

A Discussion of American Ethics

Thinking Differently about the Cultural and Psychological Bases of Fraud

By Toby Groves and
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Despite the profession's continuous efforts to maintain high ethical standards and implement codes of conduct, highly publicized cases of corporate misconduct still occur with disturbing regularity. These ethical violations continue to multiply, even as firms and business schools increase their focus on ethics. Is the way Americans think about ethics—and even ethical codes themselves—the real problem?

Personal and professional experiences have allowed this article's authors to explore this question in detail. They have met and spoken to people associated with shocking financial scandals, which gave them a perspective that they never imagined holding. In today's ethical training and education environment, it is often assumed that individuals know when they are confronted with an unethical situation. It is further assumed that with proper ethical training, individuals will make the correct ethical decisions. The authors' conversations with individuals involved in scandals, however, have made them realize that many steps the profession takes to protect against such scandals might actually have an opposite effect.

A Tale of Two Dinners

On June 29, 2009, a close friend of one of the authors was dining at a trendy New York restaurant with an auditing and corporate fraud expert. The two had just left an accounting conference not far from the courthouse where, earlier that day, Bernard Madoff had been sentenced to 150 years in prison for running the largest Ponzi scheme in history.

Among other topics, the men discussed legislation and sophisticated technology



that had emerged in recent years as a means of battling corporate malfeasance. The wave of corruption earlier in the decade—Enron, WorldCom, Adelphia, and others—resulted in major bankruptcies and court cases, and spurred the Sarbanes-Oxley Act (SOX) of 2002. With a harsh spotlight on ethics, companies were essentially required to institute formal ethical codes and install ethics officers. The author's friend and his dinner partner concluded that although much effort was being exerted, tangible progress and real answers remained far out of reach.

Six hundred miles away, Toby Groves was having a similar discussion, and he was getting his first true insight into why

ethical codes are not working. His dinner was with Dick Scruggs, a billionaire who had formerly been America's most powerful trial lawyer. Groves considered Scruggs a hero for standing up to the powerful tobacco lobby in the 1990s (as portrayed in the 1999 film, *The Insider*). The conversation drifted toward what role, if any, ethical standards and codes played in shaping professional judgment and making the law more effective in stopping corporate wrongdoing.

This dinner was not in some trendy restaurant; it took place in the federal prison where Groves and Scruggs were both serving time. Groves had been convicted of fraud, and Scruggs had pleaded guilty to bribery charges.

Following this dinner conversation, Groves became obsessed with the idea of how fraud occurs. He contemplated several questions: Why do intelligent, successful people commit crimes? And why do otherwise well-meaning people follow almost blindly along? Ascribing the trait of greed to these individuals seemed the easy answer, but Groves wondered whether greed represented the main motivation behind most frauds or whether the fraud was the result of competitive pressure, or even a byproduct of success.

Groves' motivation to research this topic was extremely personal. As a teenager during the 1980s, his family was shaken to its core after his oldest brother committed financial crimes. Determined to take an opposite path, Groves became a CPA and fraud fighter who built a successful national company and reputation as an ethical businessman. But 20 years and nearly \$2 billion of business later, his training and principled upbringing failed him. Groves found himself confronted with a situation not covered by any ethical code. On one hand, he could try to protect his reputation; on the other hand, he could do what was truly right. But he made the wrong decision, which eventually landed him to prison. What started rather innocuously evolved into a multimillion-dollar fraud that enveloped multiple companies and affected hundreds of individuals.

Profile of the Fraudster

Twenty years after his brother's acts rocked his family, Groves was convicted of the same crime at the same age—and even by the same judge in the same courthouse. The disturbing coincidences of the two brothers' situation led Groves to wonder if genetics had played a role; however, a thorough search found no other criminal convictions of any type in his family history. A review of numerous studies about crime and genetics found that almost all were related to antisocial or violent crimes, not the type of white-collar crimes that the authors had interest in (Glenn D. Walters, "A Meta-Analysis of the Gene-Crime Relationship," *Criminology*, vol. 30, no. 4, 1992, p. 595).

