the borrower’s knowledge and understanding of the context or processes being asserted. In one case we have academic dishonesty, in the other one we do not.

Therefore, in order to analyze the issue raised in the previous paragraph, we propose to survey students and faculty alike, and ask them for their own perception on several scenarios based on the four major axes of academic dishonesty set by Brown (1996) described above. Each scenario will portray a hypothetical situation in which one or more students engage in an activity
that might be construed as academically dishonest. In order to not bias the respondent, each scenario is intentionally made vague.

**METHODOLOGY**

A total of 16 scenarios were created for the study (see Appendix A for the full questionnaire). An example scenarios are: “Jane is taking a test in a learning center by herself. She is stumped by one question and texts her friend Maria for help. Maria responds with an incorrect answer.” And “John is taking a test in class, while professor Absent Minded is not looking; John looks at his friend Jane’s test and see that she answered “C” for question #5.” Each respondent was then asked if Jane, John, or both were cheating.

The surveys were distributed to students and faculty members in several institutions located in South Dakota, Louisiana, and Utah. The institution in South Dakota is a small faith based liberal art college, while the one in Louisiana is a regional extension of a large state-funded university, and the institution in Utah is a large state university.

In order to select our respondents for the survey, a convenient sampling methodology was used; surveys were administered during class time and were collected a few minutes after being handed out, usually as students exited the class. As anonymity was guaranteed, it wasn’t possible to tract who had responded or not to the survey; therefore, a response rate cannot be calculated. As a result, 256 students and 52 faculty members responded to the survey and were used for analysis.

**RESULTS**

Prominence of Academic Dishonesty

In our sample, 91 students self-reported that they had previously cheated in college. That number put our number of students cheating in the low range compared to other studies. Indeed, only 35.54 percent of the respondent indicated that they have cheated. In comparison, 18 professors declared that they had cheated during their academic studies, which represent 34.61 percent of the sample.

Further analysis per classification of student showed that freshmen and sophomores seem to cheat less than their juniors and seniors counterpart. Table 1 shows the number of students that reported cheating per student classification. Percentage wise, students in higher classifications are more likely to have engaged in academic dishonesty than students in lower classifications. In our sample, juniors were the most likely to have cheated at least once in their college education (51.47%). An ANOVA analysis showed no statistical significance between the four groups of students, therefore, no classification of students is more likely to cheat than any other classification.

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*Journal of Legal, Ethical and Regulatory Issues, Volume 18, Number 2, 2015*
Perception of Academic Dishonesty between Faculty and Students

The goal of our research was to study whether there were any differences in opinion on what constituted cheating between students and faculty members. Table 2 presents the result of a T-Test analysis based on the responses given by our sample of students and faculty members to the 16 scenarios used in the survey.

<table>
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<th>T-TEST STUDENTS COMPARED TO FACULTY</th>
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* Significant at the .1 level, ** Significant at the .05 level, *** Significant at the .01 level

As one can see in table 2, several scenarios (3, 4a, 4b, 5, 7a, 7b, 9, 11a, 11b, 13a, 13b, 15b, and 16, see Appendix A) indicate significant differences in the average belief between the students and faculty. Similarly, a more detailed analysis was done by comparing the four different classes of students, freshmen to seniors, with faculty member’s perception of cheating. The result of that analysis can be found in table 3 through 7. A few variations were found between the classifications of students, indeed scenarios 5, 9, 11a, 11b, and 15b exhibit some classifications as non-significant while the whole student group was significant. Also, some more scenarios became significant for a specific classification: scenario 1a for freshmen (p-value of .088), 1b for sophomores (p-value of .088), and 8 for juniors (p-value of .089). However, as all their significances are marginal, we will focus our analysis on the significant student vs. faculty scenarios and then discuss any particular differences within the classification of students in the next section.
Table 3
T-TEST FRESHMEN COMPARED TO FACULTY

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* Significant at the .1 level, ** Significant at the .05 level, *** Significant at the .01 level  
 a: exact same mean between the two groups

Table 4
T-TEST SOPHOMORES COMPARED TO FACULTY

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* Significant at the .1 level, ** Significant at the .05 level, *** Significant at the .01 level

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a: exact same mean between the two groups

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* Significant at the .1 level, ** Significant at the .05 level, *** Significant at the .01 level

a: exact same mean between the two groups

**Scenario Analysis**

Scenario 3: “While working on a take home test, John asks his friend William to double-check his math for a problem that is in the test. William doesn’t find any errors.”
The results for that scenario show a very different perception between the groups: a strong majority (72%) of the students believed that John was not cheating while most of the faculty members (65.39%) thought that John’s action constituted academic dishonesty. That difference was found to be strongly significant with a p-value of 0.000. Furthermore, that significant difference was established throughout the four classifications of students, each had a p-value of 0.000 except for the seniors who had a p-value of 0.001. As far as percentage is concerned, freshmen were at 80.26%, sophomore at 68.63%, juniors at 67.12%, and seniors at 67.92%. The higher percentage from the freshmen compared to the three other groups may also indicate a possible difference between the freshmen and the higher classification. It may also be that being fresh out of high school, that they have a different attitude regarding collaborative work or that they exhibit some lack of confidence in their own ability and think that it is ok for them to have their work checked out while the other classifications have higher expectations.

Scenario 4: “Jane’s calculator comes preloaded with mathematical formulas. John’s calculator doesn’t have some formulas in it. Both calculators are in an approved list by their professor. Before the test, John enters the missing formulas in his calculator. They both use some of the formulas during the test.” (4a John, 4b Jane)

In this case, 78.8% of the students considered that John was not cheating, while an overwhelming majority of faculty members (96.4%) believed that John was not cheating. As far as Jane is concerned, 17.1% of the students surveyed thought that Jane was cheating, and only 1 out of 52 (2%) of the faculty said that she wasn’t cheating. Once again, the difference in perception between the students and faculty was found to be strongly significant; for John (4a), the p-value was .001, and Jane’s (4b) was .006. As far as the different classifications are concerned, the results showed some slight variations between the groups. For John, freshmen, sophomores, and seniors had a strong significant difference with faculty as their respective p-value was .008, .001, and .002. However, juniors had only a moderate significant difference (p-value of .013). For Jane, the classifications were split into two groups, freshmen and juniors were found to be moderately significant (p-value of .018 and .033 respectively) while sophomores and seniors were found to be strongly significant (p-value of .004 and .010).

Scenario 4a and 4b also exhibit a particularity in their results: they are the only instances where students are tougher on themselves than faculty members. All other significant scenarios, students are less likely to believe that their actions constitute academic dishonesty than what faculty members think.

Scenario 5: “Jane is taking a test in a learning center by herself. She is stumped by one question and texts her friend Maria for help. Maria doesn’t respond.”

Our survey showed that 92.59% of the faculty members surveyed said that Jane was cheating, but only 81.81% of the students agreed that she was cheating. Even so both groups, in an overwhelming majority, agree that Jane is cheating; the variation between the two groups is slightly significant with a p-value of .052. However, the analysis of the different classifications show a much different picture than the previous result may indicate. Indeed, only the freshmen exhibit a moderate significant difference with the faculty (p-value of .020), all other classifications are not significantly different. Specifically, 17 out of 75 (22.67%) freshmen who responded to that question said that Jane’s action was not cheating. In comparison, only 4 out of 54 (7.41%) faculty members thought the same. Sophomores, juniors, and seniors are all very similar to one another and stand between the faculty and the freshmen percentage with respectively 9 out of 52 (17.31%), 11 out of 71 (15.49%), and 9 out of 55 (16.36%). Even if
their numbers are much higher than the one from the faculty, their individual differences are not significant. However, as a group, it is not surprising to see that students have a slightly different, more lenient, perception about attempting to cheat compared to faculty.

Scenario 7: “While working on her take home test, Jane asks John if he found the same response for a given question. He didn’t, she checks her math and finds an error, she corrects it and now her answer matches John’s.” (John 7a, Jane 7b)

In this case, 32.16% of the students believed than John had cheated and 45.10% said that Jane did too. As far as faculty members are concerned, 60.78% considered that John engaged in academic dishonesty, and 70.59% believed that Jane cheated. Scenario 7, like scenario 1, clearly shows a wide disagreement between the groups. Students believe that, in this particular situation, their peers do not engage in academic dishonesty while faculty members thought that John and Jane were cheating. The difference in perception is strongly significant for both John and Jane with a p-value of .000 and .001. As far as John is concerned, the analysis of the student groups also revealed a strong significant difference for each group compared to faculty with a p-value of .000 for the freshmen, .010 for the sophomores, .005 for the juniors, and .007 for the seniors. Like in scenario 1, freshmen had a higher percentage of respondents believing that John’s action was not cheating (76.32%). At the same time, sophomores had 64.70%, juniors had 64.38%, seniors had 65.45%, and faculty had only 39.21% of their members thinking the same.

For Jane, the finer analysis showed the same strong significant difference for the freshmen, sophomores, and juniors with p-value of .002, .007, and .004. However, seniors exhibited only a moderate significant difference (p-value of .039). In this case, the three lower classifications had quite the same percentage of their rank believing that Jane did not cheat (56.58%, 55.77%, and 55.55% respectively) while seniors had a lower percentage (49.1%) but still not as low as faculty (29.41%).

Once again, we have a strong difference in perception of what is acceptable while taking a take-home exam between students and faculty. Like for scenario 1, the points of view are opposed with one group thinking that the action (checking answer) is permissible while the other group believe the opposite.

Scenario 9: “While writing a paper for Dr. Shake Spears, Jane goes to the library and downloads a few papers to support her writing. After reading them, she cuts and pastes in her text some sections of what she has read and she cites only a few of her sources.”

This plagiarism related question provided some interesting results. As a whole, the student body showed a moderate significant difference compared to faculty (p-value of .012). As with scenario 5, both group showed a strong percentage believing that Jane cheated, 83% for the students and 96.3% for faculty, still that gap was found to be moderately significant. The sub-group analysis exposed some more differences between the classifications: freshmen and sophomores were found to be moderately significant (p-value of .012 and .011), juniors were found to be strongly significant (p-value of .003), while seniors were not significantly different than faculty. Percentage wise, we found that 81.33% of the freshmen, 82.35% of the sophomores, 78.08% of the juniors, and 92.59% of the seniors agreed that Jane cheated. All student classifications are still lower than the 96.3% of the faculty but the result seems to indicate that the concept of plagiarism is finally comprehended by the seniors.
Scenario 11: “John and Jane are in the same class, Professor Absent Minded gives a take home exam for the class. John and Jane work together on the exam.” (John 11a, Jane 11b)

That third scenario focusing on a take home exam yielded a strong significant finding for both John and Jane with p-value of .007 and .009. Overall, 53.14% of the students though that John was not cheating when he decided to collaborate with Jane. However, 68.08% of the faculty indicated that they believed that John did engage in academic dishonesty. Regarding Jane, the numbers were very similar to the one John’s case received: 53.17% of the students said that Jane was not cheating, and the same 68.08% of faculty disagreed with that statement. When we analyzed the results from the different classifications, the exact same pattern of result emerged. Freshmen were found to have a strong significant difference with a p-value of .005 for both 11a and 11b, they also had the same 57.89% of respondents thinking that John and Jane were not cheating when they worked together on the take home exam. Surprisingly, sophomores were found to be statistically not significant in both cases. Finally, juniors and seniors were found to be moderately significant (John’s p-value were .030 and .022, Jane’s .044 and .022). For John, 52.05% of juniors and 54.72% of seniors thought that he didn’t cheat. For Jane, 50.70% of juniors and 54.72% of seniors thought the same.

Scenario 13: “John couldn’t be here for a test and asked his professor if he could take it at a later time. Before taking his test, John discusses with Jane about what he really needs to review for the test.” (John 13a, Jane 13b)

For that scenario, students and faculty alike found that John cheated; however, around half of the students (52.96%) thought that he engaged in cheating behavior while a clear majority of the faculty members thought so (81.13%). As far as Jane is concerned, the gap between the two groups was even wider, with this time the majority of students believing that Jane was not engaging in academic dishonesty. Indeed, students did not believe that she cheated (44.84%) whereas faculty thought she did (80.77%). In both cases, the difference between the two groups was found to be strongly significant (p-value of .000). The analysis of the different student classifications showed one distinctive deviation between the groups. In John’s case (13a), freshmen, sophomores, and juniors were found to have a strong statistical difference with each a p-value of .000. However, seniors exhibited only a marginal statistical difference with a p-value of .063. Overall, we had 57.89% of freshmen, 47.06% of sophomores, 52.11% of juniors, and 27.78% of seniors thinking that John didn’t cheat; in comparison, only 18.87% of faculty would agree to that account. As far as Jane is concerned, all classifications were found to be strongly significant with p-value of .000, .000, .000, and .005. In her case, 64.47% of freshmen, 54.90% of sophomores, 52.11% of juniors, and 44.44% of seniors believed that Jane did not cheat while merely 19.23% of faculty thought the same.

Scenario 15: “Professor Absent Minded likes to use listing questions in his test (i.e. list the Marketing four Ps). John knows that and writes possible questions and answers on paper to help in his review. Jane asks John if she can use his review notes.” (John 15a, Jane 15b)

This scenario yielded some interesting finding. Both students and faculty agree that in this case no cheating occurred, 88.93% of the students and 96.15% of faculty thought that John did not engaged in academic dishonesty. Furthermore, that dissimilarity between the groups was not found to be significant, except for the sophomores who had a moderate significant difference (84% vs. 96.15%). As far as Jane is concerned, the verdict is slightly different. In her case, the disagreement between the groups was found to be marginally significant (p-value
of .076). 88.14% of students and 96.15% of faculty believed that Jane did nothing wrong, but that slight difference compare to John made it significant. Additionally, freshmen, sophomores and seniors were found to be marginally significant (p-value of .077, .077, and .054 respectively), but juniors were not significant. Percentage wise, we found that 86.84% of freshmen, 86.27% of sophomores, 91.67% of juniors, and 85.18% of seniors indicated that Jane did not cheat.

Scenario 16: “Jane’s calculator, which is approved by her mathematics professor, comes preloaded with mathematical formulas. Before a test, Jane entered more formulas in her calculator. Jane didn’t use any of the extra formulas during the test.”

In this final scenario, students strongly felt that Jane was not cheating (79.92%). However, faculty members’ point of view was very different: 45.10% of them considered that Jane’s action would constitute academic dishonesty. Overall, the difference in opinion between the two groups is strongly significant (p-value of .000). As far as the different classifications of students are concerned, we found a wide variation between them. Freshmen and juniors were found to be strongly significant (p-value of .001 and .000) and had 82.89% and 84.93% of their rank thinking that Jane did not cheat. Sophomores were marginally significant (p-value of .089) and had 71.15% believing that Jane’s action was proper. Finally, seniors were moderately significant (p-value of .028) and had 75.47% of their member agreeing to the same line of thought.

**DISCUSSION**

As the scenario analysis above revealed, several differences in opinion were found between faculty and students. These differences of opinion can be clustered in four categories: Take home, attempt to cheat, getting help, and plagiarism. Moreover, some conclusions can be developed about faculty and freshmen.

First, the outcome of scenario 3, 7, and 11 clearly indicate that students and faculty have very different ideas about what actions are proper while taking a take-home exam. Indeed, faculty members seem to think that take-home exams are to be done individually, while students believe that it is perfectly fine to ask someone for some help to verify their own work, check with their classmates that they found the same results, or even collaborate with a fellow student on the test. One could wonder if students in that instance are trying to cheat or if it simply shows a lack of self-confidence? Nevertheless, the results strongly suggest that it would be a good idea for faculty members to be especially clear about what is acceptable for their students to do when giving them a take-home exam.

The second finding relates to the attempt to cheat. It seems that students believe that trying to cheat, but not succeeding, is not engaging in academic dishonesty. As scenario 5 and 16 showed, a student that tried to cheat but either didn’t received the help he or she wanted or did not used the unauthorized material he or she brought to the test is not considered by his or her peers to be cheating, whereas faculty would consider such action academic dishonesty. As a result, we would strongly recommend that faculty members need to specifically mention to their students that the academic dishonesty line is crossed at the attempting stage, not at the realization stage; that an attempt to cheat is sufficient to classify a student as a cheater.

The third conclusion can be drawn from the analysis of scenario 4, 13, and 15. In each case, a student was trying to get a little bit of help, either to gain an edge to enhance their results or to level the playing field. That kind of attitude seems to be frowned upon, especially if the
information sought is directly related to test material (scenario 13). However, if it is helping to learn that is sought for, then as far as faculty is concerned, it is not an issue, even if students seems to think that it is an unfair advantage.

The fourth finding relates to plagiarism. The results show that even if plagiarism is an important part of how students engage in academic dishonesty it seems that the issue is getting less and less of a problem as students advance in rank. This leads us to believe that this kind of cheating may not be as intentional as most research implies; and that if faculty explain what constitutes plagiarism, then the number of plagiarism instances might decrease very rapidly.

An additional finding from our research is in the agreement level, or lack thereof, that faculty members exhibited in our sample. Out of the 9 significant scenarios, only 5 showed a high consistency in the faculty ranks. Scenario 4, 5, 9, 13, and 15 all had faculty agreeing over 80% that the action referred to was unacceptable. All other scenarios had faculty relatively split 50/50 on whether or not the action described was cheating or not. If faculty members do not agree among themselves, what can be expected from their students? It has to create some confusion for students when one professor deems an action acceptable, while another professor would treat that same action as unacceptable.

Another conclusion that can be reached is about freshmen. Most of the scenarios analysis showed that freshmen had usually a larger disagreement with faculty on what constitute cheating than the rest of their peers. Based on that result, we believe that there is a need to educate our incoming first year students in regards to what is academically permissible.

Finally, we also discovered that we may need to update our definition of academic dishonesty. We used Lambert’s et al. (2003), which states that academic dishonesty is breached by any kind of unauthorized action that would result in a higher/undeserved grade for the student. However, in two cases, faculty expressed that a student helping a classmate would be considered to be engaging in academic dishonesty, even if that student would not gain any grade advantage (scenario 7 and 13). As a consequence, we would put forward the following definition: “A student engages in academic dishonesty when that student tries to enhance his or her grade by any unauthorized mean or helps another student in doing so”.

REFERENCES


APPENDIX A

Questionnaire

John and Jane are two imaginary college students. Here are 16 different situations, please tell us if you think that any of these constitutes cheating. Once completed, return the questionnaire to the envelop provided, the last respondent will seal the envelop. To ensure anonymity, please do not write your name on the questionnaire. Participation is voluntary, if you do not want to participate or have done so in another class, return your questionnaire blank.

1) John is taking a test in class, while professor Absent Minded is not looking; John asks his friend Jane if “C” is the correct answer for question #2. Jane nods.
   a) John is cheating        Yes ☐    No ☐
   b) Jane is cheating        Yes ☐    No ☐

2) While writing a paper for Dr. Shake Spears, Jane goes to the library and downloads a few papers to support her writing. After reading them, she cuts and pastes in her text some sections of what she has read and she doesn’t cite her sources.
   Jane is cheating        Yes ☐    No ☐

3) While working on a take home test, John asks his friend William to double-check his math for a problem that is in the test. William doesn’t find any error.
   John is cheating        Yes ☐    No ☐

4) Jane’s calculator comes preloaded with mathematical formulas. John’s calculator doesn’t have some formulas in it. Both calculators are in an approved list by their professor. Before the test, John enters the missing formulas in his calculator. They both use some of the formulas during the test.
   a) John is cheating        Yes ☐    No ☐
   b) Jane is cheating        Yes ☐    No ☐

5) Jane is taking a test in a learning center by herself. She is stumped by one question and texts her friend Maria for help. Maria doesn’t respond.
   Jane is cheating        Yes ☐    No ☐

6) John is taking a test in class, while professor Absent Minded is not looking; John looks at his notes in his cell phone and finds that the answer for question 3 is “D”.
   John is cheating        Yes ☐    No ☐

7) While working on her take home test, Jane asks John if he found the same response for a given question. He didn’t, she checks her math and finds an error, she corrects it and now her answer matches John’s.
   a) John is cheating        Yes ☐    No ☐
   b) Jane is cheating        Yes ☐    No ☐

8) John is taking a test in class, while professor Absent Minded is not looking; John looks at his notes in his cell phone, but does not find the answer he was looking for.
   John is cheating        Yes ☐    No ☐

9) While writing a paper for Dr. Shake Spears, Jane goes to the library and downloads a few papers to support her writing. After reading them, she cuts and pastes in her text some sections of what she has read and she cites only a few of her sources.
   Jane is cheating        Yes ☐    No ☐
10) Jane is taking a test in a learning center by herself. She is stumped by one question and

texts her friend Maria for help. Maria responds with an incorrect answer.

Jane is cheating  Yes [ ] No [ ]

11) John and Jane are in the same class, Professor Absent Minded gives a take home exam for

the class. John and Jane work together on the exam.

a) John is cheating  Yes [ ] No [ ]
b) Jane is cheating  Yes [ ] No [ ]

12) John is taking a test in class, while professor Absent Minded is not looking, John looks at

his friend Jane’s test and see that she answered “C” for question #5.

a) John is cheating  Yes [ ] No [ ]
b) Jane is cheating  Yes [ ] No [ ]

13) John couldn’t be here for a test and asked his professor if he could take it at a later time.

Before taking his test, John discusses with Jane about what he really needs to review

for the test.

a) John is cheating  Yes [ ] No [ ]
b) Jane is cheating  Yes [ ] No [ ]

14) Jane is taking a test in a learning center by herself. She is stumped by one question and

texts her friend Maria for help. Maria responds with the correct answer.

Jane is cheating  Yes [ ] No [ ]

15) Professor Absent Minded likes to use listing questions in his test (i.e. list the Marketing

four Ps). John knows that and writes possible questions and answers on paper to help

in his review. Jane asks John if she can use his review notes.

a) John is cheating  Yes [ ] No [ ]
b) Jane is cheating  Yes [ ] No [ ]

16) Jane’s calculator, which is approved by her mathematics professor, comes preloaded with

mathematical formulas. Before a test, Jane entered more formulas in her calculator. Jane
didn’t use any of the extra formulas during the test.

Jane is cheating  Yes [ ] No [ ]

17) What is your classification?

Freshman [ ] Sophomore [ ] Junior [ ] Senior [ ] Faculty [ ]

18) What is your major?__________________________________________

19) Would you consider yourself a religious person?

Not at all [ ] a little [ ] very much [ ] very strongly so [ ]

20) Have you ever seen someone cheating in College/University?

Yes [ ] No [ ]

If Yes, please list which of the previously described situation(s) you have seen.

[ ] 2 [ ] 3 [ ] 4 [ ] 5 [ ] 6 [ ] 7 [ ] 8 [ ] 9 [ ] 10 [ ] 11 [ ] 12 [ ] 13 [ ] 14 [ ] 15 [ ] 16 [ ]

21) Have you ever cheated in College/University?

Yes [ ] No [ ]

If Yes, please list which of the previously described situation(s) you have done (all answers

will be kept confidential).

[ ] 1 [ ] 2 [ ] 3 [ ] 4 [ ] 5 [ ] 6 [ ] 7 [ ] 8 [ ] 9 [ ] 10 [ ] 11 [ ] 12 [ ] 13 [ ] 14 [ ] 15 [ ] 16 [ ]
22) If you have seen someone cheating, please tell us what you did about it?
   Nothing…because I didn’t know what to do   
   Nothing…because it didn’t matter to me   
   Talked to the cheater   
   Report it to the professor directly   
   Reported it to the school administration directly   
   Indirectly/Anonymously

23) On average how many times in a month do you attend religious activities (i.e. attending Church/Temple, confession, or other rites)?
   0  1  2  3  4  5  6  7 or more
HARMONIZING COMPETING LEGAL THEORIES IN PATENT LAW, ANTIMONOPOLY LAW AND THE FIRST AMENDMENT

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ABSTRACT

The Supreme Court held in Walker Process Equip. Co. v. Food Mach. & Chem. Corp. (1965) (Walker Process) that enforcement of a patent procured by fraud on the U.S. Patent and Trademark Office can violate Section 2 of the Sherman Act. However, Walker Process left open who had standing to sue and the burden of proving such a claim. Recently, appellate courts have made large sweeping rulings on these issues. The author suggests that this trend has departed from the language of Walker Process, which left open the ability of lower courts to create nuanced rulings to reflect an effective melding of the jurisprudential theories underlying patent law, antitrust law, and the First Amendment.

INTRODUCTION

Patent law complements antitrust law. The patent system seeks to “promote the progress of science” by adjusting investment-based risk (U.S. Const. art. I, § 8, cl. 8). Likewise, the antitrust laws seek to foster competition in industry. Using civil actions to enforce the patent law and antitrust laws are complicated by the First Amendment of the U.S. Constitution. Likewise, antitrust law seeks to foster competition in industry. However, using civil actions to enforce patent and antitrust laws are complicated by the First Amendment of the U.S. Constitution.

The primary reason for this complication is that patent law antitrust law and the First Amendment have very different underlying jurisprudential theories that have guided their respective interpretations in American courts since the beginning of the twentieth century. Patent law has been formed and guided by property theories. Patent law seeks to determine when a property right is created, when that property right is misappropriated, and what remedies are available for such misappropriations (O’Brien, 2009). In contrast, antitrust law is formed and guided by microeconomic theory and, in particular, industrial organization. Industrial organization asks how firms set prices in a market economy (Fisher & Monz, 1991). A part of industrial organization regards either causing a deviation from an equilibrium market price, or punishing such a deviation when it occurs. The former is commonly called regulation, and the latter is commonly referred to as competition policy or antitrust. Antitrust often involves balancing society’s interests with the interests of a particular firm; this utilitarian balancing is similar to that used in First Amendment analysis. The First Amendment protects certain kinds of expression from interference by the government. In doing so, courts consider “competing private and public interests at stake in the particular circumstances shown.” (Barenblatt v. United States, 1959).

Consequently, patent law, antitrust law, and the First Amendment intersected in a unique variety of antitrust laws that developed over the last few decades. This article examines the interplay of these laws and their underpinnings in the context of direct purchasers, typically retailers, suing sellers of patented products for deceiving the U.S. Patent and Trademark Office.
while their patents are being obtained. This is commonly referred to as a Walker Process claim. This article argues that allowing retailers’ broad standing to sue disregards the nuance that Walker Process embraced. The article concludes with recommendations to balance the antitrust policy considerations of purchasers with property rights of patentees and the First Amendment.

**Patent Law: a Primer**

An inventor may obtain a patent for “any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof” (35 U.S.C. § 101). In order to do so, an inventor must apply to the U.S. Patent and Trademark Office (USPTO) and explain how to make and use the invention (35 U.S.C. § 112). A person is entitled to patent on a device, unless the device was “in public use or on sale [for] more than one year prior to the date of the application for patent,” or the applicant “did not himself invent the subject matter sought to be patented” (35 U.S.C. § 102(b)). Additionally, an applicant has a “duty to disclose information material to patentability” such as prior sales, previous public uses, and other inventors (37 C.F.R. 1.56). Therefore, a patent application often contains more than just a description of the invention, since it must also contain information that could negatively affect patentability.

Once a patent issues, the patentee has the right to prevent others from making, using, or selling the patented invention anywhere in the United States and the patentee can obtain money damages for an infringement of these rights (35 U.S.C. § 271). An action for infringement requires 1) an act of infringement, and 2) a valid patent (35 U.S.C. § 271). When a patent represents an entire market, and that patent is enforced, the patent holder has an opportunity to gain a monopoly in that market and obtain monopolist profits. Such large rewards have tempted some patent applicants to avoid disclosing information that could negatively affect patentability. Unfortunately, when an applicant fails to disclose known information that is material to patentability, an issued patent could later be cancelled.

In this regard, the creation and modification of a property right manifests the moral underpinning of the Patent Act. People have ownership rights to the fruits of their labor that result in an added value to society (Locke, 1986, p.8). Once ownership is established, society has the prerogative to create rules regarding modification (Epstein, 1998, p.30). The primary modification to ownership that society seeks to prevent is theft (Exodus 20:15). Without protections to prevent theft, individuals would have limited incentive to add value to society out of fear that this value may be stolen from them (Aquinas, II-II, q.66).

Wrongfully obtained property is equally troubling. The action requiring one to return wrongfully obtained property has been recognized at Common Law since the time of King Henry III (Statute or Marlbridge). Likewise, a prohibition against stealing from the sovereign has been recognized since time immemorial (Genesis 42:29-43:15 King James Version). It follows reasonably then, that patents are property rights that should be protected – unless the patent is a product of deceit on the USPTO, in which case, the patent should be cancelled. However, the extent of the ramifications of the monopoly power, in the context of patent enforcement, is the subject of antitrust law, which is discussed in the next section.

**The Intersection of Patent Law and Antitrust Law**

A patent enables the patentee to prevent others from making, using, or selling the patented device anywhere in the United States (35 U.S.C. § 271). However, there can be no
monopoly until a patent is enforced. For example, through patent enforcement, competition can be removed from the marketplace by using the threat of an infringement lawsuit (35 U.S.C. §281). Once competition has been removed, the firm with the patent is able to charge a cartel price – an artificially high price that is well above the market price of the invention. (Sexton, R. 2010, p. 370).

