Ethical Principles vs. Ethical Rules:

The Moderating Effect of Moral Development on

Audit Independence Judgments

Terri L. Herron
Department of Accounting & Finance
Gallagher Business Building
The University of Montana
Missoula, MT 59812

and

David L. Gilbertson*
Accounting Department
College of Business & Economics
Western Washington University
Bellingham, WA 98225-9071

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*Corresponding Author

Terri L. Herron, PhD, CPA, CISA is an Associate Professor at The University of Montana, where she teaches auditing, systems, and financial accounting. Dr. Herron's research interests include auditor decision making, accounting ethics, and accounting education. She has published in journals such as *Auditing: A Journal of Practice & Theory*, *Research on Accounting Ethics*, and *Advances in Behavioral Research*, and she serves on the editorial board of *Journal of Accounting Education*.

David L. Gilbertson, PhD, CMA, CPA is an Assistant Professor at Western Washington University, where he teaches undergraduate and graduate courses in auditing, financial accounting, and financial statements analysis. His research interests include audit quality, auditor litigation, professional ethics, and securities regulation. Dr. Gilbertson's publications have appeared in *Auditing: A Journal of Practice and Theory*, the *Journal of Corporation Law*, and the *Journal of Accounting, Ethics, and Public Policy*.

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ABSTRACT

Recent calls have been made to move professional standards to a more principles-based perspective, supposing that emphasizing broad principles would eliminate the legalistic focus that rules may encourage, and accountants' behavior would be more ethical and uniformly so. However, this supposition has yet to be empirically tested. The AICPA Code of Professional Conduct (Code) provides guidance in both forms: principles and rules. This experiment examines how the level of discretion inherent in the form of the Code affects independence judgments in a client acceptance context. We also examine the potential for levels of moral development to influence the effectiveness of the Code. We find that judgment and intention *conservatism is lower* when rules-based (principles-based) reasoners are provided with Code principles (rules). This mismatch also resulted in lack of consensus. Given the popularity of the view that rules-based standards are undesirable, these findings have significant implications for the profession as principles-based ethical standards are discussed.

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Accountants often face ethical dilemmas while carrying out their professional responsibilities. Codes of conduct typically guide a profession's members in present and future action (Murphy, 1989), influence the decisions that individuals make so that the resulting behavior is acceptable (Ferrell & Fraedrich, 1991), and provide information to a profession's members on how ethical dilemmas may be addressed (Jakubowski, Chao, Huh, & Maheshwari, 2002). However, ethical codes may take different forms, ranging from detailed rules and emphasizing compliance with those rules, to broad positively stated principles with an emphasis on "doing the right thing." The purpose of this study is to examine how the level of *discretion* inherent in the wording of the accounting profession's ethical expectations or standards, as expressed in the form of a code of professional conduct, might affect application of those ethical standards. We also examine the potential for accountants' *levels of moral development* to influence the effectiveness of the profession's ethical standards.

BACKGROUND

The public has long held accountants in high regard relative to other professions. For instance, in a 1986 Harris poll CPAs ranked first among the professions in moral and ethical practices, receiving a 90 percent positive rating for honesty (Pearson, 1988). However, in recent years the ethical decisions of public accountants have received increasing criticism. More recently, the wave of accounting scandals following the Enron collapse has led to numerous charges of unethical conduct on the part of accountants and auditors. In particular, the independence of auditors from their clients has been questioned. But this criticism is not new. The fifteen-year-old statement by Anderson and Ellyson (1986, 92) seems just as true today:

> . . . we have seen continued scrutiny and harsh criticism of accountants' work by the public, Congress and the media. Charges of diluted independence, substandard work, growing commercialism, opinion shopping, lax attitudes toward management fraud . . .

One proposed solution to the current problem is the development of "principles-based" accounting, auditing, and ethics standards. With regard to accounting standards, the Financial Accounting Standards Board (FASB) issued its proposal for principle-based accounting standards late last year (FASB, 2002). The Sarbanes-Oxley "Corporate Responsibility" Act (P.L. 107-204) enacted by Congress in July 2002 requires the SEC to conduct a study on the adoption of principles-based accounting standards in the U.S.. With regard to auditing and ethics standards, The International Federal of Accountants (IFAC) recently completed a four-year project to re-write its Code of Ethics for auditors, moving to a principles-based approach that has already been endorsed by the European Union (Cheney, 2002; IFAC, 2003). For example, the IFAC Code of Ethics states "a conceptual framework that requires firms and members of assurance teams to identify, evaluate and address threats to independence, rather than merely comply with a set of specific rules which may be arbitrary, is therefore, in the public interest" (IFAC 2003, §8.10). In testimony before the New York State Senate Higher Education Committee, Marilyn Pendergast (chair of the IFAC Ethics Committee) highlighted the "need for clear and unequivocal accounting and auditing standards of international application and based on principles, not detailed rules" (New York State Senate, 2002, 1).