Related criminological research, dating back to the 1970s, has had contradictory results—for example, the research conducted by Gregory Carey on twin studies ("Twin Imitation for Antisocial Behavior:

Implications for Genetic and Family Environment Research," *Journal of Abnormal Psychology*, vol. 101, no. 1, 1992, p. 18). More recent studies have attempted to isolate a "criminal" gene, but they have failed to find a reliable predictor of criminality (Katherine I. Morley and Wayne D. Hall, "Is There a Genetic Susceptibility to Engage in Criminal Acts?," *Trends and Issues in Crime and Criminal Justice*, no. 263, 2003, pp. 1–6).

In prison, Groves conducted research as scientifically as he could under the circumstances. After his release, he continued his research by speaking to hundreds of auditors, fraud examiners, federal agents, and probation officers. In addition, he interviewed 40 white-collar criminals about their criminal history and family background, among other topics. He found that 95% were in prison on their first offense, and most had never run afoul of the law before. These individuals averaged 16 years in their respective lines of business, held management or higher positions, and had an average age of 46.

Although it appeared that genetics and family history did not influence these fraudsters, Groves wondered whether psychology had something to do with it. When it came to personality disorders, only one of the 40 white-collar criminals interviewed had what appeared to be clinically diagnosable narcissistic personality disorder, characterized by the arrogance, callousness, and self-centeredness that the public often associates with these crimes. The anecdotal evidence was similar to that of federal probation officers who work with criminals after release. This evidence contradicts the belief of more than half of the forensic accountants and auditors spoken to who agreed with the statement, "Most white-collar criminals are psychopaths." Experienced probation officers reported that the public and even many experts grossly overestimate these dispositional traits, which apply to less than 5% of white-collar criminals.

The Seeds of Scandal

Many scandals start with small, sometimes imperceptible, steps. More than 90% of those interviewed reported that their crimes happened in such small increments that they were fully involved before consciously realizing that they were taking

part in a criminal act. In "Out of Control: Visceral Influences on Behavior," George Lowenstein discussed the theoretical challenges confronting decision theory. People often act out against their self-interests and know they are doing so, which results in a feeling of being "out of control" (*Organizational Behavior and Human Decision Processes*, vol. 65, no. 3, Mar. 1996, pp. 272–292). He refers to this phenomenon as the impact of "visceral factors."

These visceral factors have a hedonic impact on individuals that is normally negative, and they also affect the relative desirability of different actions. For example, the aversive experience of hunger will affect one's desire to eat, but it will also affect other actions. Lowenstein stated that visceral factors therefore have a disproportionate effect on behavior, which tends to crowd out all goals except those that mitigate the visceral factor. These visceral factors have an impact on decision making, and they relate to one's motivation and actions. Lowenstein contends that visceral responses dominate at the time an individual makes a decision.

Of the criminals interviewed, 85% agreed with the statement, "I did not consciously weigh the risk of prison when committing my crimes," and an additional 10% said they were unsure; overall, 90% reported that they believed themselves to be basically ethical people. When interviewing these individuals, it became clear that they had difficulty discussing their crime in the context of "right and wrong" outside of a legal framework.

In discussing their crimes, the fraudsters focused on the situation that caused their actions and what the law said about their behavior. They found it difficult to focus on the broader context of how their actions affected others or the alternatives they could have chosen. The only exception to this trend was one middle-aged Asian-American man—a seemingly inconsequential factor at the time, but one that would later have greater implications.

Cultural Influences

During the 1970s, social psychologist Lee Ross coined the term "fundamental attribution error" to explain the self-serving bias that causes humans to see their own actions as a reaction to their environment but other people's actions as a reflex-

tion of their character (Lee D. Ross, Teresa M. Amabile, and Julia L. Steinmetz, "Social Roles, Social Control, and Biases in Social-Perception Processes," *Journal of Personality and Social Psychology*, vol. 35, no. 7, 1977, pp. 485–494).