Cartel prices can cause two possible antitrust injuries. The first possible injury is a competition injury that applies to either those persons about to enter, or those persons who are presently in, the market place. Typically, this injury is calculated as the business loss of the plaintiff who was unable to enter the marketplace and is independent of any profits of the defendant (Foer & Cuneo, J. 2010, pp. 84-86). The second possible injury is an overcharge injury that applies to the direct purchaser and is calculated as the difference between the cartel price and the market price (Foer, A. pp. 84-86). Practically, direct purchasers typically suffer very minor and speculative injuries – perhaps only a few pennies (Crane, 2010, p. 12-14). This minimal injury is because most of the injury to the direct purchaser is passed through to the consumer (Crane, p. 12-14).

Section 2 of the Sherman Antitrust Act prevents the willful acquisition or maintenance of monopoly power in a market (Sherman Antitrust Act). However, obtaining a patent gives the patent holder an exception to Section 2 and the ability to charge cartel prices without facing criminal penalties under the Sherman Act or civil penalties under the Clayton Act (United States v. General Electric Co., 1926). This exception would appear to comport with the moral underpinnings of the Patent Act, by creating a property right for the inventor, and then giving the inventor the opportunity to enforce the property right. However, the termination of a property right, specifically by the sovereign, raises First Amendment issues.

**Utilitarian Balancing under the First Amendment**

In Walker Process Equip. Co. v. Food Mach. & Chem. Corp., (1965) (Walker Process), the U.S. Supreme Court held that “the enforcement of a patent procured by fraud on the Patent Office may be violative of § 2 of the Sherman Act provided the other elements necessary to a § 2 case are present”. In that case, Walker Process Equipment sued Food Machinery & Chemical for infringing its patent for knee-action swing diffusers used in aeration equipment for sewage treatment systems. Food Machinery & Chemical counterclaimed, claiming that Walker Process Equipment “illegally monopolized interstate and foreign commerce by fraudulently and in bad faith obtaining and maintaining . . . its patent . . . well knowing that it had no basis for . . . a patent” (Walker Process Equip. Co., at 175). In particular, Food Machinery & Chemical stated that Walker Process Equipment, in its patent application, failed to report sales that would qualify as prior art, thereby violating the duty to disclose information material to patentability (Walker Process Equip. Co., at 175). In short, the defendant counterclaimed that Walker Process Equipment, by suing Food Machinery & Chemical, was seeking to enforce a patent that should not have been issued by virtue of the previous undisclosed sale.

The Supreme Court recognized that the counterclaim in Walker Process involved balancing conflicting interests between the Sherman Act and the First Amendment of the U.S. Constitution. The Sherman Act prevents willful acquisition or maintenance of monopoly power in a relevant market (Sherman Antitrust Act; United States v. Grinnell Corp., 1966). Simultaneously, Americans can “petition the Government for a redress of grievances” under the First Amendment (U.S. Const. amend. I). This “right to petition extends to all departments of the Government,” (Cal. Motor Transp. Co. v. Trucking Unltd, 1972) and thus creates an “antitrust
immunity” from liability under the Sherman Act for such petitions, including patent applications (Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc., 1961 (Noerr)). In Noerr, a group of rail companies lobbied the Pennsylvania State Legislature for an advertising campaign that disparaged the trucking industry in the state. The statute was vetoed, but the trucking companies claim to have suffered some losses from the debate surrounding the law and sued under the Clayton Antitrust Act (1914). The U.S. Supreme Court dismissed the case, stating that under the First Amendment, the rail lobby had the right to lobby for whatever it wanted. Therefore, Noerr (1961) created an antitrust immunity existed for activities that were protected under the First Amendment, even if those activities would otherwise incur liability under the Clayton Antitrust Act (1914).

However, the Supreme Court held that this “antitrust immunity” does not extend to petitioning considered to be “a mere sham to cover what is actually nothing more than an attempt to interfere directly with the business relationships of a competitor,” (Noerr, 1961). In Cal. Motor Transp. Co. v. Trucking Unltd (1972) (Cal. Motor Transp. Co.), one group of highway carriers sought to prevent a second group of carriers from obtaining permits for operation on highways by filing “a pattern of baseless, repetitive claims....” (Cal. Motor Transport Co. 1972). This abuse of administrative and judicial processes was found to be outside of the Noerr antitrust immunity. The U.S. Supreme Court allowed an action under the Clayton Antitrust Act (1914) to proceed against the first group of highway carriers.

A similar exception from Noerr’s antitrust immunity exists in “the enforcement of a patent procured by fraud on the Patent Office” (Walker Process Equip. Co., 1965). Thus the Court ruled that a viable claim (hereafter a “Walker Process claim”) arises when one party claims that another party, which has obtained a patent based on fraud, is trying to enforce that fraudulent patent to obtain a monopoly in the market, in violation of the Sherman Act.

Interestingly, the issue of who has standing to assert a Walker Process claim was not raised in Walker Process. Similarly, the requirements for successfully pleading a Walker Process claim were not enumerated in that case either. The Court’s decision to leave the issue open-ended resulted in a plethora of divergent views, applying different principles on the matter. This was arguably done by design to afford lower courts more flexibility to reach nuanced rulings. A few of these rulings are discussed in the following sections.

**Who Can Assert a Walker Process Claim and How?**

The battlefield for stating a viable Walker Process claim is often found in the Federal Rules of Civil Procedure (hereafter “Rules” or “Rule”). In particular, Rule 12(b)(1) permits a defendant to dismiss a case for a lack of standing. Standing is an injury that is sufficiently significant in order for a lower court to hear a case. Additionally, Rule 12(b)(6) permits a defendant to dismiss a claim when a plaintiff has failed to adequately plead enough facts to show that the claim is plausible.

Turning first to standing as a constitutional matter, a plaintiff must have standing in order to sue. Constitutional standing exists where a plaintiff suffers an injury in fact, which is caused by the defendant, and can be remedied by a favorable court decision (Lujan v. Defenders of Wildlife, 1992). However, the Supreme Court, in Assoc. Gen. Contractors of Cal., Inc. v. Carpenters (1983), explained that “the focus of the doctrine of ‘antitrust standing’ is somewhat different from that of standing as a constitutional doctrine. Harm to the antitrust plaintiff is sufficient to satisfy the constitutional standing requirement of injury in fact, but the court must make a further determination whether the plaintiff is a proper party to bring a private antitrust

Generally speaking, U.S. Supreme Court precedent seeks to provide for economic efficiency by allowing fewer potential plaintiffs in antitrust cases than in other cases because antitrust damages can quickly become fractured if too many plaintiffs assert overlapping injuries. Too many plaintiffs asserting overlapping injuries would create the unfavorable situation where there are fewer antitrust lawsuits and less antitrust enforcement.

As a practical matter, private parties, or those who are not the government, enforce the Sherman Act through the Clayton Act. In particular, Section 4 of the Clayton Act allows for money damages, including treble damages, and has very strict standing requirements, while section 16 of the Clayton Act allows for injunctive relief and has comparably lesser standing requirements than Section 4 (Schoenkopf v. Brown & Williamson Tobacco Corp., 1980 (Schoenkopf). Schoenkopf explained that Section 16 relief more encompassing because language is less restrictive than Section 4 and because injunctive remedy is flexible, adaptable tool for enforcing antitrust laws (Schoenkopf, 1980). However, both Sections 4 and 16 require a plaintiff to meet a higher standard of standing than constitutional standing by showing a favorable balance of five factors: “(1) the nature of the plaintiff’s alleged injury; that is, whether it was the type the antitrust laws were intended to forestall; (2) the directness of the injury; (3) the speculative measure of the harm; (4) the risk of duplicative recovery; and (5) the complexity in apportioning damages” (Amarel v. Vonnell, 1996; Assoc. Gen. Contractors of Cal., Inc. v. Carpenters, 1983). In the context of Walker Process claims, the question of how direct the injury must be to assert standing has been the most controversial.

Theoretically, both competition injuries and pricing injuries are actionable in antitrust actions. This is because pricing injuries can also affect consumers who purchase products from direct purchasers. However, federal antitrust injuries cannot be remedied by indirect purchasers, (Illinois Brick v. Illinois, 1977). This rule applies to pricing injuries for indirect purchasers in Walker Process claims as well (In re Relafen Antitrust Litig., 2005)). It follows that, standing for Walker Process claims has historically been reserved for those parties who suffer a competition injury and wish to utilize a Walker Process claim as a counterclaim in a patent infringement case.

A question of law that has, until recently, remained unresolved is whether a direct purchaser may have standing to assert a freestanding Walker Process claim for an overcharge injury. As with many cases, the issue of whether or not a direct purchaser has standing to assert a Walker Process claim, was first tackled by the federal district courts. This district-level discussion resulted in two distinct lines of reasoning from the East and West Coasts of the United States – the first from the District of New Jersey, and the second from the Northern District of California. We turn now to the former, or what is referred to herein as the “New Jersey approach,” which is characterized by giving the property rights of the patent holder, more weight than the likelihood of injury to the direct purchaser.

The New Jersey Approach to Walker Process Standing

The New Jersey approach is encapsulated in the legal theory espoused by former Federal Judge Orlofsky in In re K-DUR Antitrust Litig. (2007) (In re K-DUR). In that case, Judge Orlofsky determined that a competition injury, caused by an antitrust violation, is best litigated by a competitor (who is the party closest to the harm), and that direct purchasers do not have standing to bring a Walker Process claim for pricing injuries (In re K-DUR, 2007).

To arrive at this result, Judge Orlofsky examined a series of cases that discussed the issue
of Walker Process standing in terms of both competition injuries and pricing injuries. The first word on the matter was by Judge McCurn in Indium Corp. of Am. v. Semi-Alloys, Inc., 1984. Indium Corp. of Am. involved a declaratory judgment action for patent invalidity, where the plaintiff raised a Walker Process claim for a competition injury. The court in Indium extended Walker Process standing to producers who “were ready, willing, and able to produce the article and would have done so but for the exercise of exclusionary power by the defendant” (Indium Corp. of Am., 1984).

Two years later Judge Thompson, in Carrot Components Corp. v. Thomas & Betts Corp. (1986) (Carrot Components), reached the exact opposite conclusion. Carrot Components, much like Indium, sought a declaratory judgment of invalidity of two of the defendant’s patents, and damages for competition injury under a Walker Process claim (Carrot Components, 1986). However, in Carrot Components, the court ruled that with respect to declaratory judgment claims, only parties that have been directly threatened with suit, or parties who can demonstrate that they reasonably anticipate a patent infringement suit or some other effort by the patent holder to enforce a patent, might have standing to bring such a claim for relief.

Next to speak on the matter was Judge Posner, sitting by designation in Asahi Glass Co. v. Pentech Pharma., Inc., 2003 (Asahi Glass Co.) In Asahi Glass, the plaintiff was a supplier of paroxetine, the active ingredient in a generic version of the drug Paxil. Asahi sued the defendant, GlaxoSmithKline (Glaxo), in a declaratory judgment action similar to Carrot Components, in an effort to have the patent for Paxil declared invalid. To show the “directness of injury requirement,” Asahi argued that its potential customers were not purchasing its paroxetine product because they feared being sued by Glaxo for infringement (Asahi Glass Co., 2003). Judge Posner observed that if the plaintiff's potential customers were deterred by Glaxo's threat of suit, then those customers had a cause of action against Glaxo based on competition injuries. However, Asahi itself had no right to bring an action on that basis. With regards to direct purchasers, Asahi Glass notes, in dicta, that direct purchasers who face an infringement lawsuit have standing to pursue Walker Process claims, but a supplier who is not the target of a suit by a patent holder does not have standing to bring a Walker Process claim.

After the Asahi Glass decision was In re Remeron Antitrust Litig (2005), where direct purchasers claimed they suffered an overcharge injury after Remeron published its patent for mirtazapine (In re Remeron). Judge Orlofsky noted that Remeron consolidated Indium and Carrot Components to create what would become the majority rule: “Plaintiffs, as direct purchasers, 1) never had the ‘099 patent enforced against them, 2) were never threatened with such enforcement, and 3) were not in a position to manufacture a competing generic version of mirtazapine” (In re Remeron, 2005). Essentially, under Remeron, at least one of these three conditions must be satisfied to have Walker Process standing for money damages. Remeron went on to explain that direct purchasers could seek injunctive relief under Section 16 of the Clayton Act, but that the speculative nature of the overcharge injury was too vague for Section 4 money damages (In re Remeron, 2005; Clayton Antitrust Act, 1914).

The only case Judge Orlofsky could find that granted direct purchasers standing to bring a Walker Process claim based on an overcharge injury was Molecular Diagnostics Labs. v. Hoffman-LaRoche, Inc., (2005) (Molecular Diagnostics) which departed from all existing case law at the time. In Molecular Diagnostics, the plaintiff, a direct purchaser of the subject patented product, brought suit under Section 1 of the Sherman Act. The plaintiff charged that it had been forced to pay artificially inflated prices for the product as a result of the defendants’ enforcement of the patent, which the plaintiff alleged was obtained by fraud on the USPTO. In his opinion for
Molecular Diagnostics, Judge Kennedy distinguished Carrot Companies from the present case, because here, the plaintiff was a direct purchaser, and not a competitor. Judge Kennedy also dismissed Remeron for its poor reasoning (Molecular Diagnostics, 2005). As he explained, the rationale behind heightened standing requirements was not to limit antitrust plaintiffs, but to ensure the correct plaintiff was in court.

Examining these factors, the court sees no reason to limit standing to competitors. While entities facing enforcement actions are more likely to rely on Walker Process, this reflects more that they are in a stronger position to detect wrongdoing than a Congressional preference. If one believes that one of the primary purposes of a treble damages action is deterrence, then increasing the number of parties scrutinizing the actions of potential monopolists will further that goal. Moreover, because direct purchasers have frequent interactions with the defendants, they have a strong incentive to discover and litigate the offense. See William H. Page, The Scope of Liability For Antitrust Violations, 37 STAN. L. REV. 1445, 1488 (1985). Those against whom a patent is enforced, by comparison, will generally have limited contact with a defendant unless there is the suspicion of infringement (Molecular Diagnostics, at 281-82).

Thus, the court in Molecular Diagnostics ruled that direct purchasers and competitors are equally well-suited to pursue Walker Process claims against both patent holders whose patents are obtained through fraud or “inequitable conduct” on the USPTO and against those who collude with them.

However, Judge Orlofsky rejected Judge Kennedy’s reasoning.
Against the backdrop of this case law, I conclude that Molecular Diagnostics is an isolated anomaly. The fact that the Molecular Diagnostics court found an exception to the general rule of antitrust standing in that case certainly does not mean that the “rule” has lost sway in cases where antitrust claims are based on Walker Process-type allegations (In re K-DUR, at 2007).

In short, the New Jersey approach adopts the majority rule, which reserves standing for Walker Process claims for competitors alleging competition injuries, and rejects the reasoning in Molecular Diagnostics as it “created an unnecessary … split of authority, without any compelling reason” (Fisher v. San Jose, 2007). But was Molecular Diagnostics really “an isolated anomaly” (In re K-DUR, 2007)? The Northern District of California answered that question in the negative.

The Northern District of California Approach

As referred to herein, “the Northern District of California approach” is the legal theory adopted by Judge Alsup in In re Netflix Antitrust Litig. (2007) (In re Netflix), in which direct purchasers were granted standing to bring a Walker Process claim. This theory adds a new dimension for plaintiffs to attack not only the property rights of patentees who allegedly use deception to obtain patents, but to punish such patentees for their ill-gotten gains on both the competitor level and the direct purchaser level.

As a matter of background, Netflix operates an online DVD rental business covered by two patents: U.S. Patent Nos. 6,584,450 and 7,024,381. On April 4, 2006, Netflix sued Blockbuster for infringement of the ‘381 patent and the case went into discovery before settling (Netflix, 2007). Dennis Dilbeck, a consumer who rented DVDs from Netflix, tried to intervene in the action, stating that he suffered an overcharge injury as a result of Netflix’s patent, which was obtained by fraud. The court denied Mr. Dilbeck’s request and the parties subsequently settled. Undaunted, Mr. Dilbeck filed suit, alleging a Walker Process antitrust violation based on
the Blockbuster lawsuit. He claimed that the Netflix patents prevented others from entering the market and that the Blockbuster lawsuit was a sham, resulting in a price injury for direct purchasers like him. In granting Mr. Dilbeck standing in Netflix, Judge Alsup found Molecular Diagnostics persuasive because he believed that in some antitrust cases, the consumer suffers most directly. Judge Alsup determined that the New Jersey cases were not dispositive in Netflix because those cases were dealing with issues different than in the current case:

> This order finds Molecular Diagnostics persuasive. Even though Walker Process claims are predicated on enforcement of a fraudulently-obtained patent, the harm still accrues directly to consumers. Competitors are excluded from the market allowing the patentee to create or maintain an unlawful monopoly (Netflix, Inc., 2007).

However, Judge Alsup ultimately dismissed the claims for failure to plead with the particularity required by Rule 9(b) of the Federal Rules of Civil Procedure. Rule 9(b) requires that allegations of fraud be stated with particularity. This requires that adequate allegations to be present to show that relief are plausible. Where relief is not plausible the claim will be dismissed.

This issue recently came before the Northern District of California again in Ritz Camera & Image, LLC v. SanDisk Corp. (2008) (Ritz Camera I). By way of background, in SanDisk Corp. v. STMicroelectronics, Inc., (2008) (SanDisk) SanDisk sued STM and others for patent infringement (SanDisk, 2008). The case was eventually consolidated with Ritz Camera and another case, and STM settled. Presently, SanDisk is not suing anyone for patent infringement relating to the patents in this case. The issues in Ritz Camera and STMicroelectronics are essentially identical, and only the parties differ. In Ritz Camera, the plaintiff alleged that Eliyahou Harari tortuously converted flash memory technology from his former employer, STM, which led to SanDisk obtaining U.S. Patent Nos. 5,172,338 and 5,991,517. Further, Ritz Camera alleged that SanDisk failed to disclose prior art to the Patent Office, making the patents procured by fraud. Moreover, SanDisk’s effort to enforce the ‘338 and ‘517 patents against STM and others, created a cartel price for flash memory above the market price. This created an overcharge injury to Ritz Camera, who purchased chips containing the patented flash memory technology for its cameras from SanDisk. Ritz Camera argued that it should have direct purchaser standing to remedy the overcharge injury with a Walker Process claim.

Unlike Netflix (2007), where there was no pleading support for a Walker Process claim, Judge Fogel found sufficient support in STMicroelectronics. Thus, the only question in Ritz Camera, was whether or not direct purchasers could assert a Walker Process claim for a price injury (Ritz Camera I, 2011). Judge Fogel answered that question in the affirmative, but only for the very narrow reason that SanDisk’s patents were tainted from STM’s Walker Process claim in STMicroelectronics. In that case, STM had alleged a competition injury and its Walker Process claim survived summary judgment before the case eventually settled. Thus, with regards to Ritz Camera’s direct purchaser standing for an overcharge injury in the present case, Judge Fogel opined:

> However, because viable Walker Process claims are rare, it is unlikely that many direct purchasers will be in the same position as Ritz is here. Moreover, as the Supreme Court observed in Walker Process, “the interest in protecting patentees from ‘innumerable vexatious suits’ [may not] be used to frustrate the assertion of rights conferred by the antitrust laws” (Ritz Camera I, 2011).

Further, the court noted that “because of the heightened evidentiary requirements necessary for a showing of fraud, few Walker Process claims survive summary judgment,”
putting Ritz Camera in a very unique position (Ritz Camera I, 2011). While Judge Fogel cited no authority for the proposition that a Walker Process claim surviving summary judgment is rare, his citation to In re DDAVP Direct Purchaser Antitrust Litig., (2009) (DDAVP) made it clear that he sought to make a narrow ruling based on the facts of the particular case.

In re DDAVP dealt with a patented antidiuretic drug that was patented as a result of declarations made of the drug’s novelty during the patent application process. However, those declarations were made by employees of Ferring, the drug’s maker, who did not disclose their financial interest in the transaction. In subsequent litigation, the district court found that the non-disclosure of the employees’ interest in Ferring amounted to inequitable conduct and declared the patent invalid. Shortly thereafter, a number of retailers who sold DDVAP sued Ferring for a direct purchaser Walker Process claim. The Second Circuit allowed the claim to go forward stating that Ferring’s situation was unique as another court had found the patent invalid. (DDAVP, 2009).

With DDAVP (2009) in mind, Netflix and Ritz Camera raise the question of which individuals antitrust statutes are intended to protect. In both cases, the Northern District of California held that direct purchasers should be protected alongside competitors. By embracing the reasoning found in Molecular Diagnostics, these cases rekindled the debate about the scope of permissible Walker Process claims, which was absent just five years ago. The debate raged on as SanDisk sought an interlocutory appeal before the U.S. Court of Appeals for the Federal Circuit on its denied motion to dismiss. That appeal is discussed in the next section.

The Federal Circuit Takes on Direct Purchasers and Walker Process Standing

In Ritz Camera & Image, LLC v. SanDisk Corp. (2012) (Ritz Camera II), Ritz Camera argued that Walker Process left open the possibility that anyone could assert a Sherman Act claim, and that the Supreme Court only discussed the matter in the context of a counterclaim due to the procedural posture of that particular case (Walker Process Equip. Co., 1965). SanDisk countered that the Second Circuit had ruled in DDAVP that only in circumstances where a patent had already been found to be invalid was a fraud sufficient to assert a Sherman Act claim (DDAVP, 2009). Further, SanDisk argued that its patents had not been “tainted” by STMElectronics the same way as in DDAVP, because its patents had never been found to be invalid (Ritz Camera II, 2012). Therefore, SanDisk concluded that, Ritz Camera could not assert a valid Sherman Act claim. Ritz Camera responded that, by surviving a motion for summary judgment, STM’s Walker Process claim in STMElectronics had “tainted” SanDisk’s patents in a manner similar to DDAVP and, therefore, its Walker Process claim was valid.

SanDisk also argued that, in terms of direct injury, a direct purchaser should lose standing in favor of a patent infringement defendant who has a substantial monetary stake in the outcome (Ritz Camera I, 2011). Thus, SanDisk asserted that STM was in the best position to assert a Walker Process claim in this situation, not Ritz Camera (Ritz Camera I, 2011). As previously mentioned, STM had indeed asserted a “substantially identical” Walker Process claim as a counterclaim in its initial litigation against SanDisk that survived summary judgment, but which ultimately resulted in a settlement. This settlement concerned the Federal Trade Commission (FTC), which noted in an amicus brief that settlements of this variety allowed the market dominant company to settle claims in order to continue dominating the market. Due to this unfavorable result, the FTC sided with Ritz Camera and argued in favor of direct purchaser standing.

In reaching its ruling the Federal Circuit noted in its opinion that two appellate courts had
found direct purchasers to have standing, while none had ruled to the contrary. 

The Second Circuit has held that direct purchasers had standing to pursue their Walker Process claim despite the fact that, as purchasers, they could not directly challenge the patent's validity (In re DDAVP, 2009). The D.C. Circuit has likewise allowed a Walker Process claim to proceed even though the patentee had disclaimed the patent and thus the plaintiff faced no risk of an infringement suit (Oetiker v. Jurid Werke, GmbH, 556 F.2d 1 (D.C. Cir. 1977). (Ritz Camera II, 2012).

Thus, the Court ruled that direct purchasers, who face no threat of an infringement lawsuit, have standing to pursue Walker Process claims regardless of the procedural posture of the case. There is, however, still a requirement for the defendant to enforce the patent and to have that enforcement result in an unreasonable restraint of trade. That is, direct purchasers may have standing, but only by standing on the shoulders of competitors.

Consequently, in Ritz Camera II (2012), the Federal Circuit essentially adopted the Northern District of California approach, instead of the New Jersey approach, by granting direct purchasers standing to bring Walker Process claims arguably at the expense of efficiently enforcing antitrust statutes. This is because direct purchasers are in a poor position to pursue antitrust litigation in this context, except as a class action, which presents its own problems – namely, providing meaningful relief to victims. Because the majority of the injury suffered by the direct purchaser is passed on to the consumer, allowing direct purchasers the ability to sue causes one corporation to receive a windfall from another corporation, while consumers are the ones who suffer as a result of cartel prices. As a result, providing direct purchasers with standing to bring a Walker Process claim does not accomplish the goals of antitrust enforcement – to create a more competitive marketplace, nor does it provide consumers with any meaningful relief.

On the other hand, unlike direct purchasers, competitors have a keen knowledge of the marketplace that puts them in a strong position to detect and remedy antitrust violations by pursuing competition injuries. As a practical matter, price fixing is only found a small portion of the time it occurs – perhaps 13-17% of the time – making direct purchasers ineffective plaintiffs (Crane, D., 2010, p. 13). On the other hand, competitors who have a patent enforced against them have a very tangible stake in litigation and can seamlessly enforce the Walker Process claims as part of the infringement litigation. Judge Posner came to such a conclusion in Asahi Glass, which was similar to the majority opinion articulated in Walker Process, when he considered the nature of adjudication at the trial level, and implored the trial court on remand to examine “the injurious consequences to Walker of the patent's enforcement” (Walker Process, 1965). Judge Posner reasoned that fraud on the USPTO was an injury that was directed to competitors of the patented device and not to others affected in the supply and marketing chains. “The claim of fraud on the patent office fails for the reason just given: if patent 723 was obtained by fraud, it was a fraud aimed at competing manufacturers of drugs…” (Asahi Glass Co., 2003). In other words, fraud on the USPTO is a competition injury and thus, only competitors should have standing to remedy this injury (Asahi Glass Co., 2003).

Furthermore, to the extent that direct purchasers are oppressed by the marketplace, injunctive relief under Section 16 of the Clayton Act is sufficient to address their harm, as discussed above in Section II. Remeron (2005) explains that while direct purchaser injuries may be too speculative for money damages, they may be appropriate for an injunction under section 16 of the Clayton Act. To that end, Remeron (2005) cites In re Warfarin Sodium Antitrust Litig. (2000), which held that the class plaintiffs could sue for antitrust violations under Section 16 for
three reasons. The first reason was that the class plaintiffs alleged injury by unlawful restraint on market competition, which is a type of injury that can be redressed by antitrust statutes. Second, because the class plaintiffs could only obtain an injunction, and not money damages, there was no risk of duplicative recovery. The last reason was that the class plaintiffs were necessary and foreseeable victims of defendant DuPont's effort to exclude generic competition and an injunction allowing generic competition would address this injury. Thus, in the cases of Ritz Camera I (2009) and Ritz Camera II (2012), an injunction allowing others to practice SanDisk’s patents would have opened the market to competition in a more efficient manner than granting money damages to Ritz Camera.

In the rare circumstance where money damages for direct purchasers might be appropriate, a more nuanced approach for standing determination left open by the Supreme Court in Walker Process could accommodate such a circumstance instead of a broad rule – a fact that Ritz Camera II (2012) failed to acknowledge. While the issue of direct purchaser standing itself has fractured the trial courts and birthed several different of views on the matter, this is precisely the fact intensive result that Walker Process intended. With its emphasis on the “examination of market effect and economic consequences,” Walker Process urged courts to look at the unique posture of each case, and determine injuries through the lens of economic data (Walker Process, 1965). Such an approach grants courts a great deal of flexibility, but also leads to a variety of outcomes. This is why the Second Circuit, in DDAVP, ruled that the enforcement of a patent after it is found to be invalid could violate the Sherman Act, while the Northern District of California narrowly granted direct purchaser standing to Ritz Camera, despite the fact that SanDisk’s patents had never been invalidated in Ritz Camera I. By broadly ruling that all direct purchasers have standing to bring Walker Process claims, the Federal Circuit in Ritz Camera II disregarded the careful analysis urged by Walker Process to the detriment of the efficient enforcement of antitrust laws.

**Harmonizing Legal Theories in the Walker Process Claim**

Ritz Camera II (2012) deviated from Walker Process in that it broadly embraced the antitrust principal of providing recovery for an overcharge injury at the expense of adequately considering the social value of the property interest of the patent and the limitations imposed on sham litigation created by the First Amendment. One way to rebalance the nuance embraced by Walker Process can be found in other kinds of intellectual property civil actions that invoke antitrust law.

As noted above, an action for patent infringement requires 1) a valid patent and 2) an act of infringement. The antitrust claim arises when patent infringement litigation is pursued either without a valid patent or without good faith belief of an act of infringement. At a high level, this is the same kind of vexatious litigation that created a claim under the Clayton Antitrust Act (1914) in Cal. Motor Transp. Co. (1972) as an exception to Noerr immunity discussed above. More specifically, when a plaintiff files a complaint for patent infringement without a valid patent, a Handgard claim results. Where there is no act of infringement, a Loctite claim results. Both Handgard and Loctite claims are embodiments of the sham litigation exception to Noerr immunity and are explained in more detail below.