The idea of principles-based professional standards system is not new. In 1989, the American Institute of Certified Public Accountants (AICPA) restructured its Code of Professional Conduct (Code). The "new" Code was separated into rules and principles. The AICPA believed that the previous rules-based Code contained too many technicalities providing opportunities for finding loopholes, while broadly-stated principles would encourage more ethical conduct in general without the loopholes. The bottom-line expectation of the AICPA was that including principles in the Code would encourage more ethical behavior and serve to "express the basic tenets of ethical and professional conduct" (AICPA, 2002, 51.02).

> The restructured code will shift the emphasis from compliance with specific rules to an emphasis on achieving positively stated goals. Professionalism requires much more than compliance with specific rules. It requires a pattern of conduct – indeed, a pattern of thinking – that results in the performance of all professional activities with competence, objectivity, and integrity. Specific rules by themselves cannot be comprehensive and flexible enough to provide members with the incentive to achieve that level of performance. (AICPA, 1986, 22)

Despite this widely-held belief that a more principles-based Code will lead to more ethical conduct, this proposition has not yet been empirically demonstrated. Research is still needed regarding the role of ethical codes and whether accountants will follow them (Gaa, 1992). In this study, we examine the issue of how the level of *discretion* allowed in the wording of a professional standard (principles vs. rules) can influence audit independence judgments. This study also examines the potential for auditors' *levels of moral development* to influence the effectiveness of the professional standards. We find that the level of moral development does moderate the effects of discretion allowed in the Code. Additionally, we find that if one's level of moral development is "mismatched" with the form of the Code of Conduct, independence assessments are not as conservative, and a lack of consensus is evident. This study provides insights into the efficacy of different forms of professional ethics standards in influencing public accountants' behavior.

RELEVANT RESEARCH

This study asks the basic research question, "Does it matter what form the accounting profession's Code of Professional Conduct takes?" Since the Code guides the members of the profession "in the performance of their professional responsibilities and … *ethical* and professional conduct" (AICPA, 2002, §51.02, emphasis added), we examine the research question in the moral judgment context. First, we briefly review Kohlberg's theory of moral development, incorporating Rest's modifications to the theory regarding moral schemas. Second, we consider research into accountants' moral development. Third, we summarize research regarding principles versus rules-based standards and codes.

Moral Development and Moral Schemas

There are several models of ethical decision making in a business context. Most agree, to some extent, that ethical decisions are affected by the decision maker's level of moral development, awareness of relevant professional standards, and contextuality, defined as the interaction between issue characteristics and person characteristics (Wright, Cullinan, & Bline, 1997). Kohlberg (1969) believed that ethical decision making is largely a function of one's level of moral development, and he formulated a six-stage model of moral development that was further classified into three levels: pre-conventional, conventional, and post-conventional.

Rest, Narvaez, Bebeau, and Thoma (1999a) present a schema-based paradigm with three types of ethical schemas roughly corresponding to Kohlberg's stages: Personal Interest (Kohlberg's Stages 2 and 3), Maintaining Norms (Kohlberg's Stage 4) and Postconventional (Kohlberg's Stages 5 and 6). This social psychological approach posits that one makes a moral judgment (one component of ethical decision making) within the framework of the moral schema invoked by the particular situation. While Kohlberg favors a developmental approach placing a person at a single, progressive stage of moral development at one point in time, research supports the notion that one moves upwards in terms of "gradually shifting distributions of the use and preference for more developed thinking" (Rest et al., 1999a, 4). In terms of Rest's schematic approach, the more developed the moral schema, the more frequently a higher level schema will be invoked. Higher level schema are more cognitively complex, thus they are more difficult to form. These three schemas and their corresponding Kohlberg stages are summarized in Table 1.