Americans have a particularly damaging strain of this bias; Ross's experiments found that Americans focus so much on personality characteristics and individual responsibility that they dismiss the critical importance of context and situations when determining causes of behavior ("The Intuitive Psychologist and His Shortcomings: Distortions in the Attribution Process," *Advances in Experimental Social Psychology*, vol. 10, New York: Academic Press, 1977). The analysis of corporate crime is an excellent example of this concept, with almost all discussions centering on the criminal, rather than the situation and events preceding the crime.

In a classic psychology study on cheating, researchers at Columbia University examined the behavior of 11,000 schoolchildren between ages 8 and 16 over a five-year period (Hugh Hartshorne and Mark A. May, "Character Education Inquiry," *Studies in the Nature of Character: Vol 1: Studies in Deceit*, Macmillan, 1928, pp. 381–400). The children would cheat for different reasons at different times, with no reliable way to tell when cheating would occur. The researchers concluded that "even slight changes in the situation affect individual behavior in unpredictable ways."

This study found what many other studies in social psychology and criminology have found: the correlation between what anyone will do under two different situations is "lower than would be required for an accurate prediction of individual behavior." Nevertheless, Americans think they can predict who will commit crimes based on dispositional aspects or generalized situations.

Americans normally have difficulty recognizing context; in the authors' research, the only exception among the 40 white-collar criminals was the one Asian-American man, who understood the broader context of his actions. What surfaced in this research is supported by brain-imaging studies involving both Asian and American participants who were presented with pictures that had different backgrounds (Lucas L. Jenkins, Yung-Jui Yang,

Joshua Goh, Ying-Yi Hong, and Denise C. Park, "Cultural Differences in the Lateral Occipital Complex while Viewing Incongruent Scenes," *Social Cognitive and Affective Neuroscience*, vol. 5, nos. 2–3, pp. 236–241).

In this study, Asians saw the contextual differences in the pictures, whereas Americans seemed oblivious to them. When scenes changed and incongruent images were shown, Americans worked even harder to focus on the subject and ignore the background. Could this explain why the sole Asian-American subject in the authors' study could see the context of the moral aspects of his crime without reference to the law? Was his Asian identity enough to explain why his brain processed his crime differently from the other fraudsters?

Brain-imaging technology also shows that when Americans think about whether they are honest, their brain activity is different than when they think about whether someone else is honest (Ying Zhu, Li Zhang, Jin Fan, Shihui Han, "Neural Basis of Cultural Influence on Self-Representation," *NeuroImage*, vol. 34, no. 3, 2007, pp. 1310–1316). This is not the case, however, for a Chinese person, according to the study; when Chinese individuals think about whether they are honest, the brain activity is nearly the same as when they think about whether someone else is honest. These results imply that Chinese people focus on context and situations rather than on disposition, and do not experience the same fundamental attribution error as Americans. Genetic studies have even noted that genetic mutations coevolving with respect to American and East Asian cultures are related to these national belief structures (Joan Y. Chiao and Katherine D. Blizinsky, "Culture–Gene Coevolution of Individualism–Collectivism and the Serotonin Transporter Gene," *Proceedings B: Biological Sciences*, Royal Society Publishing, vol. 277, no. 1681, 2010, pp. 529–537).

Small Crimes Escalate into Larger Ones

If most fraud crimes start small and without evil intent, how do they escalate to such surprising heights? Perhaps the strangest and most difficult to understand aspect encountered during the authors' research was that all of the criminals inter-

viewed described a feeling of being "trapped" in their crime. They all reported an overwhelming sense that they could somehow make the problem better, and that they would take whatever actions necessary to "get through another day."

One of the interviewees, convicted due to his association with a \$350 million international Ponzi scheme, captured the thoughts of many of the convicted criminals when he commented, "You wake up every day and you have three choices, and you don't like any of them." Comments by Bernie Madoff saying that

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he wished he had been caught earlier and expressing amazement that he wasn't have an eerie echo in these findings.