In Handgard Inc. v. Ethicon Inc., the Ninth Circuit ruled that engaging in patent infringement litigation when the plaintiff knew that the patent at issue was invalid was a violation of Section 2 of the Sherman Act (Handgard Inc., 1979). Today, this kind of action is widely called a Handgard claim and has been broadly construed to include a variety of
intellectual property where trademarks, copyrights, and so on, were the subject of suits in bad faith. However, a Handgards claim utilizes the nuanced balancing of Walker Process and fails as a pleading matter if the patent was affirmed, or was even considered close to valid, in another hearing.

This reasoning provides respect for the property right of the patent holder and espouses the idea that an established property right should be protected by society and not cast away. This prevents theft of intellectual property rights, or, infringement. For instance, in Bio-technology Gen. Corp. v. Genentech, Bio-technology General Corp. (BTG) sued Genentech for infringement of U.S. Patent No. 4,601,980, and Genentech counterclaimed with a Handgards claim based on ongoing litigation at the International Trade Commission (ITC) (BTG, 2001). The District Court dismissed the counterclaim because the ITC had issued an initial determination that the claims were valid and infringed. While this decision was not final, it was sufficient to prevent an antitrust claim from being pleaded under Rule 9(b).

The reciprocal of Handgards is Loctite, which held that Noerr immunity to a Sherman Act suit would be lost if one filed a patent infringement lawsuit knowing that no infringing act occurred. In Loctite Corp. v. Ultraseal Ltd., Loctite sued Ultraseal for infringement of two patents directed to holding wood together with a substrate (Loctite Corp., 1985). Like in BTG, the parties had an ongoing action at the ITC, in addition to the Federal Circuit, where eventually Loctite would drop its infringement claims arguing it now believed them to be invalid. Ultraseal counterclaimed with a Sherman Act claim, here with a modified Handgards claim, where Ultraseal argued that it was implausible for its substrate to be the one claimed in Loctite’s patents given their chemical differences. The Court found that the chemical differences existed, but did not agree that Loctite had acted in bad faith; rather, the Court found that Loctite had done some testing and found enough similarity to make its original claim for infringement, even if that claim failed.

Both BTG and Loctite, in affirming the property rights of patent holders, demonstrate the fundamental idea behind patent law jurisprudence – that society ought to defend property rights. And in these narrow instances allows for a deviation from an equilibrium price and enforcement of a patent that would otherwise cause a Sherman Act claim to arise under antitrust law. Nuanced rulings like BTG and Locite also support the free speech rights of patentees to assert good faith claims to defend their property without having to fight off an antitrust lawsuit every time they do so.

Another example of nuanced rulemaking can be found in In re Lipitor Antitrust Litig. (2013) (In re Lipitor), which can in the wake of the Federal Circuit adopting the broad ruling on direct purchaser standing in Ritz Camera II. With the exception of DDAVP, the value of the patent as a property right was not considered in the viability of the Walker Process claim under Rule 12(b)(1). Rather, the focus was on the overcharge injury. In re Lipitor took a totally different approach on this matter under Rule 12(b)(6) by looking at a patent as a property right in the first instance. This antitrust litigation showed how direct purchasers pounced on patented products where the patent was enforced and then challenged. This was the unfortunate result theorized by SanDisk in Ritz Camera II (2012). After a patent was successfully defended in a series of court proceedings, direct purchaser drugstores Walgreens and Meijer sued Pfizer with a Walker Process claim, arguing that Pfizer’s patent for its drug, Lipitor, was procured by fraud on the USPTO.

Lipitor is a drug that lowers cholesterol by inhibiting a liver enzyme. The drug was covered by a large number of heavily litigated patents, but the litigation primarily dealt with U.S.
Patent Nos. 4,681,893 and 5,273,995. The patent examiner initially rejected the ‘995 patent as not being patentably different than the ‘893 patent. Pfizer appealed to the Board of Patent Appeals and Interferences, arguing that the ‘893 patent did not disclose preferred quantity ranges of two primary compounds in the drug, and that those quantity ranges resulted in the drug in the ‘995 patent being ten times more effective than the drug in the ‘893 patent. The Board remanded the case to the examiner to consider whether the ‘995 patent was obvious in view of the ‘893 patent (Ex parte Roth, 1993). The examiner responded by simply issuing the ‘995 patent. The plaintiffs claimed that Pfizer had lied in a table in the ‘995 patent, which contained “cherry-picked” and deceptive results.

As the lives of the ‘893 patent and the ‘995 patent were winding down, Ranbaxy, on August 19, 2002, filed and Abbreviated New Drug Application (ANDA) to market generic Lipitor. Ranbaxy then asserted that the generic Lipitor did not infringe the ‘893 patent or the ‘995 patent, and that neither patent was valid at all. Infringement litigation proceeded for the next two years, with the District Court subsequently finding the ‘893 and ‘995 patents valid, enforceable, and infringed (Pfizer, Inc. v. Ranbaxy Labs. Ltd., 2005). Relevantly, Ranbaxy raised the “cherry-picked” data allegation, and it was rejected by the District Court. Similar proceedings between Ranbaxy and Pfizer were instituted in Canada, Australia, and at the USPTO (Ranbaxy Australia Pty Ltd. v. Warner-Lambert Comp., 2006; Pfizer Canada Inc. v. Novopharm Ltd., 2006). These proceedings went on until April 2008, when Ranbaxy and Pfizer entered into a settlement agreement, which the plaintiffs characterized as a reverse payment agreement.

A reverse payment agreement is where the patentee offers to pay an alleged infringer to not produce the patented product until the patent's term expires (FTC v. Actavis, 2013). These agreements only violate antitrust laws when their effect is an unreasonable restraint of trade (FTC v. Actavis, 2013). Here, Meijer and Walgreens alleged that Ranbaxy agreed to settle its claims with Pfizer and that Pfizer agreed to waive its outstanding judgments against Ranbaxy creating an unreasonable restraint on trade in violation of the Sherman Act. This cleared the way for the Ranbaxy product to enter the market the day the ‘893 patent expired. Other competitors could only enter the market if they could show they were not infringing on Pfizer’s numerous other patents for Lipitor. It is on these facts that the direct purchaser plaintiffs based their Walker Process claim.

Judge Sheridan began his analysis in Lipitor (2013) by noting that the direct purchasers did have standing because they alleged they suffered an overcharge injury. Here, he distinguished Reneron (2005) and Carrot Components (1986) by applying the overcharge injury rule in Ritz Camera II (2012). Judge Sheridan, however, dismissed the Walker Process claims for failure to allege claims that plausibly showed an antitrust violation. A Walker Process claim requires:

1) The patent at issue was procured by knowing or willful fraud on the USPTO; (2) the defendant was aware of the fraud when enforcing the patent; (3) there is independent evidence of a clear intent to deceive the examiner; (4) there is unambiguous evidence of reliance, i.e., that the patent would not have issued but for the misrepresentation or omission; and (5) the necessary additional elements of an underlying violation of the antitrust laws are present (Nobelpharma AB v. Implant Innov., Inc., 2008).

With regard to the first four elements, the claim could not plausibly be argued because these same arguments for invalidity had already been tried, and had failed in a plethora of courts around the world. That is, since the property right had been firmly established, it could not be taken away. This is a reciprocal of the rule in DDAVP (2009). In DDAVP (2009), the patents’ proven prior invalidity grounded the antitrust claim. In Lipitor (2013), the patents’ proven
validity foiled the antitrust claim. Pleading an antitrust claim based on the fraud exception to
Noerr immunity fails as a pleading matter under the First Amendment when any prior proceeding
indicated that either 1) the intellectual property was valid, or 2) there was a reason to believe
infringement had occurred.

This failure results because the fraud exception to Noerr immunity claims “sound in fraud,” and must be pleaded with particularity under Rule 9(b) (In re DDAVP, 2009). This
requires explaining both the circumstances and the results of the fraud. Where the pleaded facts
indicate that the outcome was not fraudulent, that is, a valid patent issued or there was an act of
infringement, then the claim fails in the first instance because there was no fraudulent outcome.
Judge Sheridan embraced the nuance that Walker Process allowed while weighing the
competing concerns of antitrust law, patent law, and the First Amendment. The vindication of
Pfizer’s patents’ in three proceedings reaffirmed the property right and foreclosed the retailer’s
challenge under Walker Process as a pleading matter. This represents the same kind of
jurisprudential balancing that created workable rules in BTG and Ultrasel.

CONCLUSION

Walker Process represents an opening for lower courts to balance three areas of law with
very different jurisprudential underpinnings. The best way to balance patent law, antitrust law,
and the First Amendment is with a nuanced approach to formong rules. To contrast, Ritz Camera
II created too broad of a rule and prevented the flexibility available from making nuanced rules
in the lower courts. These nuances can permit plaintiffs who have suffered antitrust injuries to
recover damages, while at the same time allowing courts to dismiss claims where the patent in
question has been affirmed in another proceeding. This approach enables litigants to have their
day in court while preventing vexatious litigation at the onset.

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CORPORATE SOCIAL RESPONSIBILITY AND CONFLICTING STAKEHOLDER INTERESTS: USING MATCHING AND ADVOCACY APPROACHES TO ALIGN INITIATIVES WITH ISSUES

Zinaida Taran, Penn State Harrisburg
Stephen Betts, William Paterson University

ABSTRACT

Corporate Social Responsibility (CSR) is a topic of great interest at many levels. To society, CSR can be instrumental in moving toward sustainability and achieving other social goals. For organizations it is a way to do good while improving organizational reputation and brand equity. For an organization’s various stakeholders, social responsibility may be interpreted in narrow and specific ways. It is ideal for organizational CSR activities to align with the interests and concerns of the organization’s stakeholder groups. However choosing particular CSR activities and directions can be rather challenging if stakeholder groups have interests at odds with one another. In this paper we examine these conflicts and use reactive matching and proactive advocacy strategies to provide prescriptions to practitioners. This paper closes a gap in the literature by examining stakeholder group’s heterogeneity and conflict with as well as among the stakeholder groups in combination with ambiguity and uncertainty of CSR decision making.

INTRODUCTION

As the new millennium progresses, organizations are escalating their commitment to “do good” by practicing Corporate Social Responsibility (CSR) (Peloza & Shang, 2011) with such things as donating money to various charities, promoting social and environmental issues, changing their business practices and products to be greener, more humane, and so on. Frequently companies consciously responding to social pressures and striving to achieve sustainability in economic, social, and environmental sense, find ways to positively include their efforts as part of an explicit competitive strategy to increase company reputation (Du, Bhattacharya & Sen, 2007). However conflicting beliefs and concerns among the key stakeholders groups can make it a challenge when choosing particular CSR activities.

Situations where stakeholder interests are at odds abound. It could be as simple as some residents in a town feeling strongly that they need a new school, while the rest of the town feeling as strongly that they really wish for the land to remain wooded and undeveloped. The Cape Wind project, a proposed offshore wind farm, stalled for many years because of such conflicts and resulting lawsuits and appeals whereby property owners did not want to have the ocean view obscured, environmentalist groups wanted to see the green energy, yet other environmentalist groups questioned the effect of the project on the marine ecosystem, etc. (Cassidy, 2014; Fraser, 2011). Wal-Mart’s CSR charitable efforts directed at several charities in New York City (such as the New York Women’s Foundation, and Bailey House, which distributes groceries to low-income residents) are not directly conflicting with the interests of activist groups and local government that objected to them (Culvert, 2014). In this case the
objection was to Wal-Mart building a store in their community and claimed that the retail giant had no real interest in those charities but were just using them to gain favor in the community.

Stakeholder management literature discusses reconciling the interests of multiple stakeholders as part of business functioning (Bridoux & Stoelhorst, 2014). However, it does not deal specifically with choosing CSR actions and directions. Moreover, it is common to divide stakeholders into functional groups (consumers, suppliers, etc.) and analyze their interests as a whole group with an implicit assumption of homogeneity within each group. However, there can be distinct subgroups within each group, with their own and conflicting interests. For example, some consumers might feel strongly about green energy while others are concerned about particular impact on local butterfly species, which the green energy project might hurt.

This paper contributes to the literature by explicitly addressing the different interests and resulting inter-group conflict between the major functional stakeholder groups concerned with corporate CSR activities, an area not previously examined. It closes this gap by suggesting a framework of reactive matching and proactive advocacy for approaching practical decision making addressing the conflict within and between the stakeholder groups, and the ambiguity and uncertainty surrounding CSR decisions caused by stakeholder heterogeneity.

In this paper we will briefly present the concept of Corporate Social Responsibility (CSR) and some of the ways in which it manifests itself in organizations. Next we will address the response of stakeholders to CSR. This is followed by the discussion of the problem of conflicting interests and objectives and interests of stakeholder groups. Finally we present some prescriptions for directing CSR activities.

CORPORATE SOCIAL RESPONSIBILITY

Corporate social responsibility are a company’s “actions that appear to further some social good, beyond the interests of the firm and that which is required by law” (McWilliams, Siegel & Wright, 2011). This rather broad description allows for a great variety of different internal and external objectives and related activities to fall within CSR. Some of the major categories that CSR activities can be divided into are those related to: philanthropy (cause-related marketing, cash donations, statements of support for charities, promotion of a social issue, etc), business practices (for example, environmental protection practices), and products (products that generate less pollution, organic, etc.) (Peloza & Shang, 2011).

This approach to classifying CSR directions is reflected in developing systems of CSR ratings and guidelines. For example, the database ‘Socrates: The Corporate Social Ratings Monitor’, also known as KLD, uses a classification scheme that separates CSR activities into six broad categories: community support, diversity, employee support, environment, non-US operations, and product (Sen & Bhattacharya, 2001). This spirit has been retained as KLD got acquired by MSCI (MSCI, 2011), even though it appears that MSCI has been de-emphasizing social support of community and other external stakeholders. MSCI’s index rests on three main pillars: social, governance and environmental. Consulting organizations such as London Benchmarking Group (LBG) is providing a slightly more detailed, but consistent with KLD approach to classifying actions as Education, Health, Economic development, Arts and Culture, Social welfare, and Emergency Relief (KLD’s/MSCI’s social and environment index).

Organizations organize and coordinate their CSR activities according to these categories (Tencati, Perrini & Pogutz, 2004). For example, many organizations consider sustainability (e. g. Hult, 2011; Hunt, 2011) a useful category of CSR activities: “Companies can contribute to the sustainable development of communities through socially responsible
activities if the values they adopt through CSR coincide with those of sustainable development and, especially, if CSR is incorporated into a company's long-term strategies” (Jucan, 2011).

A very common approach in defining and operationalizing CSR is to do so through the concept of stakeholders (Clarkson, 1995). The idea is to expand the business’ objectives to serving the stakeholders other than shareholders and customers in their direct roles and thus pursuing the triple bottom line of “People, Profits and Planet.” (Elkington, 2004). Typically, stakeholders are divided into functional groups based on the nature of their relationship with the company as employees, customers, suppliers, local community, government, etc. (Clarkson, 1995).

MULTIPLE AND CONFLICTING CSR OBJECTIVES AND ACTIVITIES

An almost unlimited number of possible CSR activities and programs are available for organizations to pursue. For example, let us consider just one category of CSR - charitable giving. In 2014 there were 966,599 public charitable organizations registered in the US (National Center for Charitable Statistics, 2014). With the great number of possible CSR activities, each with its own impact, there is significant potential for conflict between different initiatives. Normative descriptions for choosing which objectives to pursue may be at odds. A categorization scheme of the issues that can cause difficulty in making CRS decisions, as well as general solution approaches are presented in Table 1.

<table>
<thead>
<tr>
<th>TYPE OF ISSUE</th>
<th>DIFFICULTY</th>
<th>SOLUTION APPROACH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ambiguity</td>
<td>Social issue that is being addressed is overly complex, beyond the manager’s expertise</td>
<td>Secure an expert’s opinion</td>
</tr>
<tr>
<td>Change</td>
<td>New information, reasoning and/or evidence has been uncovered since the issue became prominent</td>
<td>Secure an expert’s opinion, education, advocacy, advertising</td>
</tr>
<tr>
<td>Information</td>
<td>Uninformed/misinformed stakeholders with unclear and conflicting expectations</td>
<td>Education, advocacy, advertising</td>
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Table 1 SOURCES OF CSR DECISION DIFFICULTY

Different organizations provide standards and guidelines in different areas helping companies systematically outline broad areas of important concern and choose objectives that matter to society. London Benchmarking Group (LBG) is one of several international entities that have emerged dedicated to providing standards and guidelines in the areas of sustainability (Tencati, et al. 2004). They provide members with a very detailed set of guidelines (for example, “Don’t count the advertising expenses of a cause related marketing campaign. Only count the amount that the charity actually receives.” (London Benchmarking group, 2010, p.11) The LBG model can be presented as a matrix juxtaposing why, where and toward which objective (arts & culture, environment, etc.) various inputs (cash, time, in kind, etc.) are being donated. LBG’s influence extends beyond the 300 companies that it counts as its members because its guidelines are being followed by other organizations such as Dow Jones Sustainability Index (Dow Jones Indices, 2010). Multiple research efforts are mounted to attempt to forge tools for evaluating CSR impacts on relevant stakeholders (for example, Chang, Kim & Li, 2014; Parsons &Moffat, 2014).

However, the combinations and permutations regarding choices of CSR activities can still present a considerable challenge. Some of the objectives at odds with or completely contrary to
other objectives, even within the same broad category of objectives, for example: keeping jobs in
the local community/ alleviating world poverty by building jobs elsewhere; overall reducing
consumption/raising capital for significant technological innovations; abandoning electric
operated devices such as soap dispensers to save energy/producing health hazards through germ
transference; switching from animal to soy products by “health/environment conscious”
individuals leading to rain forest depletion because people there burn them to make soy fields,
and so on (Cooper, 2011).

The range and scope of social and environmental problems which require solutions and
could possibly benefit – or not - from the managerial actions in the form of CSR activities is
enormous, with many aspects unknown or unknowable (Margolis & Walsh, 2003). The situation
becomes even more complicated if we look at the whole set of social problems as a system with
multiple interconnections. As the businesses are increasingly expected to cure social ills, the
managers may find themselves ill-equipped to handle the complicated and ill-specified task.

**STAKEHOLDER CONFLICT**

When formulating CSR objectives and activities it is important to establish a dialogue
with all important stakeholder groups and carefully evaluate issues raised by different groups
(Pederson, 2006; Maignan, Ferrell & Ferrell, 2005). Some have proposed a stakeholder model
(Maignan, et al. 2005) presenting a simplified picture of the key stakeholder groups (consumers,
government, community), however we propose expanding this model by adding heterogeneity
among the key groups, in particular, customer and community. We divide stakeholder conflict
into those between different stakeholders (external conflict) and those between stakeholders and
the organization’s position (internal conflict). Table 2 shows the difficulties presented by these
stakeholder conflicts and general solution approaches.

<table>
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<tr>
<td><strong>STAKEHOLDER CONFLICT</strong></td>
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<tr>
<td>TYPE OF CONFLICT</td>
</tr>
<tr>
<td>Stakeholder External Conflict</td>
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<tr>
<td>Stakeholder Internal Conflict</td>
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It has been noted that “the fundamental dilemma of stakeholder theory is how to
prioritize the myriad and diverse stakeholder claims from the broad range of actors involved.
“(O’riordan, & Fairbrass, 2014, p. 123). Identifying all the actors involved and the complexity of
their interrelationships with other stakeholders can be a daunting task. Each stakeholder group
has a set of interests, and each of these interests can be aligned with, unrelated to or in conflict
with the interests of any other group. When one group is for an issue and the other is against,
conflict arises. At this point the company should consider the relative importance and power of
different customer and other groups, as well as the legitimacy of their stands (Maignan, et al.
2005).

Recently members of City Council of New York has protested Walmart’s charitable
contributions to area organizations including $1 million to the New York Women’s Foundation,
which offers job training, and $30,000 to Bailey House, which distributes groceries to low-
income residents; the Council members demanded that the charitable contributions be stopped
and possibly even returned (Culvert, 2014). Well known is the multiple long-standing conflicts among local residents, environmentalists, various governmental and industry groups and other stakeholders surrounding the off-shore wind energy project Cape Wind (see, for example, Cassidy, 2014).

CSR activities will result in increased reputational equity only if stakeholders are aware of these activities and believe them to be of benefit (Lai, Chiu, Yang & Pai, 2010). However perceptions of key stakeholder groups can be at variance or even in conflict with their own long-term interests. What consumers believe is ‘good’ may be different than what more informed thinking and evidence suggests. For example, if the customers believe that a company that sells sweetened drinks using only sugar and equivalent sweeteners is irresponsible and contributes to obesity in society, the company has a problem. Customer biases and ignorance of current reasoning, technology and evidence may penalize the company’s CSR efforts. There is an additional danger when the law follows such outdated consumer beliefs, leading to laws that are obsolete and inaccurate when they are enacted. They follow the lobbies which misrepresent popular misconceptions or short-term industry interests (i.e. no sugar soft drinks in vending machines).

Sometimes the company’s key stakeholders may hold beliefs that are mutually contradictory and the company cannot meet all of them. For example, environmental and social perspectives on sustainability emphasize efficiencies in use and minimization of waste of resources, which oftentimes is contrary to popular takes on sustainability that are often associated with beliefs in anti-globalization, anti-large business, pro-small local business. Organizations cannot accommodate such self-defeating contradiction in logic. Another potential problem is that some causes and issues become disproportionately prominent in public eye, some at the expense of other, more worthy issues. For example, 80% of the world spending on ‘neglected diseases’ goes to three diseases (HIV/AIDS, tuberculosis, malaria) (Moran et al. 2009) while they account for less than 10% of the burden of disease (WHO, 2008). In some cases, long-term issues may be simply at deep odds with the short-term considerations. For example, some researchers argue that even “green” products when over consumed will lead to exacerbation of current environmental problems; thus addressing overconsumption should be integral to organization’s sustainability-oriented marketing (Sheth, Sethia & Srinivasan, 2011). However, reduction in consumption may undermine the company’s ability to pursue other objectives, including developing cleaner, healthier technologies.

Having identified the issues and stakeholder groups supporting them, especially possible conflict areas, the company can then pursue two different strategies in determining their CRS plans. In situations where the company has no strong apriori position, they can choose to match the aspirations of their current customers (and other stakeholders). If the company has a strong position, they can choose to advocate and attempt to change the stakeholder beliefs to match those of the company. The former can be called a matching or CSR Pull, and the latter and advocacy or CSR Push strategies. The matching strategy recommends pursuing causes on which the stands of external stakeholder groups match, and avoid the areas of conflict. Alternatively, the advocacy strategy can be pursued. The company may choose a to educate and persuade the customers and other stakeholders when they are slightly at variance with the company’s own views, and avoid or even reject the customers who are actively opposed to what the company stands for (remembering, however that “dialogue is possible even in situations with conflicts of interest if the conflict can be regulated and/or the stakeholders will acknowledge the potential for a fruitful cooperation” (Pederson, 2006).
CONCLUSIONS

Strategically designed and implemented CSR can help further worthwhile social causes while increasing corporate reputation and brand equity (Du, et al. 2007). The impact of CSR on the organization depends on the stakeholders’ perception of the alignment of the interests between themselves and the organization. Conflicting stands and aspirations of different stakeholder groups regarding the societal, environmental and economic issues that are pertinent to the organization present a challenge that needs to be addressed. An analysis of issues of concern to various stakeholders can help the company appropriately choose to avoid some of the more contentious directions, concentrate on the areas of consensus (matching), or persuade, educate and possibly even reject some of the groups (advocacy).

It is important to remember that the commonly discussed functional groups of stakeholders (consumer, employees, etc.) (Clarkson, 1995) are not homogeneous and may have subgroups with conflicting interests and aspirations, adding a layer of complexity to the ambiguity marred CSR decision-making.

As corporate social responsibility initiatives continues to grow, it will be increasingly important for organizations to align their efforts with stakeholder interests and for researchers to continue to develop mechanisms for helping to achieve these objectives. It may be of use to look at the distribution of stakeholder attitudes toward an issue in terms of its center on the continuum from extreme opposition to enthusiastic support (mean and skewness), spread (dispersion), and tails (kurtosis). Further research directions should also include providing models of sustainability-driven CSR given stakeholder conflicts and ambiguity and empirical research of conflicts that companies encounter in their CSR activities.

This paper closes a gap in the literature by examining heterogeneity among stakeholder groups and conflict with as well as among the stakeholder groups in combination with ambiguity and uncertainty of CSR decision making. In addition, the paper provides reactive matching and proactive advocacy strategies to develop prescriptions to practitioners. Implications of this paper for practical decision making are in providing the framework to guide their decisions regarding CSR in light of carefully identified and considered stakeholder interests as well as the company’s own stand on issues.

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SUSTAINABILITY IS APPLIED ETHICS

Sharon S. Seay, University of West Georgia

ABSTRACT

This paper posits that sustainable management and accounting are in fact applied ethics. Some companies currently reporting on sustainability entitle their report as a “Good Citizenship Report.” Good citizenship, safeguarding the environment, giving back to the community, promoting workforce health and safety, and ‘doing the right thing’ are all examples of ethical behavior. Sustainability reporting focuses on corporate accountability or stewardship. Accounting as a profession has often been characterized as the watchdog of business, ensuring reporting that is fairly presented, reflecting economic reality. Accountants and auditors are bound by their professional code of ethical conduct to protect the public interest. Accountants and auditors are ethical detectives holding businesses to ethical standards of honesty, neutrality, completeness and representational faithfulness. So grounded, accounting is the provider of one of the essential checks and balances on commerce. This paper explores a holistic definition of sustainability as viewed through the lens of contemporary ethical theory, stakeholder theory, and accountability theory. The role of accounting and auditing as related to sustainability measurement and reporting is also examined. Accounting is often considered as applied ethics. Accountants and auditors are the gatekeepers of business ethics. Contemporary ethical models are applied to the accounting profession and to sustainability. This paper posits that sustainability is applied ethics. This paper contributes to the definition of sustainability, and to the literature relative to the integration of sustainable imperatives within the business entity and how to account for sustainable performance.

INTRODUCTION

The Brundtland Report (1987) defines sustainable development as the “development that meets the needs of the present without compromising the ability of future generations to meet their own needs.” Implicit in this definition is an expanded responsibility set for companies toward society with the inclusion of stakeholders, sustainability, business ethics, and transparency in the business model (Frias-Aceituno, et al. 2013). In recent years, an increasing number of companies issue Sustainability Reports, Citizenship Reports, or Corporate Social Responsibility Reports (CSR) to complement traditional financial reporting. Currently, there is increasing investor interest as well as other stakeholders’ interest in this type of qualitative information. Sustainable investment funds have appeared over the last few years (Koellner, et al. 2005). Customers frequently demand to know if products have been sustainably produced, preferring higher-priced green products to lower cost alternatives where environmental, social, and governance issues are not considered in production decisions.

Society and the market have changed, placing more value on corporate governance, social, and environmental concerns and altering corporate strategic goals. Sandrijn Weites of ABN AMRO stated, “Sustainability is a boardroom topic. It’s not something you do because it’s nice. The time of the fast buck is over for responsible companies; the number one priority now is sustainable growth. Our horizon has become not just the next quarter, but the next quarter of a century.” He suggests challenging corporate assumptions. He suggests, “Business managers with
day-to-day profit and loss responsibility have a short-term focus. Professional accountants in business need to hold a mirror up to these people and start asking questions. A profit of $180,000 may be a loss of a million dollars a year later. You need to get people thinking about the consequences.”

Sustainability is much broader and more encompassing than just environmental responsibility. Corporate sustainability must consider all company activities and stakeholders necessary for the company to create value and ensure its long-term survival and viability. Responsibilities to company employees, customers, suppliers, the community, the environment, and to future generations must be considered. This is a holistic perspective on sustainability, with a long-term focus. Such a perspective requires a business model where the rights of all stakeholders must be considered and balanced vs. exploitative business models.

This paper posits that sustainable management and accounting are in fact applied ethics. Some companies currently reporting on sustainability entitle their report as a “Good Citizenship Report.” Good citizenship, safeguarding the environment, giving back to the community, promoting workforce health and safety, and ‘doing the right thing’ are all examples of ethical behavior. Sustainability reporting focuses on corporate accountability or stewardship. Accounting as a profession has often been characterized as the watchdog of business, ensuring reporting that is fairly presented, reflecting economic reality. Accountants and auditors are bound by their professional code of ethical conduct to protect the public interest. Accountants and auditors are ethical detectives holding businesses to ethical standards of honesty, neutrality, completeness and representational faithfulness. So grounded, accounting is the provider of one of the essential checks and balances on commerce. This paper explores the role of accounting and auditing from an ethical perspective, positing that accounting is applied ethics. Accountants and auditors are the gatekeepers of business ethics. Contemporary ethical models are applied to the accounting profession and to sustainability. Sustainability is viewed through the lens of contemporary ethical theory, stakeholder theory, and accountability theory. Our research posits that sustainability is applied ethics.