(insert Table 1 about here)

Notice that the Maintaining Norms schema (Kohlberg's Stage 4) is driven by law, rules, and duty to society. If one reasons using this type of schema, one would follow the law or rule prescribed in the situation rather than follow one's own principles. This orientation "emphasizes the importance of doing one's duty according to one's station and role position in society" (Rest et al., 1999a, 37). The Postconventional schema (Kohlberg's stages 5 & 6) is more focused on values or principles. Duties and rights follow from "the moral purpose behind the conventions; not, as at the conventional level, from de facto norms" (Rest et al., 1999a, 41). In simplistic terms, Postconventional schema lead to judging an action as best because it is right while the Maintaining Norms schema leads to judging an action as best because it is the accepted rule or law.[1]

The Defining Issues Test (DIT) is widely used to measure one's level of moral development, with the *P* score measuring one's propensity to reason at the post-conventional stage.[2] For an extensive discussion of Kohlberg and Rest's work in ethical reasoning and the DIT, please see Robin et al. (1996) and Rest et al. (1999a).

Accountants' Moral Reasoning

Though research into accountants' moral development is still growing (Gaa, 1992), a number of academic studies have addressed this issue in the last decade.[3] This research stream was jumpstarted in the early 1990's when Ponemon (1990) reported that levels of moral development were *inversely related* to increases in rank within accounting firms. Other studies also have found that accountants' levels of moral development increase until reaching the supervisory level, at which time they decrease through the partner level (Ponemon & Gabhart, 1990; Ponemon, 1992; Shaub, 1994; Sweeney, 1995). This research suggests that there are systemic characteristics of the accounting profession which inhibit an individual's moral development, at worst, or which inhibit retention of individuals with higher levels of moral development, at best.

This apparent decline in accountants' levels of moral development as they progress through the profession spawned research into the impacts of reasoning at lower (conventional) levels. Research addressing accountants' ethical judgments consistently finds that accountants reason at conventional levels, focusing heavily on maintaining norms and following rules. Sweeney & Roberts (1997) found that auditors at lower levels of moral development were *more* likely to comply absolutely with independence standards, while auditors at higher levels of moral development were *less* likely to resolve an independence dilemma by referring solely to technical standards. Ponemon & Gabhart (1990) found that the independence judgments of auditors with low DIT *P* scores were significantly influenced by penalty factors, such as the threat of legal liability, whereas auditors with high *P* scores ranked this as the least important consideration.

In summary, auditors show an increase in moral development up to the supervisory level, at which time moral development decreases through the partner level. Further, the level of moral development relates to solving independence dilemmas. Because the lower (conventional) level of moral development focuses on rules and norms, auditors operating at this level are more likely to adhere to rules and are more sensitive to penalties resulting from deviating from rules. We now consider the implication of expressing ethical expectations with less discretion allowed (specific rules) or with more discretion allowed (overarching principles).

Codes of Ethics – Principles vs. Rules

As noted above, conventional and post-conventional reasoners focus on different things: rules are important to conventional reasoners, while principles are important to post-conventional reasoners. Research considering different manifestations of a professional code of ethics is dearth, thus we first turn to research into how different manifestations of corporate codes impact ethical behavior.

Corporate and professional codes of ethics are typically viewed as codified expectations of a referent group (e.g., firm, profession). In terms of moral judgment, professional codes of ethics are a more concrete manifestation of professional expectations than general societal norms, providing information as to how members should address ethical problems and dilemmas in the course of their work (Jakubowski et al., 2002). Professional codes are often characterized by lists of "specific prescriptions and prohibitions" (Rest, 1999a, 11). However, the form of codes of ethics can vary on a continuum, from a rules focus to a focus on values, with a rules focus leaving less discretion to the decision maker.

Research in law and economics provides a useful distinction between principles and rules: *rules* are given context *ex ante*, whereas *standards* (principles) are given context only *ex post*, after the individuals act (Kaplow, 1992). This analysis also offers predictions about *compliance* decisions: ". . . when individuals can determine the application of rules to their contemplated acts more cheaply, conduct is more likely to reflect the content of previously promulgated rules than of [principles]" (Kaplow, 1992, 557).

Weaver and Trevino (1999) examined the effect of the *form* of the corporate ethical code on ethical behaviors. They distinguished between two ethics program orientations: those that emphasize shared values, responsible conduct, and role identity ("values" orientation), and those emphasizing rule compliance and threats of punishment ("compliance" orientation).

They argued, and their evidence supports their argument, that the value orientation will result in lower levels of unethical behavior. A compliance orientation, they claim, encourages a "calculative, self-interested response to the ethics program, one unlikely to enhance organizational commitment or communication" (p. 323). In terms of the accounting profession's Code, the principles are more value-oriented and the rules are more compliance-oriented.