When individuals invest time, effort, or money into something, a strange phenomenon called "entrapment in escalation" occurs (David Crump, "The Social Psychology of Evil: Can the Law Prevent Groups From Making Good People Go Bad?," *Brigham Young University Law Review*, vol. 5, 2008, pp. 1441–1464). The more time or energy that people invest in something, the more they are motivated to justify their behaviors and compelled to invest even more in order to see it through (Joel Brockner et al., "Escalation of Commitment to an Ineffective Course of Action: The Effect of Feedback Having Negative Implications for Self-

Identity,” *Administrative Science Quarterly*, vol. 31, no. 1, 1992, p. 109).

Studies show that, contrary to rational thought, when individuals have invested even a little effort into something, they feel committed to the outcome and will follow that to ridiculous lengths (Martin Shubik, “The Dollar Auction Game: A Paradox in Noncooperative Behavior and Escalation,” *Journal of Conflict Resolution*, vol. 15, no. 1, 1971, pp. 109–111). They will follow through even if a loss is imminent, as though they can’t stop themselves (Hal R. Arkes and Peter Ayton, “The Sunk Cost and the Concorde Effects: Are Humans Less Rational Than Lower Animals?,” *Psychological Bulletin*, no. 591; Allan I. Teger, *Too Much Invested to Quit*, Pergamon Press, 1980).

Follow the Leader

In the authors’ study, 70% of the convicted felons reported that their crimes required the cooperation of others—sometimes even auditors or enforcement officials. Most fraudsters reported that recruiting these individuals was effortless, even when it seemed obvious that the actions would be unethical. Why does this happen? Studies show that Americans respond to dominance (Jonathan B. Freeman, Nicholas O. Rule, Reginald B. Adams, and Nalini Ambady, “Culture Shapes a Mesolimbic Response to Signals of Dominance and Subordination that Associates with Behavior,” *NeuroImage*, vol. 47, no. 1, 2009, pp. 353–359). They are hardwired to follow their leaders, and to follow a group and its rules (Nicholas O. Rule, Jonathan B. Freeman, and Nalini Ambady, *Brain, Behavior, and Culture: Insights from Cognition, Perception, and Emotion*, ch. 7, pp. 109–122).

Research comparing values in different countries about priorities of following the group or one’s personal conscience are telling. Americans frequently favor following the rules of their group over their own conscience. Americans are significantly more likely than Europeans to say they should follow the orders of their superiors, even if they go against their conscience. In 1991, the International Social Survey Programme asked respondents from nine different nations if they agreed that “right and wrong should be a matter of personal conscience” (International Social Survey

Programme 1991: Religion). Almost 90% of Austrians agreed with the statement, but Americans nearly tied for last, with only 47% agreeing with the statement.

The organization’s 2006 survey asked, “In general, would you say that people should obey the law without exception, or are there exceptional occasions in which people should follow their consciences even if it means breaking the law?” (International Social Survey Programme 2006: Role of Government IV). Americans (at 45%) were the least likely to say that people should on occasion follow their consciences. So if Americans have been conditioned to follow their leaders and not their consciences, what does that mean when it comes to codes of ethics? Does having more rules make individuals more inclined to be ethical—or less?

Educational Approaches to Ethics

Everything the profession is doing to protect against these scandals might actually be making Americans less safe than ever. During the authors’ research, fraud professionals and college business professors overwhelmingly reported that current professional judgment and ethics training at both the college and continuing professional education levels is ineffective; this failure can be tied to the methods used in education.

Chinese children have traditionally been educated using contextual learning, whereas American children focus on standardized testing and memorization. Perhaps as a result, the Chinese tend to focus on context and process, whereas Americans focus on subject and outcome (passing a standardized test). Neuroimaging studies have shown that Chinese and American children use different parts of their brain to do math (Yiyuan Tang, Wutian Zhang, Kewei Chen, Shigang Feng, Ye Ji, Junxian Shen, Eric M. Reiman, and Yijun Liu, “Arithmetic Processing in the Brain Shaped by Cultures,” *Proceedings of the National Academy of Sciences*, vol. 103, no. 28, 2006, pp. 10,775–10,780). Chinese children have historically used an abacus as part of their instruction; thus, they visually understand mathematical relationships and concepts. American children are frequently taught math using mnemonics and memorization (e.g., memorizing multiplication tables).