CONTEMPORARY ETHICAL MODELS [BEAUCHAMP, 1982]

Religion

In the religious model, a supreme being, God, sets standards and guidance for right and wrong. The Judeo-Christian ethic provides moral imperatives as: be honest, respect human life, do good to others, respect individual rights and property, and so forth (Seay, 2010). While the global business marketplace within which multi-national firms trade may include companies and countries where the Judeo-Christian principles do not govern, religion does provide society’s broadest based ethical framework and can account for acts such as fair labor laws, environmental governance, and workplace safety.

Deontology

This ethical theory focuses on actions and ignores consequences. The emphasis is on duty. Accountants and auditors are bound by their duty to adhere to the AICPA Professional Code of Conduct along with personal ethical mores. Accountants and auditors have a moral duty to present or to assess fairly (honestly, completely, without bias). They have fiduciary or stewardship responsibility to the stakeholders. The primary duty of accountants and auditors is
to the public, rather than to their client. High standards of competence, integrity, and due diligence are required of accounting professionals. The efficient operation of our capital market system for the efficient allocation of scarce resources relies heavily on the relevance and reliability of accounting measurements, which in turn, has a significant effect on living standards.

One disadvantage of the deontological model is the lack of a framework for continuous evaluation of what is “best.” There are topics and questions for which no current GAAP or GAAS exists. These gray areas require the application of judgment on part of professional accountants and auditors. While the standard setting process for the promulgation of GAAP and GAAS is a very open, integrative process engaging many stakeholder groups, fallible human beings may promulgate fallible accounting and auditing standards. Although existing GAAP and GAAS may be inadequate in some cases, accountants and auditors have a duty to the profession to follow current standards. Ultimately, ethics should provide guidance to accountants and auditors. The ethical standard is fairness—transparency, honesty, freedom from bias. Accountants are required to apply the same professional standards to all reporting—quantitative (financial statements) and qualitative (sustainability reports).

Hermeneutical Model

This ethical model views the accountant as an agent of the business who must give an account of the business’s performance and resource utilization for the period to stakeholders. Under this ethical perspective, the relationship between the accountant and the accounting records and reports involves a greater moral imperative than the economic imperative of profit maximization and self-interest (Seay, 2010). Giving an account provides the corporation a “moral identity” (Schweiker, 1993). Schweiker (1993) claims that “…a hermeneutical and ethical examination of the activity of giving an account as basic to understanding the moral dimension of accounting practice and research.” By the act of giving an account, the accountant exposes the amoral world to ethical accountability. In the Socratic ethical question, “how should we live?” Schweiker suggests that accounting provides an identity to the “we” when the we is the corporation. Therefore, in the case of implementing a sustainable business model and giving an account to stakeholders regarding the model performance and its resource utilization, the accountant provides answers to questions relating to how the corporation “can and must live in relation to others and themselves” (Schweiker, 1993).

The corporation is a member of a moral community similar to an individual. In giving an account, the corporation subjects itself to a universal means of discourse to both examine itself and to be examined, through the fiduciary agent—the accountant or auditor. Giving an account provides a temporal identity, or snapshot, of the corporation’s actions and makes them accountable to the larger community. Thus, the accountant in effect becomes the moral conscience for the company. Accountants and auditors are professionally and ethically bound to faithfully render the company’s identity.

Communitarian Model

Aristotle, the early Greek philosopher, developed this ethical model, which argues that ethical considerations emerge within a particular community (1980). Under this ethical model, universal ethical imperatives are considered suspicious. While the deontological aspects of accounting are apparent, strong communitarian influences can also be identified by the due
process for GAAP promulgation in the U.S. Prior to the stock market crash of 1929, accounting principles had not been codified. In fact, they were inconsistent, inexplicit, and not universally enforced. More to the point, U.S. accounting principles for financial reporting emerged from within the community itself. GAAP emerged through an exchange between firms and government. The history of GAAP indicates a cycle of private standard setting, fraud resulting in litigation and often regulation, and the resultant modification of accounting standards.

GAAP, through the communitarian system of due process for standard setting, became more internally consistent, was codified, and financial statement comparability was enhanced. Financial statement relevance and reliability also increased promoting greater decision utility. International accounting standard setting, which is also influenced by the community served, demonstrates communitarian principles.

**SUSTAINABILITY**

Over 20 years have passed since the publication of the Brundtland report, the landmark text introducing the concept of sustainability to the global marketplace. Written in response to increasing concerns regarding global environmental and human rights issues, the report called for a new paradigm of economic and industrial development, one that “meets the needs of the present without compromising the ability of future generations to meet their same needs (1987).

Corporate sustainability can be viewed as a new and evolving corporate management paradigm—an alternative to the traditional growth and profit-maximization model. While corporate sustainability recognizes that corporate growth and profitability are important, it also requires the corporation to pursue societal goals, specifically those relating to sustainable development—environmental protection, social justice and equity, and economic development (Wilson, 2003). A review of the literature suggests that, conceptually, corporate sustainability draws from four concepts/theories: 1) sustainable development, 2) corporate social responsibility, 3) stakeholder theory, and 4) corporate fiduciary or accountability theory.

So, that is what an average hypothesis statement looks like. If you would like to put the numbers in subscript, you may do so. If you would like to spell out the word hypothesis, you may do so.

**Sustainable Development**

Sustainable development is a broad, dialectical concept that balances the need for economic growth with environmental protection and social equity (Wilson, 2003). Sustainable development combines social justice, economics, environmental management, business management, politics and law. In Our Common Future (1987), the World Commission for Environment and Development (WCED) recognized that sustainable development could not be left to policy makers and government regulators. Industry has to play a significant role. While corporations have always been engines for economic development, they need to be more proactive in balancing this economic drive with social equity and environmental protection. This is true because corporations are partially responsible for some unsustainable conditions, and because they have access to the resources necessary to address the problem. Sustainable development contributes to corporate sustainability in two ways. First, it identifies primary areas where companies should focus attention: social, environmental and economic performance. Secondly, it provides a common goal for governments, civil society, and corporations to work toward: social, ecological, and economic sustainability. However, sustainable development does
not explain why companies should care about these issues. Those arguments can be derived from corporate social responsibility and stakeholder theory.

**Corporate Social Responsibility (CSR)**

Corporate social responsibility deals with the role of business in society. The basic premise is that corporate managers have an ethical obligation to consider and address societal needs. The history of CSR can be traced back to the ancient Greeks, when governing bodies set rules of conduct for businessmen and merchants (Ebserstadt, 1977). Arguments in favor of corporate managers having an ethical responsibility to society draw from four philosophical theories (which incorporate contemporary ethical models):

**Social Contract Theory**

The central tenet of this theory is that society consists of explicit and implicit contracts between individuals, organizations, and institutions. These contracts evolved so that exchanges could be made between parties in a secure environment of trust and harmony. Corporations enter into these contracts with other societal members in order to receive resources, goods, and societal approval to operate in exchange for good behavior.

**Social Justice Theory**

This theory focuses on fairness and distributive justice---how and according to what principles, society’s goods (wealth, power, other intangibles) are distributed among society’s members. Proponents of this theory argue that a fair society is one in which the needs of all members of society are considered, not just those with power and wealth. Thus, corporate managers need to take into consideration the most appropriate distribution of goods in society.

**Rights Theory**

This theory concerns the meaning of rights---property rights as well as basic human rights. One argument in rights theory asserts that property rights should not override human rights. From a CSR perspective, this could be construed to mean that while shareholders have certain property rights, this does not give them the right to override basic human rights of employees, local citizens, and other stakeholders.

**Deontological Theory**

As described earlier in this paper, deontological theory asserts the belief that everyone, including corporate managers, has a moral duty to treat everyone with respect, including considering their needs. This is the “Golden Rule” theory.

CSR contributes to corporate sustainability by providing ethical arguments regarding why corporate managers should work toward sustainable development: if society in general sees sustainable development as a desirable, worthwhile goal, corporations have an obligation to assist society to move toward the attainment of that goal.
Stakeholder Theory

This theory is relatively modern, popularized by Edward Freeman (1984), who defined a stakeholder as “any group or individual who can affect or is affected by the achievement of the organization’s objectives.” This theory’s basic premise states that the stronger your relationships with external parties, the easier it will be to achieve your corporate objectives; the worse your relationships, the harder it will be. Strong stakeholder relationships are characterized by trust, respect, and cooperation. Stakeholder theory is a strategic management concept, unlike CSR, which is largely a philosophical concept. The objective of stakeholder theory is to enable corporations to strengthen relationships with external groups in order to achieve a competitive advantage.

Companies must identify their stakeholders. Generally, this would include shareholders and investors, employees, customers, and suppliers. Stakeholder criteria are somewhat unclear. Some authors define stakeholders as those who have a stake in the company’s activities—something at risk. Other authors considering the global impacts of industry—climate change or cultural changes due to marketing and advertising—define everyone as a stakeholder. Once a company’s stakeholders have been identified, the next challenge is to develop strategies for dealing with them. Different stakeholder groups often have different goals, demands, and priorities. Shareholders and investors want optimum return on investment; customers want quality goods and services at fair prices; local communities want community investment; regulators want full compliance with applicable regulations. However, common goals across many stakeholder groups include economic stability, environmental protection, and social justice. Priority levels across groups may vary.

Stakeholder theory contributes to CSR business arguments as to why companies work toward sustainable development. Stakeholder theory suggests that it is in a company’s own best interest to work toward sustainable development since by doing so they can potentially strengthen relationships with stakeholders, facilitating the achievement of corporate objectives.

Corporate Accountability

Accountability is the legal or ethical responsibility to give a reckoning or account of one’s actions/activities for which you are responsible. It is important to distinguish between responsibility and accountability. Responsibility refers to one’s duty to act in a defined way; accountability is one’s duty to explain, justify, or report on one’s actions.

While there are a number of different accountability relationships in the corporate world, the fiduciary relationship between corporate management and shareholders is most relevant in the context of this paper. The fiduciary model is based on agency theory, where corporate management is the ‘agent’ and shareholders are the ‘principal.’ In this contractual relationship, the principal entrusts the agent with capital to be used by the agent in the best interests of the principal. The agent is responsible to the principal for how the capital is used and the return on investment generated.

Likewise, the fiduciary relationship corporate management (the agent) and other stakeholder groups (the principal) represent contractual (explicit or implicit) arrangements defining accountability relationships. Companies that receive environmental permits to operate facilities are accountable to regulators for full compliance with permit regulations. Social contract theory argues that society gives corporations a license to operate in exchange for good or responsible behavior, making the corporation accountable to society for its
actions/performance.

Relative to corporate sustainability, the contribution of corporate accountability theory is that it defines the nature of the relationship between corporate managers and the rest of society. Accountability theory also provides arguments regarding why companies should report social, environmental, and economic performance in addition to financial performance. Accounting on social, environmental, and economic performance is often referred to as ‘triple bottom line’ reporting (Elkington, 1997).

SUMMARY AND CONCLUSIONS

Corporate sustainability is a holistic concept of what constitutes ethical/responsible corporate conduct, where corporate management (the agent) is accountable to all stakeholders (the principals) for their actions. Corporate sustainability or accountability encompasses giving an account or reckoning not only for financial performance, but also for corporate performance regarding social, environmental, and economic imperatives. Corporate sustainability intrinsically requires a long-term focus, and is based on fiduciary model theory. Corporate sustainability has many threads, drawing from contemporary ethical models, particularly the deontological and communitarian theories of ethics. Sustainability also draws from the concepts of sustainable development, corporate social responsibility theory, stakeholder theory, and accountability theory. Many of these concepts and theories also draw from contemporary ethical models. Since the purview of accountants and auditors is corporate reporting and attestation to the fairness of such reporting, accountants and auditors may be viewed as ethical gatekeepers holding businesses to ethical standards of honesty, integrity, neutrality, and transparency. Accounting is a discipline that is thoroughly ethical in nature (Francis, 1990). Dolfsm (2006) states that accounting as a profession is, in fact, applied ethics, and that people are likely to perceive their social environment firstly in moral terms. This paper posits that sustainability is, likewise, applied ethics.

REFERENCES


THE TALE OF TWO CFOS: THE BANALITY OF WRONGDOING AT HEALTHSOUTH CORPORATION

Robert W. Armstrong, University of North Alabama
Dennis R. Balch, University of North Alabama

ABSTRACT

This paper is a qualitative assessment of corporate wrongdoing at HealthSouth Corporation, using the Banality of Wrongdoing model. The interviewees were two of the CFOs involved in the HealthSouth scandal. Each CFO was independently asked fourteen structured interview questions that measured the following constructs: the culture of competition, ends-biased leadership, missionary zeal, legitimizing myth, the corporate cocoon, banality of wrongdoing and greed. Each CFO’s responses were compared to measure the presence or the absence of the construct and the significance of its impact on the unethical behavior at HealthSouth in the period from its founding in 1984 until the fraud was exposed in 2003.

The study found that the variables used to measure unethical behavior based on the Banality of Wrongdoing Model were an effective tool for performing a diagnostic mapping of an ethically troubled organization. The study also determined that the unethical activities undertaken by HealthSouth were not unthinking illicit behavior as originally expected but were intentional and calculated.

Keywords: banality of wrongdoing, missionary zeal, legitimizing myth, corporate cocoon, culture of competition, ends-biased leadership.

INTRODUCTION

Grasping why poorly performing businesses might resort to unethical practices to prop up a failing enterprise is easier than understanding why a high performance business would risk ruin in order to mask the inevitable flattening of performance that accompanies significant growth. Why would successful people who have no need to cheat in order to be successful, resort to cheating? This conundrum was addressed by Balch and Armstrong (2010), who argued that high performance involves challenging the status quo and pushing the boundaries of what is allowed to seek competitive advantage. Behavior at the margins of what is allowed may be critical to success, but carries with it the risk of crossing the line into unethical behavior. Success often involves defying conventional wisdom (breaking assumed rules of operation) in order to invent new methods to take advantage of evolving circumstances. It can become difficult for a high performance organization to distinguish between rule breaking that is legitimate (transcending obsolete models) and that which is illegitimate.

Drawing on the literature of normalized wrongdoing (Coleman, 1987; Ashforth & Anand, 2003; Anand, Ashforth & Joshi, 2005; Palmer and Maher, 2006), self-referential corporate cultures (Reidenbach & Robin, 1991), reputational risk (Fritzsche & Becker, 1994), reinforcement of predisposition toward wrongdoing (Baucus, 1994), and expectations of competitor behavior (Tenbrunsel, 1998), Balch and Armstrong devised the Banality of Wrongdoing model (2010) to study why high performance organizations are vulnerable to unethical behavior, and later applied this model in an empirical study of an Australian energy company (Armstrong & Balch, 2011).
The findings of several recent published and working papers strongly resonate with elements of the Banality of Wrongdoing model. The critical role of leadership in setting ethical tone has been examined in a variety of contexts: private universities in Bosnia and Herzegovina (Dinc & Zydemir, 2014), U.S. corporate environments (Deloitte & Touche, 2007), U.S. and European corporate environments (Soltani, 2014), and auditing firms (Tervo, Smith & Pitman, 2014). Linkages between ethical behavior and performance have been explored at corporate level by Blazovich and Smith (2011) and at national level by Smith, Gruben, Johnson and Smith (2013). Factors affecting ethical predisposition have been studied in education (Giacalone & Promislo, 2013), in county-level religious culture (Grullon, Kanatas & Weston, 2010), and in the U.S. accounting profession (Keller, Smith & Smith, 2007). A survey of ethics codes and CSR policies has been done by Linhoff, Martin, Smith and Smith (2014), and the potential for manipulation of CSR reporting for image management purposes has been examined by Mobus (2012). Lo (2011) has employed cognitive neuroscience to explore links between emotion and rational decision-making to illuminate the role of greed, fear and risk seeking/avoidance in producing and resolving financial crises.

Two other classic studies provide additional context. Milgram’s (1963) classic paper on obedience to authority despite awareness of ethical wrongdoing provides useful background for understanding the influence of a dominant and manipulative ends-biased leader. Hunt and Vitell (1986) point out the importance of the perception of ethical content and the interplay of deontological (righteousness of actions) and teleological (righteousness of consequences) theories of ethics; as our explication will show, obsessive focus on a specific set of consequences (financial) led to distorted teleological reasoning.

This paper performs a qualitative assessment of corporate wrongdoing at HealthSouth Corporation, employing the variables of normalized wrongdoing which were previously quantitatively tested in the Armstrong and Balch (2011) study.

The Banality of Wrongdoing model explores the implications of managers engaging in goal-seeking behaviors to gain an advantage. Whether the advantage sought is financial remuneration or a promotion or improved business results are irrelevant. The key is that legitimate and illegitimate goal-seeking behavior sometimes shares an important method—breaking rules. High performance organizations have to operate at the limits of what is allowed to avoid competitive disadvantage, and operating close to the line increases the likelihood of crossing the line. Like the football defensive back that uses his hands to hold the receiver, organizations can easily become involved in marginal unethical behavior. This behavior is often condoned under the “no harm, no foul” principle. This marginal unethical behavior sometimes spreads to other areas of the organization or through individuals as they see advantages in breaking the rules. Good or ethical organizational managers appraise this behavior as leading to future ruin and adjust management practices and condemn marginal practices, whereas unethical managers reward marginal unethical behavior that can become banal and lead to major ethical problems that are often illegal. This examination of HealthSouth CFOs tells the story of such an organization.

Under the leadership of Richard Scrushy, HealthSouth Corporation was a textbook example of a dynamic, high performance environment. HealthSouth pioneered the model of outpatient rehabilitation services and used early success and a high stock valuation to fuel a high-growth acquisition strategy. To make this strategy work, stock valuation had to remain high; otherwise, the ability to fund acquisitions would wane, growth would taper off, and valuation would further degrade. High performance environments offer favorable conditions for rule
breaking because they usually emphasize goals more than they emphasize standard methods of management that involve accounting checks and balances. Because HealthSouth was an innovative organization creating a new model for delivering rehabilitation services, the model necessarily involved breaking perceptual sets for how this business should be done. Thus, there were legitimate reasons for “icon breaking.” However, extending this practice to break accounting rules is unethical and may be illegal.

High performance at HealthSouth was accomplished through a series of acquisitions and then the subsequent “cooking the books” to always satisfy the Wall Street expected profit figures. In truth the unethical behavior was initiated by the need to please a domineering manipulative manager, and perpetuated by fear of discovery and personal disgrace. This behavior started, according to Aaron Beam (the first HealthSouth CFO), as simply doing things to gain Richard Scrushy’s favor, that is, marginal managerial favors in order to gain his support. For example, Aaron worked to book performances for Richard’s band. While not strictly unethical, such behavior is certainly marginal to the role of a CFO and was favor seeking.

**RESEARCH METHOD**

This paper performs a qualitative assessment of corporate wrongdoing at HealthSouth Corporation, using the Banality of Wrongdoing model (Balch & Armstrong, 2010). Assessment data was collected in interviews (June, 2012) with two former CFOs at HealthSouth. Aaron Beam, a HealthSouth cofounder, was its first CFO on whose watch the fraud started, and Weston Smith, HealthSouth’s fourth CFO, is the whistle-blower who exposed the fraud in 2003. Each former CFO was independently asked fourteen structured interview questions that measured the culture of competition, ends-biased leadership, missionary zeal, legitimizing myth, the corporate cocoon, banality of wrongdoing and greed. Each CFO’s responses were compared to measure the presence or the absence of the construct and to assess the significance of its impact on the ethical behavior at HealthSouth during the period from its founding in 1984 up to 2003 when the fraud was exposed. Many of the interview observations and anecdotes are echoed in Beam’s written account of his participation in the fraud, *HealthSouth: Wagon to Disaster* (2009).

**STRUCTURED INTERVIEW QUESTIONS**

Variable definitions and the associated structured interview questions are the following:

Culture of Competition: The pressures to break rules, defy convention, and engage in marginal ethical behavior to avoid conceding a competitive advantage.

1. Was it common practice to “push the limits” when competing with other managers for resources?
2. Was it acceptable to challenge the rules in order to win a client or make a deal succeed?

Ends- Biased Leadership: leadership which focuses so strongly on ends (chiefly financial) that insufficient attention is paid to the means by which the ends are achieved, thus displaying tolerance for wrongdoing.

1. How critical were “bottom-line results” versus generally accepted practices?
2. Did the ends usually justify the means?
Missionary Zeal: an exaggerated commitment to mission, regardless of side effects.

1. Did you judge your work at HealthSouth to be unique or special compared to all other businesses?
2. Would you say that unquestioning loyalty was valued above other character traits among management?

Legitimizing Myth and Image Management: a narrative (internal or external) that justifies why an organization behaves as it does.

1. Was the public image of HealthSouth more important than reality?
2. Did you defend the company against skeptics inside and outside the organization?

Corporate Cocoon: an encapsulated or isolated frame of ethical reference which accepts as normal some behaviors that would be regarded unethical by societal standards.

1. At HealthSouth were your personal ethics different than your company ethics?
2. At HealthSouth was internal approval more important than society’s approval?

Banality of Wrongdoing: the acceptance of certain levels of unethical behavior as normal and expected in an organization.

1. Was corrupt decision making both small and large a normal part of doing business at HealthSouth?
2. Did the organization develop to the point where slightly corrupt practices were commonplace?

Greed: intense and selfish desire for something.

1. Were the salary and rewards you received considered when you made unethical decisions?
2. Did social status derived from HealthSouth success contribute to your willingness to make unethical decisions?

INTERVIEW FINDINGS

The following tables juxtapose each CFO’s responses to the structured interview questions.

<table>
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<th>CULTURE OF COMPETITION Q1: WAS IT COMMON PRACTICE TO “PUSH THE LIMITS” WHEN COMPETING WITH OTHER MANAGERS FOR RESOURCES?</th>
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<td><strong>Aaron Beam</strong></td>
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| Beam did not perceive a great deal of internal competition, but observed “for many, many years I didn’t have to compete against anybody. I mean, I was the big dog. There may have been competing going on under me that I wasn’t aware of but it wasn’t the kind of thing I had to get mixed up in . . . It wasn’t Smith started as a director of reimbursement and experienced more of the give-and-take among middle managers. He recalled that HealthSouth “was a very competitive place internally . . . really fostered by Richard [Scrushy] in terms of the way he frequently pitted people against each other” and that “there was
### CULTURE OF COMPETITION Q1:
**WAS IT COMMON PRACTICE TO “PUSH THE LIMITS” WHEN COMPETING WITH OTHER MANAGERS FOR RESOURCES?**

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<td>competing against other people as much as it was trying to get Richard’s attention. That was the type of competition that went on.”</td>
<td>always this constant back and forth of trying to look good at someone else’s expense.” Smith observed that “the entire culture kind of became that way [highly competitive] where there was lots of back-stabbing among all levels of the organization” and “there was really never a team mentality.” Some of the internal competition involved flaunting wealth: “It was a contest to who was going to get that new BMW the quickest in the executive parking lot. It was always a game of oneupsmanship. Who had the best house, the big cars, the nicest lake house. I mean it was a constant show of that around there.”</td>
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### CULTURE OF COMPETITION Q2:
**WAS IT ACCEPTABLE TO CHALLENGE THE RULES IN ORDER TO WIN A CLIENT OR MAKE A DEAL SUCCEED?**

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<th>Aaron Beam</th>
<th>Weston Smith</th>
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<td>“We were probably pretty ruthless in that area. And we were very aggressive at getting doctors to do business with us. If somebody wanted to take a doctor out for drinks or on a fishing trip or whatever—the kind of stuff you don’t do today.” He notes that “doctors flew on our planes, and that one doctor “had a yacht. I think he even raced in the America’s Cup and HealthSouth was the one that paid for that. So we were very aggressive in those areas.” Beam remembers how the pattern for very aggressive accounting practice got started in the run-up to the 1986 IPO: “One of the investment bankers suggested that we capitalize our start-up costs which we’d been expensing. So we started, we told Ernst &amp; Young we were doing it, it was disclosed in our financial statements. See, I didn’t feel like it was fraud, but it was abused. Richard met with me one day and said ‘now look, part of what you do, part of what I do, it’s all start up. We ought to be capitalizing part of our salaries.’”</td>
<td>Smith recalls the pressure to be aggressive on any area of judgment on the balance sheet: “Not long after I started [1987], I could see that they were pushing the envelope on everything they were doing. I calculated the cost report numbers, the receivables…receivables and payables, and Bill came back with ‘Well, sure it needs to be at that number, we really can’t afford for it to be at that amount, go back and work the numbers again, go back and work the reserve numbers again to see if it’s really where it needs to be because we are within $20,000 of where we need to be on earnings and if you can work your side, a little more can go a long way.’” By 1996, aggressive practice had evolved to outright and indisputable fraud, which had a spillover effect on acquisition activities that caused due diligence practices to be seriously diluted. There are two factors to consider here. First, HealthSouth needed growth to justify its valuation; this meant pressure to do marginal deals: “We were also looking the other way as far as accounting digressions were concerned these other companies simply because Richard was going to do the deal no matter what no matter what we brought back no matter what bad news we identified in due diligence . . . We found plenty of things that probably should have driven purchase prices down or driven us away from the table in various deals , but Richard wanted to really grow the company, really didn’t care what we found in due diligence, we were going to close the deal, period.”</td>
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**CULTURE OF COMPETITION Q2: WAS IT ACCEPTABLE TO CHALLENGE THE RULES IN ORDER TO WIN A CLIENT OR MAKE A DEAL SUCCEED?**

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<td>The second factor speaks to the need to conceal the fraud: “Another problematic area was that we were cooking the books on our side so we kind of knew what areas to look in to uncover wrongdoing on the other people’s side, but we had to be careful when we did that because due diligence is a two-way street, especially in a deal where we were swapping stock for another company and they want some comfort that our stock is worth the paper that it’s written on. We can only push so far on due diligence of that company because we knew we would have to answer the same questions and would struggle on our side, so due diligence became weak because of that.”</td>
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**ENDS- BIASED LEADERSHIP Q1: HOW CRITICAL WERE “BOTTOM-LINE RESULTS” VERSUS GENERALLY ACCEPTED PRACTICES?**

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<td>Beam is unequivocal about the pressure to deliver results regardless of the means required: “Bottom line results was it . . . this all came from Richard. You did whatever you could do. Any creative accounting, anything you could do to tell Richard we had made our earnings was fine. He didn’t care how you got there in the least as long as you got there.”</td>
<td>Smith is blunt about the primary emphasis on results and tolerance for ethical abuses: “Oh, I mean, results were it. Nothing else really mattered with the culture at HealthSouth. It was all about making the number, whatever the number was . . . It was all about hitting the Wall Street number as opposed to what reality was within the company.”</td>
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**ENDS- BIASED LEADERSHIP Q2: DID THE ENDS USUALLY JUSTIFY THE MEANS?**

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<td>Beam offers insight into the evolution of HealthSouth’s culture suggests that people were, in effect, selected for their ethical malleability: “The first day on the job, he introduced me to his boss. I had only been at work 15 minutes and he introduced me to his boss and said Aaron and I worked on this project for hours last night. So right then I knew, to look good or do whatever he had to do, he would do or say anything. That was just Richard Scrushy. Today I really believe he did that to size me up. To see how I would react to a lie. Richard is very, very good at sizing people up, figuring out what their hot buttons are. How he can manipulate them. The way you manipulate me and the way you manipulate someone else may be very different based on our personalities, and Richard wanted to see how I would react to be included in a lie. I mean, day one. I really believe that. I believe he was that smart. He didn’t do it just flipantly. He did it on purpose.”</td>
<td>Unethical practice was explicitly condoned: “there were people, people getting kickbacks from vendors. Richard even made the comment once, well if so and so can continue getting our contracting prices down, I don’t care what he gets on the side. That was part of the whole culture—as long as we make our numbers, I really don’t care how we get there.”</td>
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**MISSIONARY ZEAL Q1: DID YOU JUDGE YOUR WORK AT HEALTHSOUTH TO UNIQUE OR SPECIAL COMPARED TO ALL OTHER BUSINESSES?**

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<th>Weston Smith</th>
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<td>As a cofounder, Beam seems to perceive the</td>
<td>Smith echoes the leadership position that HealthSouth</td>
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### Missionary Zeal Q1: Did You Judge Your Work at HealthSouth to be Unique or Special Compared to All Other Businesses?

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<td>The uniqueness of HealthSouth to derive more from its startup nature rather than the value of its work: “It was unique that I started the company from scratch, took it public, and I was CFO of a publicly held company. And a little bit unique in that I kind of grandfathered in, you know, I wasn’t promoted up through the ranks. I was founder of the company so it was kind of my job to lose.” Beam did, however, observe that “We were proud that we were the leader in our field. We were the first to come to the market place with outpatient rehab and we were considered the leading company in the field and our financial record was just unbelievable.”</td>
<td>occupied, and notes that the associated high growth was a convenient rationalization that was used internally to excuse the fraud as a temporary measure: “We were coined as the health care company of the 21st century. He [Scrushy] really wanted to promote it as something different and in some ways it was because we were one of the first to really move into the outpatient arena for physical rehab . . . we legitimately viewed it as we are kind of ahead of other people—this is an area within health care industry that is new and we are the leader in it so in terms of the growth potential, we saw that it was there . . . it was used as a rationalization of we are going to grow our way out of this problem.”</td>
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### Missionary Zeal Q2: Would You Say that Unquestioning Loyalty Was Valued Above Other Character Traits Among Management?