Similarly, Razaee, Elmore, & Szendi (2001) surveyed college and university financial administrators to determine what is included in higher education codes of conduct. The most common focus of the codes of conduct was a "low road," with an emphasis on agency issues and legal controls, rather than a "high road" code, with an emphasis on doing the right thing. They suggest that low road codes of ethics could "cause high-road efforts to be ignored by suggesting that, if the law is not broken, conduct is ethical" (Razaee et al., 2001, 178). These studies provide evidence that ethical behavior may be influenced by the focus of the code on rules versus principles. We now turn to relevant research into the accounting profession's code of ethics.

The AICPA's Code of Professional Conduct is of paramount importance to the accounting profession and to the public's confidence in the profession. More than 330,000 CPAs are members of the AICPA and are bound by its Code of Professional Conduct. Additionally, most states have adopted rules of conduct patterned after the AICPA Code (Arens & Loebbecke, 2000). The 1989 revision which added principles to the existing rules of the Code was done to enhance consistency and promote the highest levels of ethical behaviors by accountants.

An exploratory study by Lampe & Finn (1992) focused on the relationship between accountants' moral reasoning and their willingness to violate the Code. They presented senior accounting students, staff-level auditors and manager-level auditors with seven dilemma vignettes, each of which called for a decision to either follow the Code or to deviate from it. Participants' responses were grouped according to their DIT score. They found that participants with lower *P* scores were less willing to deviate from Code-prescribed rules, while those with higher *P* scores were more likely to deviate from the Code and follow a more principled action (e.g., violate auditor-client confidence to expose a potentially hazardous chemical dump). These findings indicate that how the Code is applied depends on the evaluator's level of moral development, supporting the generalization of Kohlberg's and Rest's theories to accountants in their application of the Code.

Adams, Malone & James (1995) studied the reasoning process used by CPA's in resolving ethical issues related to client confidentiality. Contrary to Lampe & Finn (1992), they found that most CPA's tended to follow the Code even when it was not the course of action they considered to be morally right. They also stated that it appeared most professional accountants did not reason at the highest levels. One of their conclusions was that CPA's ethical reasoning may be stymied by a rule-based Code. They state, "the profession needs to emphasize the 'greatest good' criterion more strongly in applying the rules of conduct" (Adams et al., 1995, 1019).

Although no studies have explicitly examined the interaction between moral development and codes of conduct, some researchers have suggested that exposure to a rules-based Code would provide an environment conducive to Stage 4 reasoning, while exposure to a principles-based Code would stimulate reasoning at Stage 5. In other words, those who reason at conventional levels may respond to the guidance in the rules of the Code more than the principles, while accountants who reason at post-conventional levels may be more influenced by the principles than the rules (Adams et al., 1995; Green & Weber, 1997). The studies reviewed above lead us to expect that when auditors use their judgment in ethical situations, the level of discretion allowed by using different forms of the Code, in conjunction with the accountants' level of moral development, may impact the Code's effectiveness. The next section presents hypotheses to this effect.

HYPOTHESES

The purpose of this study is to examine the effect of the level of *discretion* allowed – by virtue of the form of the Code – in leading to appropriate and consistent judgments. This study investigates judgments in a client acceptance context where independence *may* be impaired. Because independence must be achieved in appearance as well as in fact, an auditor must apply his or her judgment in determining if independence is impaired. The Code provides guidance in making this judgment.

The Code's Principle related to independence focuses on precluding "relationships that may appear to impair a member's objectivity" and avoiding "conflicts of interest" (AICPA, 2002, §55.01 and §55.03, respectively), without specifying exactly how one's independence may appear to be impaired or exactly in what circumstances a conflict of interest may exist. Conversely, Rule 101 on Independence presents over 25 pages of details specifying what conditions may or may not impair independence. For example, Rule 101-3 allows auditors to perform other nonattest services so long as the auditor does not "perform management functions or make management decisions" (AICPA, 2002, §101.05). The Rule then proceeds to provide both general and specific examples of impaired independence. It is important to note that Rule 101 is not an exhaustive list of independence violations. In most cases, auditors must still apply judgment in determining whether or not they are independent. The difference between the Rule and Principle on independence is that Rule 101 allows far less *discretion* in judging whether independence is impaired compared to the much more vague Principle.