Contextual learning is valuable, even for tasks that seem fit for rote memorization. By integrating context, learning takes on shape and meaning. An educator can better teach a child that $4 \times 4 = 16$ by relating the problem to the real world. One example would be asking a student who likes cars how many wheels are needed for four race cars that have four wheels each. The child not only memorizes the tables, but learns what multiplication actually does, helping her understand the thinking processes needed to solve related problems. By teaching context, learning becomes an extension of one’s natural curiosity.

Teaching to the Test

In college, many students learn business topics, including ethics, using the same standardized methods as those described above. Most ethics courses are taught based on codes of ethics and are designed so that students pass professional licensing tests, such as the CPA exam. Recent studies examining ethics education have found that the context in which an ethical dilemma is considered is critical (Damon M. Fleming, Robin N. Romanus, and Sharon M. Lightner, “The Effect of Professional Context on Accounting Students’ Moral Reasoning,” *Issues in Accounting Education*, vol. 24, no. 1, 2009, pp. 13–30). Students learning codified rules of ethics cannot as easily transfer their ethics knowledge into different contexts. When students learn about ethical dilemmas in the context of codification, they then view all problems through the lens of codified ethical principles. The problem with rules is that they narrow an individual’s scope, make individuals act in their own self interest, and undermine the ethical decision-making process. Rules encourage people to ignore context, and they make them less aware of other people and more aware of compliance with the rules.

In one experiment, for example, MBA students were asked to consider whether they would limit toxic emissions (Ann E. Tenbrunsel, and David M. Messick, “Sanctioning Systems, Decision Frames, and Cooperation,” *Administrative Science Quarterly*, vol. 44, no. 4, 1999, pp. 684–707). When they were told the agreement was voluntary, most (55%) viewed the decision as an ethical choice, whereas some (45%) viewed it as a busi-

ness or economic decision. When students were told there would be sanctions for noncompliance, however, their views changed dramatically; those viewing the choice as an ethical decision dropped below 20% and those viewing it as business (economic) decision increased to about 80%.

Accordingly, studies examining financial reporting in U.S. corporations have found that standards have become so rules-based that CFOs focus more on meeting the letter of the law instead of its spirit and underlying principles (Christopher P. Agoglia, Timothy S. Doupnik, and George T. Tsakumis, "Principles-Based Versus Rules-Based Accounting Standards: The Influence of Standard Precision and Audit Committee Strength on Financial Reporting Decisions," *Accounting Review*, vol. 86, no. 3, 2011, pp. 747-767). These studies indicate that CFOs of U.S. companies would actually be less likely to engage in aggressive financial reporting if subjected

to more less precise, more principles-based standards.

The profession's codification and standardization restricts ethical thought processes, causing individuals to focus more on complying with the rules than the underlying principles. By their nature, rules play to people's weakness because they simplify problem solving—they invoke only the minimum standards, and they do not inspire empathy or sophisticated thought patterns (Michael L. Michael, "Business Ethics: The Law of Rules," *Business Ethics Quarterly*, vol. 16, no. 4, 2006, pp. 475-504).

Thinking Differently

With overwhelming evidence that codification obstructs moral processing, professional education and judgment must move toward contextual thinking processes that will spur people's imagination and broaden their viewpoints by incorporating a wide array of conflicting perspectives. When discussing these findings with col-

leagues and imploring them to integrate them into their work with corporations, the authors were quickly reminded of their own naiveté of the power perpetuating the old belief system—consulting with companies on how to meet industry or regulatory standards in a codified format is itself a prosperous industry. As the authors were told by one friend in the industry, talk that does not support the codes and standards is considered "fighting words." These words may indeed start a fight, but when it comes to ethical processing and fraud in America, nothing will change until people learn to think differently. □

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