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<td>An unhealthy kind of loyalty was insisted on at HealthSouth; more to the point, those who were loyal to the primary goal of doing whatever was necessary to deliver Wall Street expectations was rewarded. Beam notes flatly, “You had to be loyal to Richard [Scrushy],” also saying, “I was afraid not to do what he requested.”</td>
<td>Smith notes that Scrushy’s Monday morning management meetings were abusive and created so much divisiveness that “everyone was basically loyal to one person and that was to Richard.” According to Smith, Scrushy used techniques of fear and intimidation to ensure loyalty: “he was just ruthless and it was like it was just so uncomfortable to be on his bad side that you worked really hard to stay in his good graces.” But fear alone couldn’t keep people in place for long—a little positive reinforcement was also a useful tool. Smith explains, “He used both the carrot and the stick”: “The people who really made the most money were the ones who were the most loyal to Richard and his demands. You know, Richard, at the end of the day the only thing he really cared about was the Wall Street number and would we hit it and what was the price of the stock and the people who did absolutely whatever it took to get to that point were rewarded very, very handsomely for that.”</td>
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### Legitimizing Myth and Image Management Q1: Was the Public Image of HealthSouth More Important Than Reality?

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<td>Both former CFOs confirm that image counted for more than reality during the Scrushy era at HealthSouth. Beam is very clear about this: “He [Scrushy] was most concerned with what he told the analysts. The reality wasn’t that important to him. It was the game. It was, what do you tell the analysts? . . . Richard, even early on before the fraud started, he and I were the only two that talked to Wall Street. When we were on the road show doing the meeting with</td>
<td>Smith concurs that image trumped reality at HealthSouth, saying, “Evidence of that was the hundreds of thousands if not millions of dollars that were spent on image type activities that didn’t provide one dollar of benefit to patients, investors, or employees . . . Richard was paying hundreds of thousands of dollars to have his name put on football stadiums. I mean it wasn’t HealthSouth’s name, it was Richard’s name on stadiums and buildings.”</td>
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### LEGITIMIZING MYTH AND IMAGE MANAGEMENT Q1:
**WAS THE PUBLIC IMAGE OF HEALTHSOUTH MORE IMPORTANT THAN REALITY?**

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<td>analysts, people that would do research on the company . . . he wanted to know exactly what I was going to say and how I was going to say it. It was very important to him how we spun the story rather than the reality of it.”</td>
<td>Criticism was unwelcome, and Smith describes the proxy methods used to rebut unfavorable comment on HealthSouth operation: “The Yahoo Finance Chat Board was one of the first true meeting sites for people to vent a little bit and you saw a lot of criticism on Yahoo finance back then of people coming in and questioning what we were doing, questioning waste of money, what we were doing, and Richard took tremendous offense to anybody criticizing his company. He actually hired people in the Peoria area who did nothing but sit behind their computer all day and come up with creative names and posted replies on Yahoo Finance all day long to respond to this criticism.”</td>
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### LEGITIMIZING MYTH AND IMAGE MANAGEMENT Q2:
**DID YOU DEFEND THE COMPANY AGAINST SKEPTICS INSIDE AND OUTSIDE THE ORGANIZATION?**

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<td>Both Beam and Smith described their role in representing HealthSouth to the investing public. Beam notes, “When you’re the CFO of a public company and you come under attack, the attack can hurt the stock and that hurts you. You’re a failure if you let that stock go down. So, yes, I staunchly defended the company, I mean, every time I could in a public setting . . . So, you learn to put lipstick on the pig. You always just say good things.” Beam does admit to feeling bad about “The fact that you had to be so one sided. Always be a defender of your company. That bothered me a bit. But it was just total suicide to come clean and tell stock analysts ‘here are some things we’re concerned about.’ Even though there were things you were concerned about.”</td>
<td>Of course, once the actual fraud began, a positive representation of HealthSouth means defending a lie. Smith describes the contradictions in his role: “I was a high ranking guy, I was involved in the fraud, and I would hear comments and things about the company and, yeah, in my position I had no choice [but to defend the company]. Birmingham is a small town; everyone knows someone and if I were to say, yeah, you’re right it’s a house of cards, I think it would have gotten back to Richard the very next week. So yeah, more than once I was in situations I wasn’t comfortable at all to defend the company but knowing at the same time the accusations made about them were just dead on true.”</td>
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### CORPORATE COCOON Q1: AT HEALTHSOUTH WERE YOUR PERSONAL ETHICS DIFFERENT THAN YOUR COMPANY ETHICS?

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<th>Aaron Beam</th>
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<td>Both former CFOs indicated that they probably brought personal weaknesses into HealthSouth that made them amenable to participating in the fraud and its precursor “aggressive accounting.” Beam said, “None of us are as ethical as we really think we are. We all tend to think we’re pretty ethical . . . But ethics is very situational. In some situations, you do unethical things. As I talk in my book, I cheated on my wife. I think some of my character weaknesses helped bring about me being involved in this fraud. I’m just being real</td>
<td>Smith also makes clear his view that ethical marginality usually doesn’t start and stop at the office door: “I made a lot of, a lot of personal mistakes along the way and a lot of people did the same thing. The rate of divorce, the rate of affairs, the rate of drug use of amongst people was very high and I think some of that had to do with people getting rich overnight and not being able to handle the success of it and it changed a lot of people and messed up a lot of people’s personal lives, but I also believe how somebody is in their</td>
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### CORPORATE COCOON Q1: AT HEALTHSOUTH WERE YOUR PERSONAL ETHICS DIFFERENT THAN YOUR COMPANY ETHICS?

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<td>honest with you. I could’ve been…I could’ve lived a better life, I really could’ve.”</td>
<td>personal lives is also how they will be in their business world. If you have those types of personal propensities to be an unethical person, you’re going to be the same person in the business world.”</td>
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### CORPORATE COCOON Q2: AT HEALTHSOUTH WAS INTERNAL APPROVAL MORE IMPORTANT THAN SOCIETY’S APPROVAL?

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<td>Both former CFOs note that internal approval was very important, but often for pain-avoidance reasons. Beam compared his motives for seeking internal and external approval: “My [desire for] approval from Richard [Scrushy] was out of fear. I was afraid not to do what he requested. My desire to get approval from the public wasn’t so much out of fear as it was I just wanted to be liked.”</td>
<td>Smith also notes the motive of pain-avoidance, but also describes the power of the financial motive: “Well, two reasons you wanted the approval of Richard, one, he controlled the purse strings, your raise, the bonuses, the stock options were worth a lot back then because the price of stock was doubling every year, if you got 10,000 stock options you can do the math quickly, here’s what that’s going to be worth in 6 months…so you wanted that approval for monetary reasons, but secondly Richard was a mean [person]. He would make your life so uncomfortable if you didn’t go along with the public meetings and the Monday morning meetings, the tearing you down behind your back, I mean, when he was upset with somebody, everybody knew about it.”</td>
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The carrot and the stick—in Smith’s mind, these were complementary tools for ensuring loyalty at HealthSouth: “His [Scrushy’s] mindset, in hindsight, was get young people, get them accustomed to having money and being in debt and they’ll do anything in the world I ask them to do.”

### BANALITY OF WRONGDOING Q1: WAS CORRUPT DECISION MAKING BOTH SMALL AND LARGE A NORMAL PART OF DOING BUSINESS AT HEATH SOUTH?

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<td>“I think so. I think…so, yeah. You know, I think it’s very interesting. Early on, Richard was very good at company meetings. We’d have company managers come in and he would spend a lot of time talking about ‘Do the right thing, Be honest. Don’t cheat on your expense reports. Be truthful to the patient. We’re a good company. We’re going to do everything right.’ And people would always be nodding their head. And I think for some years, maybe the first five or six years of the company, people really did not see through, particularly the ones that were not too close to Richard. They really believe he really wanted us to do the right thing. Now, I’m told after I left the company, by the 2002-3, he was a joke . . . He’d fly to work in a helicopter, company owned</td>
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<td>“Yeah there were people, people getting kickbacks from vendors . . . were taking place. Richard even made the comment once well if so and so can continue getting our contracting prices down, I don’t care what he gets on the side. That was part of the whole culture that as long as we make our numbers, I really don’t care how we get there.”</td>
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“I mean it was so corrupt that at one point we had a physician we were negotiating with in Miami who was being a tough negotiator and Richard sent a PI down there to tail the guy. To find if he could find him in an embarrassing or compromising situation to better negotiate efforts. That’s how nasty it was.” |
### BANALITY OF WRONGDOING Q1: WAS CORRUPT DECISION MAKING BOTH SMALL AND LARGE A NORMAL PART OF DOING BUSINESS AT HEATH SOUTH?

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<td>helicopter, the day after laying off a hundred people. People hated [him]. But, early on, I think they really bought in . . . I guess kind of like the corrupt preacher that can preach to congregations, ‘Don’t sin! Don’t sin!’ and he’s seeing a prostitute on the side. He may be able to convince his audience not to sin but I think Richard had some of that going on early on. He had the congregation thinking right early on. “</td>
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### BANALITY OF WRONGDOING Q2: DID THE ORGANIZATION DEVELOP TO THE POINT WHERE SLIGHTLY CORRUPT PRACTICES WERE COMMONPLACE?

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<td>The interviewees presented markedly different views of how pervasive the corruption was at HealthSouth. Beam said, “When I left, only five or six people knew about the fraud. There were no lower ranks involved. It was at the very high level, so, I really never got to know or understand why the people two and three levels down got involved.”</td>
<td>Smith, on the other hand, provides a litany of examples to demonstrate that, while few (12-15) were directly involved in implementing the corporate-level accounting fraud, many knew about it and were, in effect, petty accomplices. Furthermore, awareness of questionable accounting seemed to be widespread and not limited to a few high-level participants as early as 1989 or 1990. Smith says everyone in the Finance Department “knew things weren’t being done right. There was at one point, I remember there was an assistant controller; she was formerly at Ernst and she saw some things that weren’t being done right and she picked up her book of FASBs and chased Aaron [Beam] down the hall saying ‘This isn’t right, we can’t be doing this, we can’t be doing this!’ and Aaron basically just ran away from her down the hallway. So it was almost a joke internally, well this girl chased Aaron down the hallway with her book of FASBs, but then she went back to her office and continued doing what she was doing.” When the major fraud started around 1996, the execution was compartmentalized, but the results were still widely visible: “People at the staff accountant level who weren’t involved with fraud they would close out their monthly P&amp;Ls and close out their quarterly P&amp;Ls and then it would go to the next level of closing adjustments and the next thing they know they saw their beginning balances the next month and all the numbers and all the revenue had increased.” Nor was this insight limited to corporate accounting staff. People in the divisions and locations also saw evidence of the fraud: “People at other levels of the organization who knew that improprieties was taking place, they really had their own agendas for looking the...</td>
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### BANALITY OF WRONGDOING Q2:
DID THE ORGANIZATION DEVELOP TO THE POINT WHERE SLIGHTLY CORRUPT PRACTICES WERE COMMONPLACE?

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| other way. I mean, there were a lot of people saw magical growths in their numbers at their locations at the end of each quarter and end of each year and they would be receiving bonuses for hitting their budged numbers so were they complaining about these magical numbers? No, because they were receiving bonuses based on hitting their budgets.”  
But these weren’t just isolated individuals who were ignoring the fantasy accounting—this was a social enterprise (“I would put the number of people that knew at one level or another at probably 100 people possibly more”): “I mean all these people talk to each other, all the administrators talk and all the regional people talk, the regional controllers, primarily the inpatient division, they were pretty tight-knit group. They knew what their numbers were and they would see what they referred to as gifts coming out at the end of each quarter. But I mean a lot of that came out before the budget meeting at the end of 3rd quarter of each year, when they would come in and say we expect certain levels of growth for next year and their response more than once was ‘Well we see these . . .’ and they would put their fingers up and wink and say ‘we see these gifts at the end of each quarter, we can’t make our budget next year unless we continue to receive these gifts, can we anticipate these gifts next year? Because if not, our budgeted number would be, needs to be X without the gifts, so it was all code speak for ‘you guys are cooking my books. What are the real expectations for next year? Do I continue getting these fantasy numbers or am I going to have to do it on my own?” |

### GREED Q1: WERE THE SALARY AND REWARDS YOU RECEIVED CONSIDERED WHEN YOU MADE UNETHICAL DECISIONS?

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<td>The two interviewees reported different motives relating to salary and other rewards in return for unethical behavior. Beam says he was not offered a salary incentive, although obviously he benefited from the fraudulently-supported stock valuation: “My salary was at the level it was at before . . . now I’m talking about the hard fraud. My salary was at the level it was at when the fraud began. I did not get a pay increase to continue the fraud. I’m told by FBI agents and other people that it was apparent that as time went on . . . Richard actually got to paying them more and more and more to keep them caught in. But my compensation was never tied to the fraud per se.”</td>
<td>Smith notes that there was obviously incremental compensation, though not as a direct agreement: “I knew that by being in the circle of people involved in fraud that I was being paid a whole lot more than probably a comparable position at another company. I couldn’t put a direct dollar effect of, well if I cook the books this quarter I’ll get X dollars, it was never anything that direct. But I knew that I had attained a lot because I was a quote ‘insider’ of the fraud.”</td>
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Both interviewees confirm that social status derived from wealth was a strong influence. Says Beam, “There’s no doubt about . . . it was fun being rich. Buying a new BMW and a big house every year—it’s fun. So the wealth and the status that it brought me, to be able to walk into Highlands Bar & Grille there in Birmingham and everybody know you, that’s flattering. That’s nice.”

Smith confirms the thrill of the wealth and status, but also notes a lurking sense of apprehension because the wealth is tainted: “Yeah, I enjoyed the stuff. I enjoyed the money and the things that come with that, you know to be able to go on a ski trip, and just put it on a credit card and pay it off the next month and not even have to think about it. That was pretty heady back then. But I was never really comfortable with the entire image that we were portraying out there. I mean, it was a lot, fancy house, fancy cars, all that kind of stuff, but I couldn’t sleep at night because I knew it was a bald face lie.”

### SUMMARY OF FINDINGS

Of the five independent variables in the Banality of Wrongdoing model (Balch & Armstrong, 2010), Culture of Competition, Ends-Biased Leadership and Legitimizing Myth/Image Management seem most significant in explaining the HealthSouth Case. Missionary Zeal and Corporate Cocoon seem least significant. The dependent variable Banality of Wrongdoing (defined as the acceptance of certain levels of unethical behavior as normal and expected in an organization) is observed to be strikingly present both with regard to the major accounting fraud and to a host of other unethical behaviors. A seventh factor, Greed, is not part of the model but was included in the interview; Greed was found not to be a primary motive, but a reinforcing motive for the ongoing unethical behavior.

The following table summarizes observations gleaned from the interview responses.

### SUMMARY OBSERVATIONS

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<th>Intensity</th>
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<td>Culture of Competition</td>
<td>High</td>
<td>The competitive culture discussed in the interviews is internally focused and seems to be artificially cultivated as a means of extracting loyalty; external competition, of course, is bogus, since the HealthSouth results are manipulated. Marketplace competition is really not in the forefront.</td>
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<td>Ends-Biased Leadership</td>
<td>High</td>
<td>This is a dominant factor in the HealthSouth case. But Scrushy used the carrot as well as the stick—lots of people were persuaded to look the other way in order to keep the rewards flowing—in other words, lots of people besides just Scrushy were ends-biased. Many, in fact, may have been selected because of their willingness to subordinate means to ends.</td>
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<td>Missionary Zeal</td>
<td>Moderate</td>
<td>The sense of real mission seemed relatively low; the factor of loyalty to the charismatic leader is based on carrot and stick (financial reward and fear), which would appear to be less durable than loyalty based on shared ideals.</td>
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<tr>
<td>Legitimizing Myth and Image Management</td>
<td>High</td>
<td>This is another of the most dominant factors in the HealthSouth case. Image Management in the form of publishing financial results that met Wall Street expectations was critical to maintaining the stock valuation and the growth by acquisition on which the valuation depended. The unethical and illegal nature of this activity was excused by saying, we’ll grow out of our current problems, then we’ll play by...</td>
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### SUMMARY OBSERVATIONS

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<td>Corporate Cocoon</td>
<td>Low</td>
<td>There seemed to be little sense of a self-referential value system in which unethical behavior was laundered clean. Instead, there seemed to be a constant awareness of the potential for discovery and ruin. The interviewees acknowledged bad personal behavior as well as bad business behavior.</td>
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<td>Banality of Wrongdoing</td>
<td>High</td>
<td>While the principals in the major fraud numbered only 12-15, the fraud was visible to far more people (100 or more) who received rewards for looking the other way and accepting manipulation of their financial statements without complaint. Nor was the accounting fraud the only unethical behavior. There were contract kickbacks, improper favors to recruit physicians, use of company influence to collect favors, phony web postings, gathering of personal information to use to influence business negotiations, and use of company resources for nonbusiness purposes.</td>
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<tr>
<td>Greed</td>
<td>High</td>
<td>Scrushy used the prospect of wealth as a recruiting tool and encouraged conspicuous consumption as a way to cultivate dependence on the options and bonuses he offered. Financial gain does not appear to have been offered as a quid pro quo to induce people to begin unethical behavior, but as a way to develop loyalty so that it would be more difficult to say no to unethical instructions.</td>
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### CONCLUSIONS

This study reflects that the unethical behavior at HealthSouth, although banal (routine and expected), was not rationalized by the participants as the researchers had initially expected. The unethical activity was calculated and intentional rather than a constant form of unthinking illicit behavior. The managers involved in the fraud remained fully aware of the ethics of the situation - while the behavior was routine among the participants in the fraud, for the two CFOs interviewed it did not become a justifiable form of behavior, but was a continuing source of moral anxiety. Both managers used the defense that they were more or less forced into the behavior by the CEO, Richard Scrushy. Weston Smith admitted that the rewards were associated with his willingness to continue the fraud, even as he fretted over the awareness of wrongdoing.

This paper supports the findings of the Milgram experiment (1963) that tested the willingness of subjects to apply electrical shocks to actors under the direction of an authority figure. It seems that managers in high performance organizations who find themselves in the control of a ruthless task master are willing to commit acts that run counter to normal accounting standards and that are not only unethical but clearly illegal.

The breadth of knowledge of the major fraud was surprising, given the limited circle of implementors. There were fraud insiders but also petty accomplices who were not part of implementing the fraud, yet the fraud could not have continued without their continuing acquiescence. This reflects several interacting factors: conflict of interest made some petty accomplices reluctant to question the fraudulent results, a.k.a. “gifts” (some onlookers benefited from unearned bonuses deriving from the fraudulent results), desensitization (the unethical behavior becomes the norm; some acquiesce after initial protests), fear (of losing a job, or in some cases, fear of physical harm).
Where one type of ethical abuse occurs, others are likely to occur as well. Essentially, a culture that tolerates some ethical lapses is likely to cultivate more, and more serious, lapses, particularly when key management is involved.

Once unethical behavior is underway, it tends to be reinforced. Participants are vulnerable to discovery, so they need to surround themselves with people who are willing to collaborate, even if only passively. In the HealthSouth case, the accounting fraud corrupted acquisition due diligence - HealthSouth could not challenge accounting improprieties in acquisition targets without risking reciprocal challenge.

The study found little evidence of the corporate cocoon (compartmentalization of unethical behavior, or behaving differently at work than in personal life because of different cultural expectation). Both interviewees described personal as well as business ethics problems, and both asserted that they brought personal weaknesses into the job that enabled or reinforced the unethical business behavior.

The CFO interviews provide no evidence to support that the major accounting fraud involved the widespread active participation of lower levels of the organization. Both CFOs stated that they were not aware that this corruption was institutional but believed it to be confined to the inner circle of top level managers. In this sense, the accounting fraud was not banal. But awareness of the fraud extended well beyond the inner circle of active participants, spawning “look the other way” behaviors when undeserved bonuses were handed out because of altered financial results and when acquisition targets showed shaky financials. In this sense, the accounting fraud had a corrupting influence that was widespread and banal.

Perhaps the biggest contribution of this paper is the unique perspective yielded by a sample of CFOs who took part in a fraud of national scope. Accountants in particular would benefit from reflecting on the experiences and decisions of the sample CFOs. The qualitative assessment of the rationale for their decision making would not be unique in the profession. This perspective combined with the use of the constructs of the Banality of Wrongdoing model (culture of competition, ends-biased leadership, missionary zeal, legitimizing myth, and the corporate cocoon) are useful in measuring various aspects of unethical behavior at HealthSouth. While the intensity of the constructs vary in the HealthSouth case, four of the five are judged to have moderate to high significance, and the dependent variable is strongly supported not only by the conscious and repeated willingness to commit unethical acts by well-trained rational managers but also by the more passive “look the other way” collaboration of large numbers of employees not part of the inner circle of the fraud. The study found that the model was an effective tool for performing a diagnostic mapping of an ethically troubled organization.

REFERENCES


THE EFFICACY OF VOLUNTARY DISCLOSURE: A STUDY OF WATER DISCLOSURES BY MINING COMPANIES USING THE GLOBAL REPORTING INITIATIVE FRAMEWORK

Philip Dennis, University of Idaho
Heidi Connole, Eastern Washington University
Marla Kraut, University of Idaho

ABSTRACT

Corporate disclosure requirements and corporate reporting are based on the general premise that information about a firm must be made available in order for informed decision-making. The traditional approach to corporate reporting has focused primarily on financial performance, while environmental disclosures have gone under-reported.

Conceived in 1997, the Global Reporting Initiative is a multi-stakeholder network facilitating the development and application of sustainability reporting, including economic viability, environmental and social responsibility activities. With the intention to be a vehicle to advance the standardization of non-financial corporate reporting, the GRI has been working to develop guidelines for sustainability reporting (GRI, 2006).

Corporate issuance of sustainability reports is a wholly voluntary endeavor. Since 2003, the year-over-year growth rate of sustainability reports based on the GRI framework has consistently increased annually by 20%. More than 3,000 companies worldwide issue sustainability reports. Despite the growing interest in participation in GRI reporting, as in all sustainability reporting activities that are voluntary in nature, there are questions of the quality and comprehensiveness of the information that is reported.

The purpose of this study is to establish a baseline from which the substantive content of sustainability report disclosures (specifically water disclosures), using the GRI framework can be discussed. The study focuses on the mining industry in order to examine reporting within a water-intensive industry (one that both utilizes and impacts water resources in a significant way).

Based on a sample of 22 company sustainability reports for 2010, a content analysis of water disclosures was conducted to determine how the sample companies used the GRI G3 reporting framework. The results of the content analysis indicate a lack of completeness in water disclosures and a lack of differentiation of reports across Application Levels.

INTRODUCTION

The Global Reporting Initiative is a multi-stakeholder network facilitating the development and application of sustainability reporting. Conceived as a vehicle to advance the standardization of non-financial corporate reporting in 1997 (GRI a, 2007), the GRI has been working to develop guidelines for sustainability reporting since the late 1990s and as of the time of this study, was on its “third generation of Guidelines (G3)” (GRI, 2006 b). The G3 Guidelines, the foundation of the GRI Sustainability Reporting Framework, set out basic
principles and standard disclosures for companies using the Sustainability Reporting Framework to follow in order to ensure completeness of reporting.

Corporate issuance of sustainability reports is a wholly voluntary endeavor. Since 2003, the year-over-year growth rate of sustainability reports based on the GRI framework has consistently increased annually by 20%. Despite the growing interest in participating in sustainability reporting, there are questions of the quality and comprehensiveness of the information that is reported. Adams and Evans (2004) identified completeness and credibility as two limitations relevant to all forms of social performance reporting due to its nature as voluntary and self-monitored.

In order to establish a baseline from which the substantive content of sustainability report disclosures using the GRI framework can be discussed, the authors have identified water as the subject of analysis in this study of sustainability reporting. The GRI identifies both water specific and water-referencing indicators which allow a comprehensive examination of how this specific resource is captured in sustainability reports. Company reports from the mining industry were chosen in order to examine reporting within a water-intensive industry (the mining industry both utilizes and impacts water resources in a significant way).

This study was confined to a single year’s (2010) reports in order to provide a “snapshot” of the comprehensiveness of the reporting.

Corporate Disclosure Requirements

Corporate disclosure requirements and corporate reporting are based on the general premise that information about a firm must be made available in order for informed decision-making. The traditional approach to corporate reporting has focused primarily on financial performance. Notwithstanding Securities and Exchange Commission (SEC) and Financial Accounting Standards Board (FASB) standards requiring “material events or uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or future financial condition” (17 CFR 229.303), environmental disclosures have gone under-reported (Chan-Fishel, 2006; Repetto, 2005). Further, according to Levinson et al. (2008, p.3), “corporate disclosure of water-related risks is seriously inadequate and is typically included in environmental statements prepared for public relations purposes rather than in the regulatory filings on which most investors rely.”

Morikawa et al. (2007) performed a study of corporate sustainability and social responsibility reporting on water in 11 water-intensive industries and found the majority of companies in those industries do report water information in their non-financial reports, but there was a general lack of understandability and usefulness of the data, and inconsistency with regard to measurement hindered comparability of the data. The mining industry was one of the water-intensive industries covered by this study. Among the mining companies reviewed, water use measurement, stakeholder engagement, commitment to continuous improvement, strategic partnerships, and water policy or management approach statements were commonly reported, while water risk assessment was not commonly reported (Morikawa et al., 2007).

Corporate Social Responsibility and Sustainability

In addition to the practical aspect of disclosing water related risks in response to regulatory requirements, business is now faced with new expectations for corporate disclosure.
The understanding that business has a larger role to play in the overall well-being of the world, including both its inhabitants and natural systems, is captured in the concept of corporate social responsibility (CSR). While the concept of CSR can hardly be considered new, with literature on the subject extending back to the 1950s (Carroll, 1999) and corporate disclosure of CSR into the 1970s (Abbott and Monsen, 1979), the formalization of CSR as a corporate standard, and the GRI’s attempts to standardize reporting of CSR, are relatively recent developments (GRI b, 2007).

An evolutionary step in the development of the concept of CSR occurred in the publishing of the United Nation’s Brundtland Report (1987), when the concept of sustainable development enveloped CSR (van Marrewijk, 2003). The Brundtland Report defined sustainable development as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs.” (Brundtland, 1987). Within this definition, Elkington (1997) redefined corporate sustainability as the “triple bottom line,” which held business responsible for not just financial performance of the firm, but also social and environmental performance as well. The triple bottom line’s three dimensions, economic, social, and environmental, have since become the pillars of modern sustainability reporting and its most prevalent sustainability reporting framework, the GRI G3.

**Toward a Sustainability Reporting Framework**

The GRI envisions a global economy where the tenets of sustainability are not just operational, differentiation, or public relations strategies, but institutionalized norms that underpin the global economy. The vision is a global economy where information about sustainability performance is as transparent and ubiquitous as financial information is today (www.globalreporting.org, 2011); where information about impacts on biodiversity, local indigenous groups, or economic development is as readily available and understandable as information like earnings per share. This is unquestionably a lofty goal, but the GRI has set about to push this vision toward reality through the development, dissemination, and ongoing support of the GRI Reporting Framework (www.globalreporting.org/AboutGRI.2011).

In the extant academic literature, the Global Reporting Initiative (GRI) is widely regarded as the best-known, voluntary framework for business reporting of environmental and social performance worldwide (Overell et.al., 2008). The GRI consists of 35 indicators used in assessments predominately by large global companies (and less frequently by the public sector) (Brown, de Jong and Levy, 2009).

Recent research has focused on using GRI data to develop indices for cross-comparisons of organizations in terms of sustainability (Krajnc and Glavic, 2005), levels of sustainability practice (Veleva et.al., 2003) and stakeholder management (Reynolds and Yuthas, 2008). Such studies are directed specifically at looking beyond performance and efficiency to measuring and assessing levels of environmental impact, to include eco-efficiency, environmental effects, supply-chain and product life-cycle effects and carrying capacity issues (Veleva et al., 2003). While most reporting has focused on performance and efficiency measures, at least one recent comprehensive study has shown a positive relationship between “environmental performance and the level of discretionary environmental disclosures” (Clarkson and Richardson, 2008).

Scholars have identified additional relevant indicators not specifically covered by the G3 such as eco-efficiency, the presence of an environmental management system, the amount of environmental expenditures, and the use of sustainable energy (Van Gerven et al., 2007).
Arguments were made for sector-level analysis in order to reflect unique characteristics of a given industry, such as mining (Azapagic, 2004), pharmaceutical (Veleva et al., 2003) and food production (Gerbens-Leenes and Moll, 2003), for which there are now GRI Sector Supplements for both mining and metals and food production. Strong institutional support is identified as a key factor in mitigating biases in information reporting (Moneva et al., 2006). Regardless of its detractors, GRI is regarded as the international standard for best practices in voluntary disclosure (Overell et al., 2008), and considered to be a reputable source of business practice in sustainability despite various unique sectoral needs and “geographic discrepancies” (Richards and Dickson, 2007).