Prior research suggests that individuals with lower levels of moral development (Stages 4 and lower) are less willing to deviate from rules. Conversely, individuals with higher levels of moral development (Stages 5 and 6) are less likely to rely on rules and more likely to follow the more abstract principles. We predict that the impact of the level of discretion allowed in the Code (rules or principles) *depends on* the level of moral development of the individual. In this study, the "impact" measured relates to the quality of judgments. "Better" moral judgments are defined "in accordance with what experts in the field regard as more defensible" (Rest et al., 1999a, 104). In a client acceptance context, since the Code does not list all cases where auditors should reject engagement offers, the more defensible or conservative judgment would be to reject the engagement.[4]

Figure 1 depicts how moral development and the level of discretion embodied in the Code are expected to interact in their impact on judgment conservatism. This expected interaction is expressed as H1a and H1b:

H1a: **Lower** levels of moral development will result in more conservative judgments in independence evaluations when the Code provides **less** discretion (via Rules).

H1b: **Higher** levels of moral development will result in more conservative judgments in independence evaluations when the Code provides **more** discretion (via Principles).

(Insert Figure 1 about here)

Moral judgments precede moral intentions in the sequence of cognitions leading to moral behavior. Prior research suggests that affective judgments and corresponding intentions are not always aligned, but they are usually highly correlated (Fishbein & Ajzen, 1974). Specifically, moral judgments directly though not completely relate to moral intentions (Jones, 1991; Lampe & Finn, 1992). It follows that if one's level of moral development is expected to interact with the level of discretion embodied in the Code in forming a *judgment*, then these should also interact in establishing an *intention*. This expected interaction is expressed as H2a and H2b:

H2a: **Lower** levels of moral development will result in *more conservative* intentions in client acceptance decisions when the Code provides **less** discretion (via Rules).

H2b: **Higher** levels of moral development will result in *more conservative* intentions in client acceptance decisions when the Code provides **more** discretion (via Principles).

Recently, some promoters of accounting and auditing reform have advocated a more principles-based form of guidance (e.g., FASB, 2002). Their assumption is that principles allow more discretion, which in turn results in more principled reasoning. However, if the most effective form of the Code *depends on* the accountant's level of moral development, then it would be expected that abandoning rules in favor of principles may not serve the profession unless members of the profession generally reason at post-conventional levels. Because accountants are more prone to use Maintaining Norms schema (level 4), providing only principles would likely result in suboptimal judgments and intentions. In other words, the level of moral development of many members of the profession would *not match* the profession's form of guidance for ethical behavior.

In the face of recent suggestions that rules be abandoned, we are investigating the possible effects of abandoning one form of the Code in favor of another. We hypothesize that presenting a mismatch between having the Code in the form of principles (rules) for accountants with lower (higher) levels of moral development results in less conservative judgments and intentions.[5] These expectations are expressed as H3 and H4.

H3: Having the Code in a form that **does not match** one's level of moral development produces *less conservative* judgments in independence evaluations compared to having the Code in a form that **matches** one's level of moral development.

H4: Having the Code in a form that **does not match** one's level of moral development produces *less conservative* intentions in client acceptance decisions compared to having the Code in a form that **matches** one's level of moral development.

RESEARCH METHOD

Independent Variables

This study uses a case scenario (Gilligan Construction) regarding a potential independence problem resulting from mixing nonaudit and audit services. This setting is particularly timely, since the threats to auditor independence posed by extensive nonaudit services has been the focus of substantial public criticism in the post-Enron era. In this case, participants are asked to judge whether independence standards would be violated if they accepted an invitation to become auditor of an existing client for whom they also perform several nonaudit services. Though this experiment was administered while the Enron collapse was in progress, the Sarbanes-Oxley Act had yet to be written, and a CPA could perform both an audit and nonaudit services for both public and non-public clients so long as the CPA did not "perform management functions or make management decisions" for the client (AICPA, 2002, §101.05).

Discretion in the Code. Excerpts from the AICPA's Code were provided to participants as guidance. The scenario involved the evaluation of whether a CPA was independent, thus the relevant portions of the Code addressing independence in client acceptance decisions were the focus. This particular aspect of the Code was chosen for several reasons. First, independence is *the* central ethical issue in auditing; it is "the normative standard of accountancy" (Ponemon & Gabhart, 1990, 231) and is the cornerstone of public confidence in the profession (AICPA, 2002, AU §220.15). Second, as mentioned above, auditor independence and nonaudit services are presently subjects of intense public policy debates. Third, independence is the only topic in the Code where there is a one-to-one match between the *Principles* section and the *Rules* section.[6]

The *level of discretion* of this guidance was manipulated between participants at three different levels (hereafter, CODE). Participants were provided with either the Code's principles only, rules only, or with both. Although we only hypothesize differences between the principles and the rules, the third condition was necessary to allow for better comparison to the current state of professional standards, where both principles and rules are incorporated into the Code.[7] Participants in the principles-only (rules-only) condition were not knowledgeable about the rules (principles) on the particular independence issues. Participants in the principles condition were provided with excerpts from Sections 51, 54, 55, and 57 of the Principles section of the Code. Participants in the rules condition were provided with excerpts from Section 101.[8]

Level of Moral Development. Consistent with prior research (e.g., Ponemon & Gabhart, 1992; Ponemon, 1995; Lord & DeZort, 2001), we measure the level of participants' moral development using the DIT-2, a shorter version of the DIT.[9] Two groups are created based on a median split of the sample *P* scores (hereafter, LO-P and HI-P). To minimize participants' potential heightened awareness of the study's focus on ethics, the DIT-2 was administered two weeks prior to the case portion of the study.

Dependent Variables

The first dependent variable measures a *judgment* requiring the participants to assess the scenario regarding whether or not independence is impaired with respect to the client (hereafter, IMPAIR). Participants answered the question, "Based on your understanding of the Code of Professional Conduct, do you think your independence is impaired with respect to Gilligan Construction?" using a scale from 1 (independence not at all impaired) to 7 (independence is definitely impaired). More conservative responses are at the higher end of the response scale.

The second dependent variable measures a behavioral *intention* and requires the participants to assess whether they would accept the audit engagement (hereafter, ACCEPT). Participants responded to the following question, "If Ms. Gilligan asks you to conduct the audit of the annual financial statements, would you accept the engagement?" where Ms. Gilligan is a current tax, bookkeeping and consulting client. The response scale ranged from 1 (definitely accept) to 7 (definitely not accept). Again, the more conservative responses are at the higher end of the response scale.

To ensure that these measures capture differences between the respondents and not just different interpretations of the questions, we performed a reliability analysis on IMPAIR and ACCEPT combined. The average inter-class correlation and Cronbach's alpha is .8011 ($p<.01$).

Participants

To assure *internal* validity through cleaner manipulations of the CODE variable, we needed to control the participants' level of awareness of the professional standards (Gaa, 1992). We accomplish this by using subjects who would not already have detailed knowledge of the Code, the existence of principles and rules in general, nor the principles or rules specific to independence. Therefore we used upper-division undergraduate accounting students enrolled in the second intermediate accounting course, but who had not taken an auditing course, as study participants.[10] The emphasis on internal validity using student participants is considered appropriate for several reasons. First, in quasi-experiments internal validity is of primary interest (Cook & Campbell, 1976). If practicing auditors from different firms were used, it would be more difficult to control for potential effects of variables such as firm policies, different experiences with clients, and hindsight bias from situations similar to the one used in this case (all threats to internal validity). Second, moral development theory and measures apply to students and practitioners. The cognitive and social psychological phenomenon on which the theory is based is not expected to differ between upper division accounting students and practicing auditors. Third, these students were believed to have some identification with the accounting profession given that they were late in their junior year or early in their senior year. Prior moral development research using students and auditors shows that students have more variation in their evaluations of ethical dilemmas – which would make it more difficult to find statistical significance for explanatory variables in our study – but are generally more conservative (Lampe & Finn, 1992).

Experimental Materials and Procedures

In many accounting situations, the guidance is sufficiently imprecise as to necessitate the exercise of professional judgment. In order to observe these judgments, we needed a vignette that incorporates a certain amount of vagueness and ambiguity (Gaa, 1992). The Gilligan case was adapted from Arens & Loebbecke (2000, 107) and focuses on the independence issue created by performing an audit for a client for whom you also perform nonaudit services. In this study, the Gilligan case is presented so that the accountant currently performs tax return preparation, bookkeeping, and some consulting work for Gilligan Construction. The owner approaches the accountant seeking an audit so that Gilligan may apply for a bank loan. The case is designed to be sufficiently ambiguous so that it is not clear whether independence would be violated if the audit engagement were accepted, allowing room for participants to exercise their judgment given the Code guidance in their respective treatments (see case in Appendix A).

Participants first completed the DIT-2 instrument. Then approximately two weeks later, the participants completed the case materials. During this second session, participants read a brief instruction sheet, the Code excerpts, and the case, answering questions about the case. The rules or principles (or both) were available to participants while they answered case questions on independence. Finally, participants answered a set of demographic questions and were debriefed and excused.