GRI’s Reporting Framework expands well beyond the realm of traditional financial disclosure to capture a broader array of organizational performance in a sustainability report. The foundation the GRI Reporting Framework is the Sustainability Reporting Guidelines. Currently, these guidelines are referred to as the G3 as they represent the third version of the guidelines produced since the GRI’s inception in 2006. The G3 is composed of three parts: Reporting Guidelines, Application Levels, and Indicator Protocol Sets; each of which are discussed in the paragraphs below. A newer version of the guidelines, called G3.1, was released in early 2011 and added content to the social performance indicators.

**Reporting Guidelines**

The Reporting Guidelines introduce the major content areas that sustainability reports should cover. The Introduction and Part 1 sections of the Guidelines provide an introductory overview of sustainability reporting and describe how to approach content, quality, and setting a reporting boundary, respectively. On the topic of how to approach report content the G3 describes the following four principles: Materiality, Stakeholder Inclusiveness, Sustainability Context, and Completeness. As related to water, Materiality of water to the mining industry has already been established and some elements of the general corporate Sustainability Context were introduced earlier as well. Stakeholder inclusiveness would be demonstrated by disclosures of engagement activities and any stakeholder issues or concerns related to water, and Completeness would be demonstrated by the degree of adherence to the G3’s disclosure specifications (Indicator Protocols) and reasonableness of disclosure or nondisclosure.

Part 2 of the Guidelines, Standard Disclosures, outlines what a reporting organization will disclose, and is separated into three different informational groupings of disclosure: Strategy and Profile, Management Approach, and Performance Indicators. These three disclosure groupings are the central elements of the content analysis. They are discussed in more detail in the sections that follow.

**Strategy and Profile Disclosures**

Strategy and Profile disclosures address the organization’s strategic relationship with sustainability, describe governance and organizational structure and composition, stakeholder engagement, and cover any material that would be considered at the executive level. An organization’s strategic relationship with sustainability would encompass executive or board level sustainability committees or other governance structures, organization-wide performance targets and goals, statements from executives about sustainability, and commitments to external sustainability initiatives and organizations. Strategy and Profile disclosures also cover more
basic organizational information such as size, locations of headquarters and operations, products or services, and sustainability report information such as report scope, reporting period, GRI content index, and external assurance. (GRI b, 2006).

Management Approach Disclosures

Management Approach disclosures can be broken into the following groups: Disclosure on Management Approach, Goals and Performance, Policy, Organizational Responsibility, Training and Awareness, Monitoring and Follow-Up, and Additional Contextual Information. Disclosure on Management Approach disclosures are intended to address on a more detailed level the organization’s approach to managing the various “Aspects” that make up the performance indicators (i.e. water). Goals and Performance disclosures report on organizational goals and performance against those goals with respect to an individual “Aspect”. Organizational policies on “Aspects” clearly fall under Policy, descriptions of who in the organization is responsible for “Aspect” management are Organizational Responsibility disclosures, descriptions of organizational activities or programs to increase employee knowledge with regard to an “Aspect” are Training and Awareness disclosures, and Monitoring and Follow-Up disclosures are monitoring activities or systems and preventative or corrective actions. Additional Contextual Information disclosures include successes and shortcomings, environmental risks and opportunities, upgrades to management systems or structures, and goal-oriented strategies and procedures. (GRI b, 2006).

Performance Indicators

The Performance Indicators are broken down by Aspect, and then identified as “Core” or “Additional”. Core Indicators are those that are assumed to be applicable to all reporting organizations, while Additional Indicators are subject to materiality. The performance indicators enumerated in the G3 are each addressed in detail in the Indicator Protocol Sets. There is an Indicator Protocol Set for each of the following indicator categories: Economic, Environmental, Labor Practices, Human Rights, Society, and Product Responsibility. The Indicator Protocol Sets provide guidance on five key facets of each performance indicator: relevance, compilation, definitions, documentation, and references. The relevance facet provides explanatory language for why this information is important to report. Compilation then describes what kind of information should be disclosed. Definitions are provided for clarity, especially in cases where there may be multiple interpretations of a term used by the performance indicator. Suggestions for where data applicable to the performance indicator may be found are provided under the Documentation facet. The References facet gives examples of existing external standards, regulations, or other guidance.

Sector Supplements

Some industry sectors have the additional requirement to meet guidelines established in “Sector Supplements”. Sector Supplements are tailored versions of the guidelines addressing industry-specific issues and concerns. As of November, 2011, Sector Supplements are currently available for seven sectors: mining and metals, airport operators, construction and real estate, electric utilities, financial services, food processing, and NGOs. Once a Sector Supplement has
been issued in its final form, all sector-specific indicators included in the supplement will be considered Core.

**Self-declared Application Levels**

A reporting organization self-declares an “Application Level” upon completion of its sustainability report. A self-declared Application Level represents the degree to which the reporting organization believes it has adhered to the G3 Reporting Guidelines. The Application Levels are A, B, and C, with adherence to the G3 becoming less complete as the levels descend from A to C. The substantive difference between the three Application Levels lies in the number of Core indicators that must be reported. Application Level A reports require all Core and Sector Supplement indicators. Level B reports require 20 indicators. Level C reports require 10 indicators.

Additionally, reporting organizations can declare a “+” (plus), as in A+, B+, or C+, when the report has been subjected to external assurance procedures. External assurance can be performed by any external entity, including a public accounting firm, a nongovernmental organization, a sustainability consultant, an external board, or other. Depending upon the scope of the external assurance, the external assurance may cover the Application Level self-declaration or not. For assurance with regard to the Application Level, reporting organizations have the option of having the self-declaration checked by a third party, the GRI or both.

**Research Questions**

<table>
<thead>
<tr>
<th>Table 1</th>
<th>Research Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Category of Research Question</strong></td>
<td><strong>Sub-elements of the Research Question</strong></td>
</tr>
</tbody>
</table>
| 1.) How are reporting organizations using the G3 to disclose water impact? | • Are all “Core” water Performance Indicators utilized?  
• Are “Additional” Water Performance Indicators represented? If so, which ones?  
• Are disclosures on Management Approach to water issues present?  
• Is there Strategy and Profile information relevant to water provided? |
| 2.) What trends or patterns emerged in the disclosure on water? | • What is the significance of these trends or patterns?  
• If not present, what does that say about the efficacy of the reporting guidelines? |
| 3.) What differences can be seen between the various self-declared Application Levels? | • Were Application Levels A and A+ supported by the content analysis results?  
• Were Application Levels A and A+ early adopters of the Sector Supplement? |

**Research Approach**

Content analysis was deemed the best-suited research methodology for this study as it allowed the researchers to analyze corporate disclosures on water in sustainability reports based on the GRI G3 reporting format.

Relevance sampling was used to generate a sample that would inform this particular line of research questioning. The mining and metals industry was chosen due to its potentially high level of water resource impact and its considerable presence in the global economy. The study
was focused on a single industry and a single reporting period, 2010, in order to bound and control variability in reporting across different industries and time. Sustainability reporting mimics financial reporting and therefore is conducted on an annual basis, but not necessarily in conjunction with the calendar year. Only sustainability reports prepared using the GRI G3, the sustainability reporting framework issued by GRI, were included in the report analysis to ensure content analysis procedures were relevant to all potential reports. The reporting year 2010 was chosen as it represented the most recent sustainability reporting year for which full data was available. Restricting the study to a single industry and a single reporting year created a way to bound the study and provide a ”snapshot” of the data, controlling for historical effects in reporting.

The baseline population for the study consisted of corporations included in the GRI’s database of sustainability reports. This information is available in spreadsheet form from the GRI’s website. The sustainability report sample selection was based on the GRI’s Excel document listing that stores and lists all organizations that have issued sustainability reports following GRI guidelines. That Excel document was updated by the GRI on June 15th, 2011 and retrieved from the GRI website on June 16, 2011.

Filtered for the mining industry, the 2010 reports consisted of 75 entries. Of those, 30 of the sustainability reports were eliminated from the sample due to formatting or demographic issues (i.e. language, document type, or other issue of inaccessibility). The mining industry report entries were grouped by their self-declared “Application Level” with the results as shown in the first column of Table 2 (p 27). The Application Level is intended to represent the corporation’s adherence to the G3 and is primarily based on the number of performance indicators covered in a report. A review of the reports revealed an error in categorization. A “C+” report was inappropriately categorized as a “C” (missing external review). The authors re-categorized this report into the appropriate Application Level category.

<table>
<thead>
<tr>
<th>Application Level</th>
<th>Total Reports</th>
<th>Reports Excluded</th>
<th>Recategorized Reports</th>
<th>Available Sample</th>
<th>Sampled Reports</th>
</tr>
</thead>
<tbody>
<tr>
<td>A+</td>
<td>29</td>
<td>13</td>
<td></td>
<td>16</td>
<td>4</td>
</tr>
<tr>
<td>A</td>
<td>9</td>
<td>3</td>
<td></td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>B+</td>
<td>12</td>
<td>4</td>
<td></td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>B</td>
<td>12</td>
<td>3</td>
<td></td>
<td>9</td>
<td>4</td>
</tr>
<tr>
<td>C+</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>C</td>
<td>11</td>
<td>6</td>
<td>(1)</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td>75</td>
<td>30</td>
<td>1</td>
<td>45</td>
<td>22</td>
</tr>
</tbody>
</table>

A sample of four (4) reports was selected from each Application Level, with the exception of the C+ level where there were only two reports available. The decision to select four reports from each category was made to balance the sample across the various Application Levels. A larger sample size would have resulted in under-representation of the “C” Application Level as only four reports were available. A smaller sample drawn from each level (such as two reports from each category) would have resulted in an inadequate overall sample size. A sample size of four reports for each application level was deemed to provide reasonable and equal coverage of each application level, aside from C+ level where only two reports were available. This resulted in a sample of 22 reports used in this study as indicated in Table 2.
The final sample selection included reporting organizations from North America (7), Latin America (2), Africa (7), Australia (4), and Europe (2). While this sample represented a mix of developing or developed economies as well as a variety of organization sizes and compositions within the industry, these elements were not considered under this study. Though statistical sampling and analysis was not the intent of this study, a random number generator was used to introduce randomization of report selection for all application levels where more than 4 reports were available.

**Unitizing**

The sampling unit was defined as one sustainability report, the coding unit was based on the occurrence of the word “water”, and the context unit applied to the coding unit was based on Holstí’s description of a theme: “a single assertion about some subject” (1969, p 116). Holstí’s (1969) theme coding unit provides a coder latitude in defining the boundary of the coding unit as it can be used to select as much text as is relevant to accurately depict context. As such, a coding unit defined by its context could be a single sentence, a sentence fragment, a paragraph, a photo caption, a bulleted list, or even a chart, graph or other depiction of water data.

A search tool was used to locate every occurrence of the word “water” in both the GRI G3 documents and each sampled sustainability report. The search term “water” identified both the word itself and any word containing “water”. Those words containing “water” that represented business names (i.e. PriceWaterhouseCooper), place names (i.e. Witswatersrand), the name of an individual or group (i.e. Department of Water Resources), were excluded from the content analysis as they did not represent a “water” disclosure. Compound words such as groundwater, saltwater, waste-water, etc. were included as they are forms of “water” related to company operations.

**Coding Construct**

The coding construct design was based on the GRI G3 Reporting Guidelines, and G3 supplements such as: Indicator Protocols Sets; the Mining and Metals Sector Supplement (MMSS); and MMSS Indicator Protocols Sets. The MMSS materials were included to evaluate early adoption of the supplemental guidelines by A/A+ reporting organizations. This resulted in a two sets of Performance Indicator categories identified as “water-specific indicators” (Table 3) and “water-referencing indicators” (Table 4).

<table>
<thead>
<tr>
<th>Environmental Performance Indicators</th>
<th>Disclosure on Management Approach (Water)</th>
<th>Water-Specific Disclosures and Performance Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Aspect: Water</strong></td>
<td>EN8 Total water withdrawal by source.</td>
<td>Core</td>
</tr>
<tr>
<td></td>
<td>EN9 Water sources significantly affected by withdrawal of water.</td>
<td>Additional</td>
</tr>
<tr>
<td></td>
<td>EN10 Percentage and total volume of water recycled and reused.</td>
<td>Additional</td>
</tr>
<tr>
<td><strong>Aspect: Emissions, Effluents, and Waste</strong></td>
<td>EN21 Total water discharge by quality and destination.</td>
<td>Core</td>
</tr>
<tr>
<td></td>
<td>EN25 Identity, size, protected status, and biodiversity value of water bodies and related habitats significantly affected by the reporting organization's discharges of water and runoff.</td>
<td>Additional</td>
</tr>
</tbody>
</table>
### Table 4
**Water-Referencing Indicators**

<table>
<thead>
<tr>
<th>Water-Referencing Performance Indicators</th>
<th>Description</th>
<th>Core</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Economic</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aspect: Economic Performance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EC2</td>
<td>Financial implications and other risks and opportunities for the organization's activities due to climate change.</td>
<td>Core</td>
</tr>
<tr>
<td>Aspect: Indirect Economic Impacts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EC8</td>
<td>Development and impact of infrastructure investments and services provided primarily for public benefit through commercial, in-kind, or pro bono engagement.</td>
<td>Core</td>
</tr>
<tr>
<td><strong>Environmental</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aspect: Energy</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EN4</td>
<td>Indirect energy consumption by primary source.</td>
<td>Core</td>
</tr>
<tr>
<td>Aspect: Biodiversity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EN11</td>
<td>Location and size of land owned, leased, managed in, or adjacent to, protected areas of high bio-diversity value outside protected areas.</td>
<td>Core</td>
</tr>
<tr>
<td>EN12</td>
<td>Description of significant impacts of activities, products, and services on biodiversity value outside protected areas.</td>
<td>Core</td>
</tr>
<tr>
<td>Aspect: Emissions, Effluents, and Waste</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EN23</td>
<td>Total number and volume of significant spills.</td>
<td>Core</td>
</tr>
<tr>
<td>EN26</td>
<td>Initiatives to mitigate environmental impacts of products and services, and extent of impact mitigation.</td>
<td>Core</td>
</tr>
<tr>
<td>Aspect: Compliance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EN28</td>
<td>Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations.</td>
<td>Core</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Water Referencing Performance Indicators In Mining &amp; Metals Sector Supplement</th>
<th>wicklung</th>
<th>Core</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Environmental</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aspect: Biodiversity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EN14</td>
<td>Strategies, current actions, and future plans for managing impacts on biodiversity.</td>
<td>Core</td>
</tr>
<tr>
<td>MM2</td>
<td>The number and percentage of total sites identified as requiring biodiversity management plans according to stated criteria, and the number (percentage) of those sites with plans in place.</td>
<td>Core</td>
</tr>
<tr>
<td>Aspect: Emissions, Effluents, and Waste</td>
<td></td>
<td></td>
</tr>
<tr>
<td>MM3</td>
<td>Total amounts of overburden, rock, tailings, and sludges and their associated risks.</td>
<td>Core</td>
</tr>
<tr>
<td>Social</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Aspect: Community</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SO1</td>
<td>Nature, scope, and effectiveness of any programs and practices that assess and manage the impacts of operations on communities, including entering, operating, and exiting.</td>
<td>Core</td>
</tr>
</tbody>
</table>

The “water-specific” and “water-referencing” indicators listed in the tables above, along with Management Approach and Strategy and Profile disclosure categories, constituted the backbone of the categorical coding tool developed for this study. To account for “water” disclosures that would not fit into any of the categorical codes already mentioned two more categorical codes were defined: 1.) Other GRI Disclosures; and 2.) Non-GRI Report Data. The resultant coding tool, composed of 21 categorical codes, is attached as an appendix.

**Inter-rater Reliability**

Inter-rater reliability procedures were performed in order to establish validity of the categorical coding construct and the thematic coding. Inter-rater reliability was established.
through the use of a rater who was first taught to use the coding construct before applying it to a subset of the coding units. The initial results produced an inter-rater reliability of 62%. This initial round of inter-rater reliability check revealed a difficulty for the rater to distinguish between the Management Approach, Strategy and Profile, and Non-GRI Disclosure categories. Because these categories account for such a high volume of the coding units (60% of the total) and the categories are the three broadest in nature, difficulty distinguishing between them distorts the accuracy of the Inter-rater reliability results. Retraining specifically tailored to the distinctions of these categories was conducted and a random sample of 10% of the coding unit population was reevaluated.

The final level of agreement between the researchers was 83% (89 of the 107 sampled coding units were in agreement). The measure of reliability was calculated as the number of coding units for which there was agreement in categorization divided by the total number of coding units assessed by the rater (Light, 1971). Disagreements between the rater and the researcher were resolved by discussion. No coding units were re-categorized. No coding units were dropped from the study due to the high levels of agreement obtained.

**Water Disclosure Under the GRI G3**

Water disclosure in the sampled sustainability reports followed the G3 in most material respects. As shown in Appendix A, “Core” water-specific performance indicators were reported with few exceptions, many reports contained “Additional” water-specific performance indicators, Management Approach disclosures were not only present but prevalent, and Strategy and Profile disclosures were so common that the category led the frequency count.

The sample of 22 reports produced a coding unit population of 1075. Figure 3 depicts the distribution of the aggregate Level 1 categorical codes. Categorical Coding is presented at the aggregate level for Level 1 codes because it is statistically representative of company level data for all business units. The company level data for 21 of the 22 companies have a correlation coefficient with the aggregate data above .76. The correlation coefficient of 17 of the 22 companies with the aggregate data is at or above .84. Total coding units from the 21 highly correlated companies represent 96% of the coding unit population.

**Partial Disclosure of Water-Specific Indicators**

Most reports contained some of the information specified by the G3 for the reporting of water-specific performance indicators, but few contained complete disclosures. Partial disclosure of water-specific indicators outnumbered full disclosure, 105 to 27, respectively, or nearly 4 to 1, see Appendix B for detailed results. Full disclosure of these performance indicators is important to gain a more complete picture of the overall organizational impact on water. If, for example, a corporation reports the total volume of water withdrawals and discharges, but not the sources of the withdrawals or the destination and quality of the discharges, the impact of those activities is much more difficult to determine. Further, the simple act of reporting information at an appropriate level of detail speaks to a corporation’s ability to do so, and demonstrates that the collection and analysis of water data really is an organizational priority. Not doing so, however, leaves room to question corporations’ systems and claims of water-consciousness.
Lack of Differentiation of Reports Across Application Levels

As discussed in the following section, reports in higher disclosure Application Levels showed no discernible differences from reports in lower Application Level categories with regard to the quality of water-specific disclosures. However, in the context of voluntary disclosure, without clear delineation of what qualifies as disclosure (full or partial disclosure of reporting compilation specifications), and without an officially recognized standard for external assurance of those disclosures, the variability in quality of reporting data within and across Application Levels is unsurprising.

Variability of water disclosure frequency among reports in every Application Level except for the C+ Application Level, where only two data points existed, made generalizing about any particular Application Level unreliable. Analysis of coding unit frequency data aggregated at the Application Level seemed to indicate that A and A+ reports disclosed “water” more often than lower Application Levels. However, a comparison of context units by report revealed significant variances within and across all Application Levels, making any statement regarding water disclosure trends according to Application Level questionable. The variability of water disclosures by report is shown in Figure 4 below.
A number of possible variables may have influenced the frequency of water disclosures in a given sustainability report from the size of the reporting organization or amount of experience the reporting organization has with sustainability reporting influences, to stakeholder issues or local weather patterns exposing water management system weaknesses. Identification and analysis of these variables was beyond the scope of this research. As these other variables were not considered, there were no remarkable trends in frequency data across, or within, Application Levels.

Reporting organizations that self-declared Application Level A and A+ were required to include disclosures for Core water-specific performance indicators EN8 and EN21. The coding analysis results identified one A reporting organization that issued a partial disclosure for EN8 and a referential disclosure for EN21, two A+ and A reporting organizations that issued partial disclosures for both EN8 and EN21, one A+ and one A reporting organization that issued full disclosures for EN8 and partial disclosures for EN21, and only one A+ organization that issued full disclosures for both EN8 and EN21. These results speak fairly poorly for the quality of reporting on the Core water-specific performance indicators by organizations with self-declared A and A+ Application Levels.

While the MMSS was not required for use by reporting organizations during the reporting period under review, it was used in this study to assess early adoption of the supplement. The A and A+ were identified as the appropriate groups for assessing early adoption as MMSS performance indicators are considered Core and A and A+ reporting organizations are required to report on all Core performance indicators. There was only a slight indication of early adoption of the MMSS by A and A+ Application Level reporting organizations. Just two A and one A+ reporting organizations issued disclosures for MM3, while MM2 was not disclosed at all. This level of adoption did not differentiate the A and A+ reporting organizations from lower Application Levels as MM3 disclosures occurred in B+, B, and C reports as well.
Efficacy of the GRI G3

The general lack of full disclosure of water-specific indicators clearly establishes reporting of those indicators as incomplete. The variability of water disclosure completeness calls into question both the accuracy of the Application Level system and the reliability the reporting organizations’ Application Level self-declaration.

One of the test statements a reporting organization is to consider under the reporting content principle of Completeness states: “The report does not omit relevant information that would influence or inform stakeholder assessments or decisions, or that would reflect significant economic, environmental, and social impacts.” (GRI b, 2006, p.13). As the materiality and relevance of water has been established, the lack of full disclosure of water-specific indicators would not pass the stated test.

The “Explanations” of the report quality principle of Reliability states: “Stakeholders should have confidence that a report could be checked to establish the veracity of its contents and the extent to which it has appropriately applied Reporting Principles.” (GRI b, 2006, p.17). The issue of reliability of the self-declared Application Level is complicated because it also encompasses completeness of water-specific disclosures and consequently the accuracy of the original self declaration and the accuracy and reliability of externally assured reports given an opinion on the self-declared Application Level.

There are many limitations of the GRI G3 Reporting Framework at play here. It starts with a weakness of the Application Level system not differentiating between full, partial, or referential disclosure. When partial disclosure of a performance indicator is given equal treatment as full disclosure the incentive for full disclosure has been lost. For example, an organization reporting total water withdrawals and discharges by volume would be partially disclosing EN8 and EN21 but could declare the same application level as an organization reporting the volume of water withdrawals by source and discharges by destination and quality (where all other disclosure criteria are similarly met).

Limitations of the Study

The research effort was designed to analyze and report findings on a specific subset of sustainability reports identified by the sample selection. The sample selection was not based on statistical sampling and therefore results are not generalizable to sustainability reporting as a whole or to any subset of sustainability reporting beyond the defined sample. The sample was limited to a single reporting year, a single industry, and did not consider organizational size or cultural influences. As such, maturation effects in reporting, cross-industry comparison, and differences in organizational resources or accepted communication styles and conventions were not captured. Further, the use of only those sustainability reports based on the GRI G3 excludes other reports or documents produced to disclose corporate sustainability/responsibility. Ongoing development of the GRI Reporting Framework and Sector Supplements adds potential variability of sustainability reporting as early adopters start using newer standards prior to the date the official adoption date or organizations fail to use the current standards and issue reports based on prior versions of the guidelines. Lastly, the study did not attempt to determine comparability of data (i.e. water measurement units in cubic meters vs. gallons vs. liters).
CONCLUSIONS AND IMPLICATIONS

The overall conclusion that the results of this study support is that water disclosures are present but are characterized by a preference for “flash over substance”.

The baseline established by the results of this study indicate reporting organizations focus the majority of water related content on organizational strategy, management plans, initiatives, conservation targets, stakeholder engagement and community relations topics. In doing so, reporting organizations portray themselves as sustainability-minded, with water being an organizational priority. The general lack of fully disclosed water-specific indicators hint at either insufficient organizational control to provide the level of data needed for full disclosure, or an organizational unwillingness to disclose the level of detail described in performance indicator compilation specifications.

As this study suggests, in the ongoing process of development of the GRI’s Sustainability Reporting Framework there are clear areas for improvement. Nonetheless, the GRI G3 is playing an important role as a driver of sustainability by pushing a sustainability reporting standard onto the global business environment. It is no small feat that the number of corporations voluntarily issuing sustainability reports increases every year, or that those same corporations are following a set of voluntary standards when creating their sustainability reports. In general, the growth of sustainability reporting indicates a trend toward increased corporate transparency, and with time, continued interest in sustainability reporting by both internal and external stakeholders that will drive the quality of reporting to a higher standard.

While the results of this study are by no means a ringing endorsement of the state of the mining industry’s sustainability reporting as it relates to water, the researchers are confident that there is a future where sustainability reporting on this issue will be of the same caliber and importance as financial reporting is today.

REFERENCES


### Appendix A-1

**Categorical Coding Tool and Level 1 Categorical Coding Summary by Company**

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Water-Specific Disclosures</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Management Approach</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>AngloGoldAshanti</td>
<td>A+</td>
</tr>
<tr>
<td>DeBeers</td>
<td>24</td>
</tr>
<tr>
<td>Gold Fields</td>
<td>12</td>
</tr>
<tr>
<td>Teck Resources</td>
<td>10</td>
</tr>
<tr>
<td>Kingsgate</td>
<td>A</td>
</tr>
<tr>
<td>Minera Alumbrera</td>
<td>10</td>
</tr>
<tr>
<td>Xstrata Copper</td>
<td>32</td>
</tr>
<tr>
<td>Xstrata Mount Isa</td>
<td>11</td>
</tr>
<tr>
<td>Impala Platinum</td>
<td>B+</td>
</tr>
<tr>
<td>Merafe Res.</td>
<td>8</td>
</tr>
<tr>
<td>Xstrata Coal</td>
<td>11</td>
</tr>
<tr>
<td>Cliffs Nat. Res.</td>
<td>9</td>
</tr>
<tr>
<td>Antofagasta PLC</td>
<td>B</td>
</tr>
<tr>
<td>Hudbay Minerals</td>
<td>3</td>
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### Appendix B

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#### Research Questions Results Summary

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| 1. How are reporting organizations using the G3 to disclose water impact? | • Are all “Core” water Performance Indicators utilized?  
  • Are “Additional” water Performance Indicators represented? If so, which ones?  
  • Are disclosures on Management Approach to water issues present?  
  • Is there Strategy and Profile information relevant to water provided? | • All “Core water Performance Indicators are utilized. EN8, EN26, EC8, and EN21 were the most reported “Core” indicators.  
  • “Additional” water Performance Indicators are represented, though. EN10 and EN14 reported more often than EN9 and EN25.  
  • Management Approach disclosures represent over 20% of water disclosures.  
  • Strategy and Profile disclosures represent over 25% of water disclosures. |
| 2. What trends or patterns emerged in the disclosure on water? | • What is the significance of these trends or patterns?  
  • If not present, what does that say about the efficacy of the reporting guidelines? | • Complete disclosure of water-specific indicators was rare, partial disclosure common  
  • No discernible differences in quality of water-specific disclosures across Application Level. |
| 3. What differences can be seen between the various self-declared Application Levels? | • Were Application Levels A and A+ supported by the content analysis results?  
  • Were Application Levels A and A+ early adopters of the Sector Supplement? | • No discernible trends emerged to distinguish reports across Application Levels.  
  • Sector Supplement disclosures were not common. A and A+ reports did not stand out as early adopters. |
ACCOUNTING MAJORS’ PERCEPTIONS OF THE ADVANTAGES AND DISADVANTAGES OF SUSTAINABILITY AND INTEGRATED REPORTING

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ABSTRACT

Investor demand for information, regulatory requirements, and continually developing high-quality reporting standards has led to a globally growing trend toward formal sustainability reporting. Integrated reporting, which combines financial and sustainability-related information into one report is also emerging. Accounting professionals’ increasing involvement complements and enhances this trend. Their attitudes toward and support of sustainability reporting will influence the incidence and quality of reporting. Accounting majors are the future accounting professionals; thus, their perceptions are important.

This study deals with the current status of sustainability and integrated reporting, discusses related regulatory requirements and sustainability reporting standards, and investigates students’ perceptions regarding the potential advantages and disadvantages of sustainability and integrated reporting. This study found that accounting majors support sustainability and integrated reporting and perceive the positive effect on a company’s reputation, increased profit, and customer loyalty as the most important advantages of reporting. In addition, the study found that accounting majors perceive short-term reporting costs as the most important disadvantage. Findings from this study provide insights into future accounting professionals’ perceptions regarding the advantages and disadvantages of sustainability reporting, which helps assess their support of this important global reporting trend.

INTRODUCTION

Sustainability reporting provides information about organizations’ impact on natural resources, employees, and the community. This information may assist stakeholders in assessing organizations’ long-term creation of value beyond the products and services they provide and the profit they generate. Some global companies combine sustainability reporting with financial reporting in one integrated or linked report.