RESULTS

Sixty-nine students from two medium-size universities participated in this study. This study employed a generalized randomized block, one-factor experiment. CODE was randomly manipulated between participants, so that CODE is treated as a randomized factor. Participants were blocked based on their DIT-2 *P* scores, using a median-split. The median *P* score was 38, so the HI-P block included participants with *P* scores greater than 38 and the LO-P block included participants with *P* scores less than or equal to 38.[11] The mean *P* score in this study is 39.4, the mean p-score of the LO-P (HI-P) group was 29.7 (50.1). These scores are consistent with other studies.[12]

Descriptive Statistics

Demographic information on the group of 69 participants is presented in Table 2. The participants had a mean (median) age of 24 (22), were largely accounting majors in their junior or senior year, had not had an auditing course, and had taken an average of one ethics course in their college curriculum. No demographic variables were significantly related to dependent variable responses.

(Insert Table 2 about here)

Cell means for the dependent variables are presented in Table 3. Overall, participants' mean assessment of whether or not independence had been impaired was 5.32 (with 7=definitely impaired). Participants' mean assessment of whether they would accept the engagement was 5.10 (with 7=definitely not accept). Though the *judgment* and the *intention* variables are not the same, they are expected to be highly correlated. The infraclass correlation between IMPAIR and ACCEPT is .8011 ($p<.01$). While the case scenario did not clearly imply that independence was impaired by either Code rules or principles, the ambiguity in the scenario coupled with negative press recently devoted to nonaudit services provided by auditors likely heightened the participants' conservative awareness of the issue.[13] It is reasonable to expect participants to respond on the conservative end of the dependent variables' scales, which would also be consistent with remaining independent in appearance.

(insert Table 3 about here)

To determine if the case was sufficiently ambiguous to allow for variation in subject judgment, participants were asked "Regarding this case, what is the degree to which the AICPA Code of Professional Conduct indicates clearly the appropriate circumstances when independence is not violated?" using a scale from 1 (not at all clear) to 7 (very clearly). Overall, clarity was rated 4.74. Since the principles are not as specific as the rules, it would be reasonable for principles to be perceived as least clear, followed by rules, followed by principles plus rules. Means for the clarity question were in expected direction (principles=4.22, rules=4.70, both=5.30; p=.025), and this pattern held for both the LO-P and HI-P groups. To determine if participants were sensitive to the independence issue and the importance of building a practice, they were asked "How important would it be for you to maintain independence in that case?" using a scale from 1 (not at all important) to 7 (very important) and "How important would it be for you to build your accounting and auditing practice?" using a scale from 1 (not at all important) to 7 (very important). Responses indicated participants were sensitive to the independence issue (mean=6.38) and considered it important to build the practice (mean=5.72), with no significant difference between CODE groups (p=.743 and p=.318, respectively).

Hypotheses One and Two

Hypothesis 1a (1b) predicts that participants with lower (higher) levels of moral development will be more conservative when using Code rules (principles) in evaluating an independence *judgment*. In other words, the effect of Code discretion on independence judgments will depend on the evaluator's level of moral development. Since these hypotheses focus specifically on rules versus principles, the full model was analyzed first to see if CODE was significant, followed by a planned comparison of principles-only and rules-only conditions. The full ANOVA model including the blocking and treatment factors and interaction term was significant using IMPAIR as the dependent variable (p=.036), with the interaction between CODE and DIT *P* score also being significant (p=.010). Similarly, hypothesis 2a (2b) predicts that participants with lower (higher) levels of moral development will be more conservative when using Code rules (principles) in expressing an *intention* in a client acceptance decision. The full model using ACCEPT as the dependent variable was mildly significant (p=.055), with the interaction between CODE and DIT *P* score being significant (p=.012).

To examine whether the interactions were of the predicted nature, separate planned one-tailed t-tests between the principles-only and rules-only conditions were conducted for the LO-P and HI-P groups (see Table 3 for cell means and Figure 2 for graphical presentations of results). For the LO-P group, the INPAIR judgments were more conservative in the rules-only condition than in the principles-only condition (5.85 vs. 4.29, respectively; p=.004), and ACCEPT intentions were mildly more conservative (5.23 vs. 4.07, respectively; p=.074). Likewise, for the HI-P group, the IMPAIR judgments were more conservative in the principles-only condition than in the rules-only condition (6.11 vs. 4.70, respectively; p=.053), and ACCEPT intentions were more conservative (6.67 vs. 4.50, respectively; p=.004). Thus, H1a (1b) and H2a (2b) are supported. Conservatively interpreting the profession's guidance when making independence judgments and client acceptance intentions *depended* on both the level of moral development and the amount of discretion in the Code, with the most conservative responses made by LO-P participants using only rules and HI-P participants using only principles.