In the U.S., sustainability and integrated reporting are largely voluntary. However, globally a trend toward mandatory reporting has emerged. Accounting professionals play an important role in supporting this trend and also likely will play a continually increasing role in the day-to-day compiling, analyzing, and reporting of unbiased relevant sustainability information. In addition, accounting professionals may play an increasing role in the planning and strategic implementation of sustainability-related activities. The American Institute of Certified Public Accountants (AICPA) views CPA’s function with regards to sustainability accounting and reporting as follows: “Members in business, industry and government can add value within their organizations by serving in an integrative role in the value creation process, linking company strategy to sustainability, evaluating risks and opportunities, and providing measurement, accounting and reporting skills.” (AICPA, n.d., n.p). opportunities, and providing

For the sustainability and integrated reporting trend to continue to thrive, companies must be willing to expend resources necessary for high-quality comparable reporting. Companies that decide to report on sustainability will tend to consider carefully the benefits and challenges of reporting. Accounting professionals provide important input regarding the reporting decisions and implementation. Accounting majors are the future accounting professionals and hence will be affected by sustainability reporting. If they are convinced that the benefits are consistent with their company’s mission, they may be more inclined to support sustainability or integrated reporting. An earlier study (James, 2015) found that overall, accounting majors support sustainability reporting of environmental and social sustainability issues. Thus, their perceptions regarding the benefits and challenges of sustainability and integrated reporting are very important.

This study found that accounting majors tend to support integrated reporting for public companies and would support mandatory reporting. Accounting majors perceived that the most important advantages of sustainability reporting were the positive effects on the company’s reputation, increased profit, and customer loyalty. Accounting majors perceived that the most important disadvantages were short-term reporting costs and concerns about the accuracy and completeness of the information. This study provides information regarding future accounting professionals’ perceptions of the potential advantages and disadvantages of sustainability reporting which may affect their influence on and support of sustainability and integrated reporting and help shape their involvement with such activities.

**BACKGROUND**

The Brundtland Commission’s definition of sustainability development (U.N., 1987, 41), which states that it is a “development that meets the needs of the present without compromising the ability of future generations to meet their own needs,” is well-known and frequently cited in the literature. In the context of corporate sustainability, it generally relates to companies’ ability to create value in the long-run while minimizing their negative impact on the environment, people, and natural resources. Thus, the term “sustainability” includes not only environmental issues such as clean air, water, and the preservation of natural resources; but also the wellbeing of companies’ workforce, the community in which they operate, as well as their effect on other stakeholders.

Today, examples of sustainability-related programs and practices are diverse and for some organizations quite comprehensive and extensive. Some companies tend to primarily focus their efforts on environmental sustainability, which may include recycling programs, clean air and water initiatives, energy efficiency and renewable energy, and minimization of waste; others may focus on community-related issues. For example, a survey of 178 executives involved with corporate sustainability initiatives found that 84.8% of them were involved with environmental initiatives (Ballou et al. 2012). Social programs, including those that enhance employee wellbeing also tend to be very important. Ballou et al. (2012) found that the second most frequently reported sustainability-related initiatives consisted of social programs, with 70.2% of the executives reporting that they were involved with such initiative.

Some companies that have implemented extensive sustainability programs in their own organization also require that those that are closely associated with them adhere to minimum standards to preserve energy, minimize negative effects of their operations, respect human
rights, and adhere to a high level of ethical conduct. For example, Apple Company requires that its suppliers sign and comply with their supplier code of conduct, audits companies’ compliance with the code, maintains a supplier responsibility website, and publishes an annual supplier responsibility report (Apple, n.d.). During 2014, the company also launched a supplier environment, health, and safety academy, which represents more than 270,000 workers worldwide (Apple, n.d.). According to its 2014 supplier responsibility report, during 2014, the company called 30,000 workers to ascertain that their employers (Apple’s suppliers) complied with their rights (Apple, n.d.). Similarly, Wal-Mart, the world’s largest retailer, requires that its suppliers comply with their ethical standards, which consists of 13 fundamental standards (Wal-Mart, n.d.).

Apple’s and Wal-Mart’s extensive commitment to sustainability, which extends to its suppliers, are not exceptions but rather reflect a global trend, especially among large companies. A recent global survey of 500 manufacturing and service industry companies, revealed that 81% of survey respondents who rated sustainability as important also preferred to collaborate with their suppliers in order to generate a “responsible supply chain footprint” that is consistent with sustainability (PwC, 2013).

Incentives for Sustainability

Organizations implement sustainability programs for different reasons; these may include a desire to support the wellbeing of current and future generations, to remain competitive or gain a competitive advantage in markets where sustainability and responsibility are expected and highly valued by consumers and clients, to comply with federal and local regulatory requirements, and many more. Another incentive for implementing sustainability programs is expected cost savings, which should result in higher profits. A survey of executives at large companies found that of the 274 survey respondents, 74% identified cutting costs among the determining factors for their companies’ sustainability agendas during the next two years (Ernst and Young and GreenBiz Group, 2011). However, another study (Blazovich et al. 2013) did not find that “green” companies reported significantly higher financial performance.

United Parcel Service (UPS) represents an important example of how sustainability-related activities save natural resources and yield significant cost savings. UPS utilizes a proprietary IT system that it refers to as ORION, which optimizes pick-up and delivery routes. For example, using ORION, most turns that drivers take are right-hand turns which save time and fuel, and reduce emissions. According to UPS’s 2013 sustainability report, during 2014, use of ORION is expected to reduce fuel consumption by 1.5 million gallons and CO₂ emissions by 14,000 metric tons (UPS, 2014). The company estimates that if each of its drivers drives one mile less per day, it could save up to $50 million in costs per year (UPS, 2014). In addition to ORION, UPS utilizes other extensive programs that reduce greenhouse gas emissions, save fuel, and ultimately costs.

Some sustainability-related programs are motivated by laws and regulations. In the U.S. and many other countries, regulations related to environmental as well as social issues are extensive. For example, in 1963, the U.S. passed the Clean Air Act, which provided funding for research designed to monitor and control air quality (EPA, n.d.). Over the past five decades, a series of new legislation and amendments to the Clean Air Act included extensive requirements for improving air quality. For example, a 1990 amendment included a program for phasing-out ozone-depleting chemicals (EPA, n.d.). Similarly, the Clean Water Act, which was first passed in
1970 and regulates the discharge of pollution into water sources was amended several times (EPA Summary, n.d.). Furthermore, the Department of Labor sets forth requirements and legislation pertinent to employers and employees in the private sector (U.S. DOL, n.d.). For example, specific rules and regulations specify the amount of time that must be granted for meals and rest periods between long shifts; prohibit child labor; require safe working conditions, and provide for family leave with job security.

Individual states and municipalities also regularly impose restrictions and may regulate the consumption of water and energy. For example, after experiencing several years of severe drought, in 2014, California passed regulation that restricts the use of potable water. For example, the regulation specifies that drinking water may not be used to wash drive-ways and sidewalks (California Environmental Protection Agency, 2014). In addition, in compliance with the California Governor’s request to reduce water consumption by 20%, actual use during December 2014 reportedly decreased by 22% (California Water Boards Media Release, 2015).

In other countries, regulation may be more or less extensive than in the U.S. For example in Germany, according to the federal “Mutterschutz” (maternity protection) law, expectant mothers may not be dismissed from their employment starting from the fourth week of pregnancy; must be granted paid leave six weeks prior and eight weeks after giving birth; and may return to work if they chose to do so (How to Germany, n.d.). Family leave in Germany is also quite generous and covers both parents.

Some countries are just starting to make sustainability a priority. In 2013, the Chinese government published air pollution reductions targets focusing especially on specific high- pollution area. Specifically, China committed to a reduction in ambient air quality concentration of PM$_{10}$ by 10%, SO$_2$ by 10%, NO$_2$ by 7%, and PM$_{2.5}$ by 5%. In addition, three high pollution regions – Beijing-Tianjin-Hebei, Yangtze River Delta, Pearl River Delta - must reduce PM$_{2.5}$ by 6% by the end of 2015 (China Clean Air Policy Briefing, 2013). China’s five year plan also includes long-range targets.

**Stakeholder Demand for Sustainability**

Many consumers expect that companies behave responsibly and produce and distribute products that are consistent with social and environmental sustainability. A recent global survey of 30,000 consumers found that more than half of them reported that they were willing to pay a premium for products and services provided by socially and environmentally responsible organizations (Nielson, 2014). Another survey (Deloitte, 2009) found that 54% of the respondents considered sustainability as one of the factors influencing their purchasing decisions.

Organizations tend to be aware of the positive effect of providing stakeholders’ with Sustainability-related information as is evident in the prevalence of promotional type of ‘reporting.’ A study investigating the perceptions of 18-23 year olds (referred to as millennials) revealed that millennials tend to recommend products to their friends that they perceive as environmentally friendly as well as economical and that they tend to recommend products that utilize recycled materials (Smith, 2010). In addition, nearly 90% of the study participants associated a recycling symbol with an environmentally friendly product (Smith, 2010).

**Reporting Trends**

In the past, the primary focus of formal reporting was on financial/economic aspects of a company’s activities. However, a number of studies (for example, Holder-Webb et al.
2009) found that non-financial measures provide investors with a better understanding of corporate performance. Today, stakeholders, including employees, customers, investors, governmental agencies, and regulators are interested in the sustainability-related activities of business organizations.

Thus, formal reporting is gaining momentum. A study by Ernst & Young (one of the worlds’ largest public accounting and consulting firms) and Boston College Center of Corporate Citizenship (2013) found that of the global 250 companies, 95% currently issue sustainability reports; in addition, the study found that 53% of the S&P 500 companies are currently issuing sustainability reports (EY & Boston College Center for Corporate Citizenship, 2013).

Other studies support these findings. A study of the 100 largest companies in each of 41 countries revealed that during the 2012-2013 reporting period, 86% of U.S. companies and 79% of the Canadian companies reported on sustainability (KPMG, 2013). Furthermore, 88% of the largest Brazilian companies reported on sustainability. In Europe, companies based in the U.K, France, and Denmark most frequently reported about sustainability. The reporting rates of the 100-largest companies in those countries were 100% in the U.K, 94% in France, and 91% in Denmark (KPMG, 2013). The highest reporting rates by large companies were in Asia-Pacific countries were found in Japan, China, and Australia. Specifically, 99% of the Japanese companies, 59% of the Chinese companies, and 57% of the Australian companies reported on sustainability. In the Middle East and Africa, of the largest companies, 97 percent of South-African companies and 68% of Nigerian companies reported on sustainability (KPMG et al. 2013). In addition, the survey found that overall more than half (51%) of the 4100 companies reported formally reported on sustainability in their annual reports, most of them in a separate section. This represents a dramatic increase. In their prior comparable surveys KPMG found that in 2008 only 4%, and in 2011 only 20% of the largest global companies reported on sustainability in their annual financial statements (KPMG et al. 2013).

Some companies issue multiple reports. For example, Apple Company issues an annual environmental sustainability report, as well as a separate supplier responsibility report. For 2014, its 40-page supplier responsibility report contained information related to the following categories: educating and empowering workers; labor and human rights; health and safety; environment, accountability; and audit results (Apple, n.d.).

Sustainability reporting tends to be motivated by investor expectations. According to the US SIF (also referred to as the Forum of Sustainable and Responsible Investment), investors placed $3 trillion dollars in sustainability and corporate responsibility-related funds (US SIF, 2012); this implies that investors support and reward companies that behave in a responsible and sustainable manner. This likely contributed to a trend toward formal and informal sustainability reporting.

**Benefits of Sustainability and Integrated Reporting**

Sustainability and integrated reporting may be very beneficial to the reporting company. A study by Ernst and Young and the Boston College of Corporate Citizenship (2013) investigated the perceived benefits of sustainability reporting by public and private companies. When asked to indicate ways in which sustainability reporting provided value to their organization, the most frequently mentioned value was the positive effect on the company’s reputation; specifically, nearly 60% of the respondents indicated that sustainability reporting improved their company’s reputation. The second most frequently mentioned benefit was increased employee loyalty with more than 37% indicating that sustainability reporting had a
positive effect on employee loyalty. The ability to reduce inaccurate information about a company’s social performance and helping to refine the company’s corporate strategies and mission were the third and fourth most frequently mentioned benefits.

Sustainability reporting and especially integrated reporting may assist a company in improving its long-term creation of value. Integrated reporting necessitates that decision makers consider the comprehensive impact of their plans and actions. This includes consideration of not only financial aspects, but also of the short-term, intermediate-term and long-term effects on the community in which they operate, the company’s workforce, the environment, the impact on the future availability of natural resources – in short, the wellbeing of future generations. In a recent speech, His Royal Highness (HRH) the Prince of Wales emphasized the importance of organizations adopting integrated reporting and the underlying vital “integrated approach to management” as soon as possible (HRH the Prince of Wales, Dec 5, 2013). According to HRH the Prince of Wales, the potential value of integrated reporting is that it helps organizations and their decision makers focus not only on financial, but also human and natural capital; that it challenges the historical perspective of accounting information; and focuses on the long-term effect of organizations’ decisions and actions (HRH, 2013). Integrated reporting according to HRH is a starting point that enables companies to recognize and communicate their effect on natural capital (HRH, 2013).

Mervyn King, Chairman of the International Integrated Reporting Council (IIRC), links integrated reporting with ‘integrated thinking,’ which according to Mr. King, “deals with value creation short, medium and long term and the integrated report tells the story of this value creation in clear, concise and understandable language” (King, 2013, 5). According to PwC, the global accounting firm, ‘integrated thinking’ can contribute to strategic insights on long-term success, alignment of key business priorities, and more meaningful communications internally and with external stakeholders” (PwC, 2013, Point of view).

While expectations of investors and other stakeholders contribute to the demand for voluntary sustainability reporting, and the value of perceived benefits encourage reporting, regulation provides the necessary incentives and structure for reporting practices in some countries.

**Reporting Regulation**

In the U.S., SEC Regulation S-K, which public SEC reporting companies must comply with, requires consideration and reporting of risks associated with climate change regulation (SEC, 2010). Specifically, section 101 of SEC regulation S-K requires that registrants provide a description of their business and in subsection 101(c)(1)(xii) stipulates:

“Appropriate disclosure also shall be made as to the material effects that compliance with Federal, State and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have upon the capital expenditures, earnings and competitive position of the registrant and its subsidiaries. The registrants shall disclose any material estimated capital expenditures for environmental control facilities for the remainder of its current fiscal year and its succeeding fiscal year and for such further periods as the registrant may deem materials” (SEC, 2010, 13).

Furthermore, reporting is required with respect to conflict minerals. Specifically under section 1502 of the Dodd-Frank Act of 2010, SEC reporting companies must disclose their use of
conflict minerals if they are needed for the “functionality or production” (SEC, n.d.). In addition, provisions under the Clean Air and Clean Water Acts require various reporting requirements. Companies required to comply with the Clean Air Act (e.g., automobile manufacturers) must explain risks and compliance in the “business” section of their 10-K statements filed with the SEC. For example, in its 2010 annual report, Ford Motor Company made 17 references to the Clean Air Act (Ford Motor Company, 2010).

Thus, in the U.S., reporting tends to focus on specific issues and industries. This is starting to change. The global financial exchange company - NASDAQ OMX - which includes the NASDAQ stock exchange, strongly encourages sustainability reporting (NASDAQ QMX, n.d.). The CERES Institute supports this recommendation and advocates that other major U.S. stock exchanges require corporate disclosures about ten sustainability-related categories. The ten categories are: governance and ethical oversight, environmental impact, government relations, climate change, diversity, human rights, employee relations, the impact of products and services; and integrity, supply chain, and community relations (CERES, 2014).

In Europe, the EU Modernization Directive of 2003 requires that public companies include information about environmental and employee-related issues in their annual and consolidated reports (KPMG et al. 2013). In addition, an amendment to the directive requires that listed companies report annually on corporate governance (KPMG et al. 2013).

While the majority of large global companies already report on sustainability, most of them issue a standalone report that is not integrated with their annual (financial) reporting; this is especially the case for U.S. companies. According to the KPMG survey of the 4100 large companies in 41 countries, only ten percent indicated that they reported on sustainability in an integrated format (KPMG et al. 2013).

Reporting rules and regulations in some countries strongly encourage or require integrated reporting by stock exchange listed companies. For example, the South African Code of Corporate Governance (King III) requires that companies listed on the Johannesburg Stock Exchange must issue an integrated report (IIRC, 2013). In 2012, Brazil’s BM&FBOVESPA exchange adopted a “report-or-explain” approach, requiring that companies report sustainability-related information in their annual report, or explain why they are not reporting (PwC, 2012).

In Europe, the Danish Financial Statements Act requires that large public companies provide in their annual report information about their corporate social responsibility-related activities (CSRgov, n.d.); and France’s article 225 of ‘Grenelle II’ (a 2010 law) requires that stock exchange listed companies include sustainability-related information in their annual report (PwC, 2012, How France).

While financial reporting rules in a few countries require sustainability or even integrated reporting, in the U.S. and in many other nations, sustainability and integrated reporting are voluntary and the nature, extent and quality of the reporting varies considerably, resulting in a lack of comparability. Reporting standards are necessary to support comprehensive, high quality and comparable sustainability reporting. The continued efforts of global standard setters to develop reporting standards may help improve comparability and hence the usefulness of the reported information.

**Reporting Standards and Guidelines**

Several organizations, such as the Global Reporting Initiative (GRI), the U.N. Global Compact, the Carbon Disclosure Project, and the International Organization for Standardization provide sustainability-related guidelines. In addition, the IIRC recently issued its first framework
for integrated reporting (IIRC, 2013). Currently, the most widely used comprehensive guidelines are provided by GRI, which was founded in 1997 by the U.S.-based not-for-profit organizations CERES and Telles and is now headquartered in Amsterdam. Since then, their continues efforts to develop and periodically update their global sustainability reporting guidelines have resulted in four generations of widely used sustainability reporting standards. At present, approximately 63% of the S&P 500 companies that issue formal sustainability reports utilize the guidelines provided by the GRI (E&Y and Boston College, 2013).

In the U.S., the Sustainability Accounting Standards Board (SASB), which is an independent standard setter founded in 2010 through Harvard University’s “Initiative for Responsible Investment,” is developing industry-specific sustainability reporting standards (SASB, n.d.). SASB’s mission is to develop sustainability accounting standards for 80 industries in ten sectors that can be utilized for disclosures included in reports filed with the SEC, such as 10-K and 20-F filings (SASB, Vision, n.d.). According to the SASB, “SASB’s accounting standards provide companies with standardized accounting metrics to account for performance on industry-level sustainability topics. When making disclosure on sustainability topics, companies adopting SASB’s accounting standards will help to ensure that disclosure is standardized and therefore useful, relevant, comparable, and auditable.” (SASB, Services Download Page, n.d.). As of February 2015, SASB has issued reporting standards for six sectors – health care, financials, technology and communications, non-renewable resources, transportation, and services. In addition, several other reporting guidelines are currently in the public comment stage (SASB, Key Dates, n.d.). A key difference between the SASB and the GRI standards is that the SASB standards address issues and provide metrics for sustainability reporting on industry and sector-specific factors.

While currently, most companies issue standalone sustainability reports, some companies, such as SAP, BASF, Novo Nordisk, and Sony, issue integrated reports. The integrated reporting framework recently issued by the IIRC may lead to more companies considering combining their sustainability reports with their annual financial reports. The IIRC was established in 2010 under the Prince of Wales’ Accounting for Sustainability Project (Accounting for Sustainability, n.d.). After a global consultation period, on December 9, 2013, the IIRC issued its first framework (IIRC, 2013). The IIRC’s efforts enjoy the support of key professional organizations, such as the American Institute of Certified Public Accountants (AICPA), which welcomed the issuance of the framework (AICPA, 2013). In addition, the A4S Accounting Bodies Network, which helps promote accounting for sustainability, supports use of integrated reporting (Accounting for Sustainability, Accounting Bodies Network, n.d.).

Purpose of Study

As formal sustainability reporting becomes more and more common, accounting professionals’ involvement is expanding. Accounting professionals, who perceive that the benefits of sustainability reporting coincide with their company’s mission, are more likely to support reporting. In addition, accounting professionals are ideally suited to help companies explore the benefits of integrated reporting.

Accounting majors, as future accounting professionals, may play an important role in supporting organizations’ sustainability-related activities as well as sustainability and integrated reporting. Thus, their perceptions regarding the potential advantages and disadvantages of sustainability and integrated reporting are important. This study was designed to investigate accounting majors’ perceptions.
METHODOLOGY

Research Instrument

The researcher developed a survey instrument that consisted of three sections. The first section addressed the overall benefits of voluntary integrated reporting for companies and their investors, and the need for U.S. regulators to mandate integrated reporting. Study participants were asked to indicate their level of agreement with several statements utilizing a 5-point Likert scale, where “5” was defined as strongly agree, “4” as agree, “3” as neutral, “2” as disagree, and “1” as strongly disagree. The results from this section were used to test for statistically significant associations between study participants’ attitudes toward sustainability and integrated reporting and their rankings of potential advantages and disadvantages of reporting presented in section two of the survey instrument.

Section two addressed potential advantages and disadvantages that may arise from sustainability/integrated reporting. A brief instructional/explanatory paragraph preceded sections two of the research instrument as follows:

“Assume that you are responsible for external reporting for a well-established, moderately profitable public company that manufactures consumer products and has implemented a series of sustainability programs relating to the environment and natural resources (such as company-wide recycling, purchasing of energy-efficient equipment, significant investments in renewable energy, etc.); human capital (such as educational and health-related resources and programs); and social programs (such as community involvement and support).”

Study participants were then asked to consider potential advantages and disadvantages of formal reporting of their company’s sustainability-related efforts in either a separate (standalone) or integrated report format. With respect to the advantages, students were instructed as follows:

“Indicate your perceptions regarding the potential advantages of formal reporting of your company’s sustainability-related efforts in either a separate or integrated report. Rank the potential benefits in terms of what you perceive as most important to your company’s decision to report on its sustainability efforts.”

With respect to the potential disadvantages, students were instructed as follows:

“Indicate the potential disadvantages that would be most important to your company in deciding whether to formally report on sustainability.”

The study participants were asked to rank ten potential advantages of reporting where “1” was defined as the most important advantage and “10” as the least important advantage. The participants were also asked to rank five potential disadvantages of reporting sustainability-related information in either a stand-alone or integrated format. A rank of “1” was defined as the most important potential disadvantage and “5” as the least important disadvantage.

The ten potential advantages and the five potential disadvantages were adapted from the survey by E&Y and Boston College of Corporate Citizenship (2013). The potential advantages that study participants were asked to rank were enhanced reputation, enhanced industry leadership, increased employee loyalty and recruitment, enhanced customer loyalty, cost savings arising from more effective and efficient operation, increased profit, enhanced access to financial
capital, enhanced regulatory compliance, enhanced opportunities for grants, and refinement of corporate mission and strategies.

The five potential disadvantages of reporting that study participants were asked to rank were short-term and long-term reporting costs, availability of data, concerns about accuracy and completeness of information, and concerns about disclosure of proprietary information to competitors. The study participants were informed that the advantages and disadvantages were listed in random order; and instructed to review the lists of advantages and disadvantages prior to ranking them and to assign each rank only once for the list of advantages and once for the disadvantages. The researcher emphasized that the study participants should address each question and ranks the advantages and disadvantages solely based on their own personal perceptions. At the end of section two of the survey, students were asked whether they would recommend to their company that they adopt sustainability reporting in either a standalone or an integrated format. The third section of the survey asked students to provide information about their career aspirations and to provide demographics-type information.

Since awareness and knowledge of significant current and emerging reporting trends represents one of the learning objectives of each course in which this survey was administered, participation was voluntary, and responses were anonymous, administration of this survey did not require IRB approval.

Sample Selection and Administration of Research Instrument

All accounting majors at a Western Region University must complete the Intermediate Accounting course sequence consisting of Intermediate Financial Accounting and Reporting I & II. Furthermore, some students also complete Advanced Financial Accounting and Reporting, which is an elective course. The fundamental concepts and principles underlying financial accounting and reporting, accounting and reporting of common transactions, and the major financial statements and disclosures are discussed in Intermediate Financial Accounting and Reporting I and II. In Advanced Accounting, advanced financial accounting and reporting topics including consolidated financial statements are discussed.

In addition to discussions of major financial accounting and reporting issues under U.S. GAAP and to some extent under International Financial Accounting Standards, current significant reporting trends are briefly discussed during the Intermediate Accounting course sequence as well as in the Advanced Accounting course. Furthermore, ethical aspects of accounting and reporting choices are considered throughout each course with an emphasis on the importance of the highest level of ethical conduct.

During the Winter, Spring, and Summer 2014 quarters, students enrolled in one section of Intermediate I, in three sections of Intermediate II, and three sections of Advanced Accounting participated in the survey. Participation in the survey was voluntary and students’ responses were anonymous. The survey was administered during the ninth instructional week. One-hundred sixty-five students completed the survey resulting in 151 useable responses. Surveys that included reused or skipped ranks of advantages and disadvantages were excluded from the final sample.

Prior to administering the survey, the researcher discussed current and emerging issues in financial reporting that are currently or will in the future significantly affect the accounting profession and thus accounting majors’ careers. Sustainability and integrated reporting represents one of the three major issues that were discussed during a class session. Specifically, during one class session in each course, the instructor discussed current reporting trends, including the
globally growing trend toward sustainability reporting and the emerging trend toward integrated reporting. The instructor provided some statistics on the prevalence of sustainability reporting among large global companies and briefly discussed the regulatory environment governing sustainability/integrated reporting in several selected countries, including the U.S.

Demographics

The study participants were asked to indicate their major, academic standing, gender, and work status. Ninety-eight percent of the students who completed the survey indicated that accounting was their major, and 2% that accounting was their minor field of study. Twenty-seven percent of the students indicated that they also minored in another business discipline, with computer information systems mentioned most frequently. Of the study participants, 24% were juniors, 67% were seniors, and 9% were graduate students. Sixty-eight percent indicated that they currently worked, 44% of them in accounting-related positions. Forty-eight percent of the study participants were female and 52% were male.

The students were also asked open-ended questions about their career aspirations, what area of accounting they expected to specialize during the next five years, whether they intended to work for a private or public company, and what professional certifications they expected to earn. Thirty-nine percent of the study participants indicated that they wished to work in the tax area, 32% indicated that they wished to work in financial accounting or auditing, 13% that they wished to work in cost accounting, and 16% indicated multiple areas. Nearly 50% of the study participants indicated that they wanted to work for a public company, 29% indicated that they wished to work for a private company, and 21% indicated that they wished to work for a governmental agency, with the IRS most frequently mentioned. Sixty-six percent expressed a wish to earn the designation of (Certified Public Accountant) CPA. The second most commonly mentioned designation was CMA (Certified Management Accountant). Demographic data was utilized to test for statistically significant associations.

Statistical Tests Utilized

Student responses were summarized and statistically evaluated using Microsoft Excel statistical tests. The researcher utilized matched sample t-test and test of correlation to determine significant associations. Means and standard deviations were derived to report descriptive statistics. The results of the study were evaluated utilizing a 0.05 significance level.

EMPIRICAL RESULTS

The study participants were asked whether in the long-run integrated reporting would benefit large and midsize companies and their investors and whether integrated reporting should be mandatory. A 5-point scale with “5” representing “strongly agree” and “1” representing strongly disagree was used. With respect to the benefit of integrated reporting, the mean score was 4.30 for large companies and 3.76 for medium size companies. With respect to integrated reporting benefiting investors, the mean score was 4.13. When asked whether integrated reporting should be mandatory, the mean score was 4.09 for public and 3.54 for private companies.
Advantages of Sustainability and Integrated Reporting

Study participants were asked to rank ten potential advantages of sustainability reporting based on the perceived relative importance of each. Table 1 presents the mean ratings and associated standard deviations for each advantage. A lower numeric mean indicates a higher perceived importance of a particular advantage.

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Mean rankings</th>
<th>Standard Deviations</th>
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<tbody>
<tr>
<td></td>
<td>1 = most important</td>
<td>10 = least important</td>
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<tr>
<td>Increased profit</td>
<td>4.54</td>
<td>2.78</td>
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<tr>
<td>Cost savings arising from more efficient and effective operations</td>
<td>5.06</td>
<td>2.77</td>
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<tr>
<td>Enhanced reputation</td>
<td>5.13</td>
<td>3.37</td>
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<tr>
<td>Enhanced customer loyalty</td>
<td>5.19</td>
<td>3.05</td>
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<td>Increased employee loyalty and recruitment</td>
<td>5.29</td>
<td>2.79</td>
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<tr>
<td>Enhanced industry leadership</td>
<td>5.36</td>
<td>2.55</td>
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<tr>
<td>Enhanced access to financing capital</td>
<td>5.81</td>
<td>2.60</td>
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<tr>
<td>Refinement of corporate mission and strategies</td>
<td>6.36</td>
<td>2.92</td>
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<td>Enhanced regulatory compliance</td>
<td>6.40</td>
<td>2.81</td>
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<tr>
<td>Enhanced opportunities for grants</td>
<td>6.96</td>
<td>2.62</td>
</tr>
</tbody>
</table>

Thus, on average, the students who participated in the study perceived increased profit and cost savings as the most important advantages of sustainability reporting. Since means may not capture in sufficient detail the perceived importance of potential advantages and disadvantages associated with sustainability reporting, the researcher calculated frequencies and related percentages of each rank assigned by study participants to each potential advantage. Table 2 presents the percentage of study participants who assigned each rank to each specific potential advantage.

<table>
<thead>
<tr>
<th>Ranks 1= most important</th>
<th>Reputaion N=144</th>
<th>Industry leadership N=147</th>
<th>Employee Loyalty N=148</th>
<th>Customer Loyalty N=148</th>
<th>Cost Savings N=151</th>
<th>Profit N=149</th>
<th>Financind Capital N=151</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>22.22</td>
<td>9.45</td>
<td>8.11</td>
<td>11.49</td>
<td>12.58</td>
<td>17.45</td>
<td>3.31</td>
</tr>
<tr>
<td>4</td>
<td>9.03</td>
<td>11.81</td>
<td>12.84</td>
<td>6.08</td>
<td>14.57</td>
<td>12.75</td>
<td>8.61</td>
</tr>
<tr>
<td>5</td>
<td>8.33</td>
<td>11.02</td>
<td>13.51</td>
<td>14.19</td>
<td>7.29</td>
<td>12.08</td>
<td>11.26</td>
</tr>
<tr>
<td>6</td>
<td>6.94</td>
<td>11.02</td>
<td>11.49</td>
<td>5.41</td>
<td>9.27</td>
<td>9.40</td>
<td>14.57</td>
</tr>
<tr>
<td>7</td>
<td>4.17</td>
<td>17.33</td>
<td>10.14</td>
<td>7.43</td>
<td>9.27</td>
<td>7.38</td>
<td>13.25</td>
</tr>
<tr>
<td>8</td>
<td>9.03</td>
<td>11.02</td>
<td>6.75</td>
<td>7.43</td>
<td>12.58</td>
<td>8.05</td>
<td>9.93</td>
</tr>
<tr>
<td>9</td>
<td>10.42</td>
<td>7.09</td>
<td>6.08</td>
<td>10.14</td>
<td>8.61</td>
<td>6.04</td>
<td>8.61</td>
</tr>
<tr>
<td>10</td>
<td>9.03</td>
<td>3.94</td>
<td>8.78</td>
<td>9.45</td>
<td>4.64</td>
<td>3.36</td>
<td>9.93</td>
</tr>
</tbody>
</table>
Study participants most frequently ranked “enhanced reputation” as the most important advantage of sustainability reporting, with 32 (22%) of them ranking it as number one. The second most frequently top-ranked advantage was “increased profit,” with 26 (17%) of the participants ranking it as number one.

Cumulative scores consisting of the sum of participants who ranked a particular advantage as the either first, second, or third most important, were also calculated. Based on cumulative frequencies, 62 (43%) of the participants ranked enhanced reputation among the top three most important advantages; 61 (41%) ranked increased profit among the top three most important advantages; and 57 (40%) ranked enhanced customer loyalty among the three most important advantages.

Students most frequently ranked “refinement of corporate mission and strategy” as the least important advantage (rank 10). Based on cumulative scores of the most frequently lowest ranked advantages (ranks 8, 9, 10), enhanced corporate mission and strategies, regulatory compliance, and enhanced opportunities for grants emerged as the advantages of sustainability and integrated reporting perceived as least important.

**Disadvantages of Sustainability and Integrated Reporting**

Students were also asked to rank five potential disadvantages commonly associated with sustainability reporting, with “1” reflecting the most important potential disadvantage and “5” reflecting the least important potential disadvantage. Table 3 presents means rankings for the perceived disadvantages of sustainability reporting.

---

**Table 2 – continued**

<table>
<thead>
<tr>
<th>Ranks 1 = most important</th>
<th>Regulatory Compliance N=149</th>
<th>Grants N=146</th>
<th>Corporate Mission N=151</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>6.04</td>
<td>1.59</td>
<td>7.28</td>
</tr>
<tr>
<td>2</td>
<td>6.04</td>
<td>7.14</td>
<td>6.62</td>
</tr>
<tr>
<td>3</td>
<td>5.37</td>
<td>4.76</td>
<td>9.93</td>
</tr>
<tr>
<td>4</td>
<td>11.41</td>
<td>6.35</td>
<td>5.30</td>
</tr>
<tr>
<td>5</td>
<td>10.74</td>
<td>9.52</td>
<td>5.30</td>
</tr>
<tr>
<td>6</td>
<td>9.40</td>
<td>9.52</td>
<td>12.58</td>
</tr>
<tr>
<td>7</td>
<td>8.72</td>
<td>11.11</td>
<td>9.94</td>
</tr>
<tr>
<td>8</td>
<td>10.74</td>
<td>13.49</td>
<td>12.59</td>
</tr>
<tr>
<td>9</td>
<td>18.79</td>
<td>15.07</td>
<td>12.58</td>
</tr>
<tr>
<td>10</td>
<td>12.75</td>
<td>21.43</td>
<td>17.88</td>
</tr>
</tbody>
</table>
In terms of potential disadvantages, on average, the students perceived concerns regarding the accuracy and completeness of reported information and concerns about the disclosure of proprietary information as the most important disadvantages associated with sustainability reporting. As with the advantages, the researcher calculated frequencies of each rank assigned to each perceived potential disadvantage of sustainability and integrated reporting. Based on these frequencies, percentages were calculated. Table 4 presents the percentage of study participants who assigned each rank to each specific potential disadvantage.

The potential disadvantages of sustainability reporting ranked most frequently as the most important disadvantage were short-term reporting costs and concerns about the accuracy and completeness of the information. Based on cumulative frequencies, the potential disadvantage of sustainability reporting most frequently ranked as first or second most important were concerns about the accuracy of information and short-term reporting costs, closely followed by competition and the disclosure of propriety information.

**Table 3**

<table>
<thead>
<tr>
<th>Disadvantages</th>
<th>Mean Ratings</th>
<th>Standard Deviations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concerns about accuracy and completeness of information</td>
<td>2.83</td>
<td>1.37</td>
</tr>
<tr>
<td>Concerns about competition and disclosure of proprietary information</td>
<td>2.92</td>
<td>1.40</td>
</tr>
<tr>
<td>Short-term reporting costs</td>
<td>2.99</td>
<td>1.49</td>
</tr>
<tr>
<td>Long-term reporting costs</td>
<td>3.07</td>
<td>1.44</td>
</tr>
<tr>
<td>Availability of data</td>
<td>3.18</td>
<td>1.38</td>
</tr>
</tbody>
</table>

**Table 4**

<table>
<thead>
<tr>
<th>Rank</th>
<th>Short-term Reporting Costs N=150</th>
<th>Long-term Reporting Costs N=150</th>
<th>Data Availability N = 150</th>
<th>Accuracy and Completeness of Information N=150</th>
<th>Competition and Proprietary Information N=149</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>23.34</td>
<td>18.67</td>
<td>$14.67</td>
<td>22.01</td>
<td>21.33</td>
</tr>
<tr>
<td>2</td>
<td>19.33</td>
<td>19.33</td>
<td>$19.33</td>
<td>23.33</td>
<td>20.67</td>
</tr>
<tr>
<td>3</td>
<td>13.33</td>
<td>22.67</td>
<td>$24.00</td>
<td>20.00</td>
<td>20.00</td>
</tr>
<tr>
<td>4</td>
<td>22.67</td>
<td>15.33</td>
<td>$17.33</td>
<td>19.33</td>
<td>20.67</td>
</tr>
<tr>
<td>5</td>
<td>21.33</td>
<td>24.00</td>
<td>$24.67</td>
<td>15.33</td>
<td>17.33</td>
</tr>
</tbody>
</table>

**Significant Correlations**

The researcher tested for significant correlations utilizing a significance level of 0.05. Based on this analysis, several statistically significant associations were identified. Specifically, the perceived advantage of "enhancing the company’s reputation" was positively associated with the perceived advantages of “enhancing employee loyalty and recruitment” and also with “enhancing customer loyalty.” In addition, the perceived advantage of “enhanced customer loyalty” was highly correlated with “employee loyalty.” Furthermore, the perceived advantage of “access to financing capital” was highly (positively) associated with “enhanced opportunities
for grants”, as were “refinement of corporate mission and strategies” and “regulatory compliance.

Study participants’ perceptions were not statistically significantly associated with gender, academic standing, career aspiration, or any of the other demographics-related responses.

SUMMARY AND IMPLICATIONS

Reporting of sustainability-related information is becoming common practice and is motivated by stakeholder demand for information. Integrated reporting, which combines sustainability and financial reporting is also beginning to emerge globally. Accounting professionals’ continually expanding involvement supports and complements this trend. Their understanding of regulatory requirements and reporting standards and their support of formal reporting are critical to helping companies plan, implement, monitor, and report sustainability-related information. Accounting majors represent the future accounting professionals, who during their careers likely will become involved with issues surrounding sustainability and integrated reporting. Thus, their perceptions are important.

This study found that overall, accounting majors perceived that integrated reporting would be beneficial and that reporting should be mandated for public companies. The study participants perceived that the most important benefits arising from sustainability/integrated reporting were enhanced reputation, increased profit, and enhanced customer loyalty. Study participants perceived availability of grants, regulatory compliance, and support and refinement of corporate mission as the least important advantages of sustainability reporting. The study participants perceived as the most important potential disadvantages of sustainability reporting concerns about the accuracy and completeness of the reported information, short-term reporting costs, and competition and disclosure of proprietary information.

The findings from this study agree in part with those of the E&Y and Boston College of corporate citizenship survey, which also found that executives perceived the effect on companies’ reputation as the most frequently mentioned benefit of sustainability reporting. The second most frequently mentioned advantage in their survey was increased employee loyalty, while in this study the second most important advantage of reporting was customer loyalty. As accounting majors enter the profession, they likely will become involved with some aspects of their employers’ sustainability-related activities. Their perceptions of the advantages and disadvantages of reporting may influence their employers’ sustainability reporting practices. Thus, findings from this study provide important insights useful to multiple stakeholders.

REFERENCES


AN INVESTIGATION OF MANAGEMENT ACCOUNTANTS’ EXPERIENCE WITH ETHICAL DILEMMAS INVOLVING FINANCIAL REPORTING AND EMPLOYEE SUPERVISION

Timothy L. McCoy, Lamar University

ABSTRACT

The decision making role of management accountants continues to expand as does the likelihood that many of these decisions will involve ethical dimensions. This paper reports upon an investigation of ethical dilemmas encountered by management accountants. The investigation was limited to the areas of financial reporting and employee supervision because of their importance to practicing management accountants. Merz and Grobner (1982) and Mihalek, Rich, and Smith (1987) document the importance of financial reporting ethical dilemmas to management accountants. Toffler (1986) and Fraedrich and Ferrell (1992) document the importance to managers of ethical dilemmas involving employee supervision. This study included personal interviews with 30 subjects from 15 business firms. Each firm’s participants included the chief financial officer and an entry level management accountant. Eleven of the subjects reported they had experienced an ethical dilemma involving financial reporting, and an additional six subjects reported witnessing such a dilemma. Thus, 57 percent (17 of 30) of the subjects were involved in some manner with an ethical dilemma involving financial reporting. In addition, 19 of the subjects reported encountering an ethical dilemma involving employee supervision. The findings of this study highlight the importance of the efforts put forth by employers and professional accounting organizations, such as the IMA and AICPA to encourage ethical behavior on the part of employees and members.

INTRODUCTION

As the decision making role of management accountants continues to expand, so does the likelihood that many of these decisions will involve ethical dimensions. This paper reports upon an investigation of ethical dilemmas encountered by management accountants. The investigation was limited to the areas of financial reporting and employee supervision because of their importance to practicing management accountants.

The National Association of Accountants (now known as the Institute of Management Accountants) commissioned a study in 1979 to determine what posture, if any, the organization should take regarding ethics for management accountants. Data were collected from management accountants using interviews and mail questionnaires. Phase one of the study was designed to determine the types of ethical dilemmas encountered by management accountants in their work and the frequency with which these dilemmas occur. The IMA needed this information in deciding what action it should take, if any, concerning a code of ethics for management accountants. Among the most common ethical dilemmas faced by management accountants were ones involving pressure from management to manipulate profit and income taxes (Mertz and Grobner, 1982). This study provided groundwork for the organization’s first code of conduct
“Standards of Ethical Conduct for Management Accountants” (NAA, 1983). Their ethical code is now called the “Statement of Ethical Professional Practice” (IMA, 2010).

In a study involving 2,000 members of the IMA, Mihailek, Rich, and Smith (1987) found that 52 percent of the respondents in lower level positions (accountants, analysts, etc.), 47 percent in middle level positions (divisional controllers, managers, directors, etc.), and 32 percent in upper level positions (chief financial officers, controllers, corporate vice presidents, etc.) had been pressured by management to alter financial results. Over 50 percent of the respondents with publicly-held organizations felt pressure to alter net income and return on investment figures, compared with only one third of those with privately-held organizations. Respondents reported differing levels of pressure to alter financial results based on whether they worked on a divisional or corporate level. Only 39 percent of the management accountants in corporate positions reported pressure to materially alter financial results, while 50 percent of those in divisional positions reported such pressure. The study revealed that respondents with professional certifications were less likely to yield to pressure to alter financial statements. Respondents indicated that in resolving an ethical dilemma they would first seek help from their chief financial officer; second, they would seek help from a friend. In contrast, the IMA Code of Ethics suggests that in resolving and ethical dilemma members should follow the chain of command in their organization (Mihailek, Rich, and Smith, 1987).

Merz and Grobner (1982) and Mihailek, Rich, and Smith (1987) revealed that financial reporting ethical dilemmas are quite common. In addition concurrent congressional investigation supported their findings in the “Treadway Commission on Fraudulent Financial Reporting”. The Treadway commission report revealed that management accountants had indeed participated in the preparation of their company’s fraudulent financial reports (Schultis and Williams, 1985).

Supervision is another area in which management accountants are often faced with ethical dilemmas. Toffler (1986) studied ethical dilemmas of 33 managers, ranging in position from first-line supervisors to chief executive officers. The study revealed that over 66 percent of the ethical situations described by the managers involved managing human resource processes and personnel. Further complicating the supervision issue for managers are the revelations of research that shows significant differences exist between individual employees regarding their values and philosophies which leads to differences in how they approach ethical issues (Fraedrich and Ferrell, 1992). Because people are culturally diverse and often carry different values, employees often interpret situations differently and make diverse choices based on the same ethical situation.

According to Fraedrich and Ferrell (1992), approximately 10 percent of employees take advantage of situations to further their own advantage. These individuals are more likely to manipulate, cheat, or act in a self-serving manner when the benefits they would receive are greater than the penalties for their misconduct. Another 40 percent go along with the workgroup on most issues. These people may have their own opinions, but are primarily concerned about social implications of their actions and “fitting in” therefore; they are easily influenced by what the people around them are doing. About 40 percent of employees always try to follow company policies and rules. While they have a strong penchant for acting acceptably within the organization, they are not likely to speak out against those who go along with the group that might be in violation of policies. The remaining 10 percent attempt to maintain formal ethical standards that focus on rights and duties. This group tends to believe their values are correct and superior to other value systems and when an ethical conflict arises, they are more likely to report
the ethical misconduct of other employees or speak out when they view the activities of the company as unethical.

DATA

Subjects for the study were selected from business firms in Arkansas, Louisiana, Mississippi, and Tennessee. A total of fifteen firms were selected, with two individuals from each firm participating in the study. An effort was made to select the chief financial officer and an entry level management accountant from each firm. Since input was sought from higher level executives (CFOs), only large firms were included in the sample. The CFOs in this study managed accounting departments ranging from four to sixteen employees with an average accounting department of seven. Personal interviews were conducted in 2014 and used to gather the data. The study was limited to thirty subjects so that detailed information could be obtained concerning the ethical dilemmas described by the subjects. Knowledge of detailed information should lead to a greater understanding of the ethical dilemmas faced by management accountants. Such an understanding may assist managers in identifying and resolving future ethical dilemmas that they confront.

RESULTS

Subjects were asked questions regarding whether they had experienced or witnessed an ethical dilemma involving financial reporting or employee supervision. Analyses of their responses are provided in the following two sections.

Ethical Dilemmas Involving Financial Reporting

Subjects were asked if they had experienced or witnessed an ethical dilemma involving financial reporting. Table 1 shows that 11 of the subjects reported they had experienced an ethical dilemma involving financial reporting, and an additional six subjects reported witnessing such a dilemma. Thus, 57 percent (17 of 30) of the subjects were involved in some manner with an ethical dilemma involving financial reporting. Eight (47 percent) of the dilemmas involved the manipulation of reported profits, three (18 percent) involved the understatement of federal income tax liability, two (12 percent) involved the falsification of production figures, two (12 percent) involved the misappropriation of company funds for personal use, one (6 percent) involved treating capital expenditures as expense items, and one (6 percent) involved the preparation of a false invoice.

<table>
<thead>
<tr>
<th>Dilemmas Experienced:</th>
<th>Number Reported</th>
<th>% of Total Reported</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant manager asked me to expense capital expenditure items.</td>
<td>1</td>
<td>6%</td>
</tr>
<tr>
<td>Controller was including sales invoices twice and I reported this to corporate.</td>
<td>1</td>
<td>6%</td>
</tr>
<tr>
<td>Controller asked me to lie to the auditors concerning the balance in an account.</td>
<td>1</td>
<td>6%</td>
</tr>
</tbody>
</table>
My boss, the plant controller, asked me to falsify plant production figures.  
I was asked to falsify figures for the company tax return.  
Sales manager asked me to provide a customer with a false invoice so the customer could secure advances on a loan.  
I was asked to defer certain expense items until the next accounting period.  

<table>
<thead>
<tr>
<th><strong>Dilemmas Witnessed:</strong></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Falsifying inventories to manipulate reported profits.</td>
<td>2</td>
<td>12%</td>
</tr>
<tr>
<td>Deferral of expense items.</td>
<td>1</td>
<td>6%</td>
</tr>
<tr>
<td>Inflating sales figures to manipulate reported profits.</td>
<td>1</td>
<td>6%</td>
</tr>
<tr>
<td>Overstating travel expenses.</td>
<td>1</td>
<td>6%</td>
</tr>
<tr>
<td>Payment of personal expenses with company funds.</td>
<td>1</td>
<td>6%</td>
</tr>
</tbody>
</table>

Of the 11 subjects who had experienced financial reporting ethical dilemmas, only one subject reported that he/she committed the unethical act. This subject explained:

There was a questionable entry involving a reserve account. I was told more or less to lie to the auditors concerning this entry. I always thought I would not do something like that, but when I got backed against the wall I did it. I felt sick about it, and I swore I would never do it again. Since this happened, I choose my words very carefully, and if I don’t agree with something I will tell the people involved how I feel. It really made me feel guilty. I am not going to get caught up in a situation like that again.

Another subject reported that he/she resigned because management was falsifying information for the federal income tax return. The subject stated:

I worked as an accountant for a privately-held company several years ago. One day the plant manager came to me and indicated that he was going to understate ending inventory in order to reduce federal income taxes. That same day the credit manager told me that he was told to hold back on billing certain sales invoices in order to reduce sales revenue. I discussed this situation with the internal auditor, and he suggested that we had to do it in order to reduce the income tax liability. I resigned on the spot.

One subject who had never experienced a financial reporting ethical dilemma felt that certain pressures might cause someone to do something unethical. This subject stated:

It is much easier to talk rationally about an ethical dilemma when you are not actually faced with it. Put yourself in that position, and it becomes very stressful. Depending on your financial situation, which could involve family hardships such as a sick child, maybe cancer, your whole outlook and list of priorities could change. There are so many factors that can enter into the type of decision you are going to make. Depending on those factors, people are all human, and we do make mistakes. If it is a matter of survival, it might be a different ballgame.

These examples provide anecdotal evidence that management accountants are often faced with an ethical dilemma involving financial reporting. Since a majority of the dilemmas involve the manipulation of reported profits, perhaps some companies need to reevaluate their pursuit of “profits at all costs.” Considering all but one of the subjects in this study reported that they had refused to commit the unethical act, hopefully this suggests that other management accountants will exhibit ethical behavior when confronted with similar situations.
Employee Supervision Ethical Dilemmas

Researchers have found that little empirical research has been conducted to determine the types of ethical dilemmas that managers and employees confront in the work place (Toffler, 1986). To investigate this matter, subjects in this study were asked if they had experienced an ethical dilemma involving the supervision of employees. If they had experienced an employee supervision dilemma, they were asked to explain the facts of the situation. The results are provided in Table 2.

<table>
<thead>
<tr>
<th>Dilemmas Experienced:</th>
<th>Number Reported</th>
<th>% of Total Reported</th>
</tr>
</thead>
<tbody>
<tr>
<td>Termination of an employee.</td>
<td>5</td>
<td>26%</td>
</tr>
<tr>
<td>Eliminating jobs (i.e., Mergers, Cost cutting, Cut backs).</td>
<td>4</td>
<td>21%</td>
</tr>
<tr>
<td>Advising an employee who has found a position with another company.</td>
<td>1</td>
<td>5%</td>
</tr>
<tr>
<td>Trying to find a position where someone can function, rather than terminating him/her.</td>
<td>2</td>
<td>11%</td>
</tr>
<tr>
<td>Employee theft.</td>
<td>3</td>
<td>16%</td>
</tr>
<tr>
<td>Romantic involvement between employees.</td>
<td>3</td>
<td>16%</td>
</tr>
<tr>
<td>Interdepartmental transfers.</td>
<td>1</td>
<td>12%</td>
</tr>
</tbody>
</table>

Five subjects indicated that they had experienced an ethical dilemma involving the termination of an employee. One subject stated:

One of my worst situations was an employee I had to fire. He was a professional employee. He was always very punctual, and he completed his work assignments in a very professional manner. His problem was that he kept all the clerks upset all the time. He talked to them in a disrespectful manner. His general way of approaching them about things, and the way he would ask for information was often very rude. I warned him concerning his behavior, but I eventually had to fire him. It was a dilemma for me because this was his only source of income, and he was single. I finally had to resign myself to the fact that I didn’t do this to him. I had given him every opportunity to improve the situation, and he did it to himself. I didn’t cause this to happen. After I thought this situation over for a long time I finally said to myself that I was not being fair to other employees. I had 15 other employees in this department and this person was making life miserable for these people.

Another subject stated:

I had an employee that I liked very much and he was doing a very good job. I had to lay him off after he had been working about a year. The production superintendent disguised this as a cost-cutting measure dictated by the parent company, but I later found out that he had a friend’s son he wanted me to hire for that position (junior plant accountant). I eventually quit the company. I apologized again to my friend, and told him the real reason he was laid off. He did file a lawsuit against the company, but I don’t know how it turned out.

Mergers, buyouts, centralization of departments, advances in technology, and cost-cutting measures are just a few of the situations that in recent years have resulted in numerous employees losing their jobs. One subject stated:
Our bank was bought out by another large bank. We knew for months that we were going to eliminate certain jobs. The parent company wouldn’t let us tell the people in advance. We wanted to shift some people to other departments in the bank. They wouldn’t let us do that either. Their philosophy was, ‘If we do this for one person we have to do it for all the people involved.’ We were hiring outside people to fill bank job openings when we had competent people who were going to be terminated in three months. Finally, one person was allowed to transfer, because she had 30 years’ experience with the bank. This was very difficult for me. Many of these people were my friends. The employees were given two-week notice and one-month severance pay, but there was still a lot of turmoil.

One of the subjects indicated that he/she was placed in an ethical dilemma when an employee asked his advice concerning an employment opportunity he had with another company. This subject stated:

I had an excellent employee who came to me asking if he should take a position offered to him by another company. My problem was that I knew once I lost this employee, due to hiring freeze, I would not be allowed to replace him. I told him that I couldn’t promise him anything here, and I was not going to tell him that he was making the wrong decision. I told him that this looked like a much greater opportunity for him, and I was not going to stand in his way. In fact, under the circumstances, I almost encouraged him to go ahead and accept the other job. It did hurt me and my department, but this was obviously a big promotion for this person, and I would have been lying to him had I told him otherwise.

Perhaps one of the most difficult situations a supervisor can be placed in involves trying to find a position where an employee can function adequately. This situation is compounded when the employee has family problems that could make termination an inhumane alternative. These employees might have mentally or physically disabled dependents and they provide the only source of income for the family. One subject explained his/her ethical dilemma involving just such an employee. This subject explained:

We hired a man several years ago thinking he was qualified to become a department manager. It quickly became apparent he was not. In the process we found out that he had a mentally retarded daughter, and that he was under tremendous pressure because of that. So, for eight years we have worked with this man trying to find the right position for him. We just moved him again within the past couple of weeks. We have gradually found places for him where he can fit, and we continue to assure him that he is going to have an income so he can deal with his family problems. To me this is doing things in the way you would like to be treated. Perhaps this is ethics, applying the golden rule, or whatever. I couldn’t, in good conscience, terminate this employee.

Dealing with employee theft is a common problem faced by today’s managers. Ethical dilemmas can occur as a result of dealing with the ramifications of employee theft. Three of the subjects reported that they had experienced ethical dilemmas involving employee theft. One subject felt that it is unethical if you do not prosecute an employee who is caught stealing. This subject explained:

We had a person over the payroll department who was preparing bogus payroll checks and then cashing these checks. Her husband also worked at the plant and was the union steward. When she was eventually caught, management at the plant decided not to prosecute her. In fact, all she got was a reprimand, and she didn’t have to pay the money back. The parent company made this decision because of the union. To me that decision was absolutely unethical.
Another subject describes the dilemma he/she faced when considering how the reporting of employee theft would affect other innocent members of the employee’s family. This subject stated:

In addition to my controllership responsibilities, I am treasurer of the credit union. I discovered that one of the credit union employees was embezzling. Her family was a nice, normal, middle-class, church-going family. She gave me a real sad story about why she had borrowed the money. I fired the employee; that was no problem. The problem was that her husband was a policeman. The real quandary I had was what to do as far as reporting it. I knew that once I reported it, her husband’s career as a police officer would be affected. She had teen-aged children, and I knew this could really adversely affect them. This was a real dilemma for me, but I am legally responsible for the financial reporting of this organization. I felt I had to do what was right. I wasn’t going to go out and rent a newspaper ad and publicize it, but I had to do what was right. I contacted the credit union league and found out what my options were. I found that I had no choice. I had to report this to the FBI and the local authorities, since the amount stolen was over $1,000. I reported it; I had no choice.

Romantic affairs between employees in the same work area can create significant employee morale problems. The problem can be even more complicated when one or both parties to the affair are married. Three of the subjects reported experiencing ethical dilemmas involving romantic affairs. One subject reported that the controller, the subject’s boss, was involved with one of the subject’s employees. This subject stated:

I was previously employed where the controller was having an affair with one of the people I was supervising. He was married and she was single. The controller even brought her to an office party one night. It was very open; therefore all the employees knew. She really took advantage of the situation. She would leave early, call in sick, and sometimes just do nothing. The other employees resented this, and it certainly brought down their morale. If I tried to discipline her, the controller would defend her. I talked to the assistant controller, and he wouldn’t back me. He had just gotten married and was afraid he would lose his job if he got involved. It was very stressful for me. I didn’t want to go behind my boss’s back, but I felt like I had no other choice. I finally went to the personnel director and discussed the problem with him. I don’t think this went over very well with either the personnel director or the controller. Eventually, by the way, I was laid off.

One subject reported that he/she had experienced and ethical dilemma involving interdepartmental transfers of employees. This subject stated:

Our bank doesn’t really have a policy involving interdepartmental transfers. When I have an opening in my department, employees from other departments will often come to me inquiring about the position. I will tell these employees that they should tell their current supervisor they are looking into a transfer. Recently, when this happened the other supervisor didn’t respond very well to the employee’s request. He lambasted the employee for wanting to leave and accused me of trying to steal his employees. This created a real dilemma for me in trying to determine what to do. I haven’t done anything about this situation yet, but it continues to bother me a great deal. Obviously, there was some reason this employee wanted to move. Apparently, he wasn’t satisfied with the job he had. My experience has been that you are better off in the long run to let them transfer because they are going to leave, even if they have to leave the company.

CONCLUSION

This study provides anecdotal evidence that suggests that ethical dilemmas are a serious problem faced by management accountants. Indeed 11 of the 30 subjects surveyed had encountered an ethical dilemma involving financial reporting, and six subjects had witnessed
other management accountants involved in a financial reporting ethical dilemma. In addition, 19 of the subjects have encountered an ethical dilemma involving employee supervision. The findings of this study highlight the importance of the efforts put forth by employers and professional accounting organizations, such as the IMA and AICPA to encourage ethical behavior on the part of employees and members.

REFERENCES


Institute of Management Accountants (2010) *Statement of Ethical Professional Practice*, Montvale, NJ.