(insert Figure 2 about here)

Hypotheses Three and Four

To test whether failure to have a match between the level of moral development and the appropriate form of the Code produces less conservative independence judgments and acceptance intentions, we use a variable to indicate if this match existed (hereafter, MATCH). In testing these hypotheses, the CODE condition with both principles and rules was included, since this is the current state of the Code in the profession and having both available would provide a match for both categories of moral development. MATCH was coded 0 for "unmatched" participants – those in the LO-P group receiving only principles and those in the HI-P group receiving only rules. MATCH was coded 1 for all other participants ("matched"). For example, LO-P participants having either rules only or rules with principles were coded MATCH=1 because they had the rules available to them in either case. Planned one-tailed t-tests were conducted to test H3 and H4.

Cell means are reported in Table 4, Panel A. Participants in the groups where the Code form was *not a match* to their level of moral development had *less conservative* independence judgments and acceptance intentions. The unmatched participants had less conservative IMPAIR judgments than the matched group (4.46 and 5.78, respectively; $p=.001$), as well as less conservative ACCEPT intentions than the matched group (4.25 and 5.56, respectively; $p=.004$). Thus, H3 and H4 are supported: the form of the code is not as important as the "match" between the Code form and the participants' moral reasoning.

(insert Table 4 about here)

Additional Evidence

Professional codes of conduct represent collective norms about what is and what is not appropriate. They attempt to foster predictable behavior as well as conformance to the community's expectations. The AICPA Code should "represent the general consensus viewed by the profession as to what constitutes proper and ethical behavior" (Jakubowski, et al., 2002, 112). It seems reasonable, then, to expect that participants will demonstrate greater behavioral consensus if the Code plays an important role in guiding them. Based on the preceding discussion and our experimental results, we expect that when the Code is *mismatched* with the participants' level of moral development, then the Code will not be effective in guiding the behavior of the collective group.

To examine this question, we converted the ACCEPT variable to a dichotomous accept/reject variable, as follows: Participants with responses that were 5 or higher on the ACCEPT question were the "reject engagement" group. Participants with responses of 3 or lower were in the "accept engagement" group. Four participants responding at the midpoint on the ACCEPT question scale were not included in this analysis. A contingency analysis was then performed using the dichotomized reject/accept variable. Again, all three conditions of CODE were included in this analysis.

Chi-square tests were significant, indicating that the matched and unmatched groups had different accept/reject intentions (Table 4, Panel B, p=.001). When participants had available to them a form of the CODE that matched their level of moral development, 81% would *reject* the engagement (the more conservative response) and 19% would *accept* the engagement. When participants did *not* have the CODE in a form that matched their level of moral development, they were evenly split between *reject* the engagement (50%) and *accept* (50%). In other words, when the form of the Code matched the moral development of the participants, there was considerable consensus (80%) that the questionable engagement should not be accepted. When there was not a match between the Code and the level of moral development, the Code seemed to have no influence over participants' behavior.

DISCUSSION AND IMPLICATIONS

In this study we examine how the level of *discretion* inherent in the form of the accounting profession's ethical standards, principles versus rules, affects judgments in a client acceptance context where independence may be impaired. We also examine how accountants' *levels of moral development* influence the effectiveness of the profession's ethical standards. In an experimental setting, we find that those reasoning at lower levels were less conservative when only principles were provided; those reasoning at higher levels were less conservative when only rules were provided. Given that principles-based standards are being touted as being superior to rules-based standards, we also examined the effect of mismatching the form of the Code with the participants' level of moral development. This mismatch resulted in less conservative judgments and inconsistent behaviors. These results have important implications for efforts to improve ethical behaviors of accountants, as well as for the current movement toward principles-based standards.

This study finds that in the highly charged ethical context of independence and nonaudit services, the way to optimize *individual* ethical judgments is to provide the appropriate form of the Code (rules or principles), depending on one's level of moral development. This, of course, is impractical. We suggest that the way to optimize the *profession's collective* ethical judgments is to provide the Code as a combination of principles *and* rules, exactly the form of the *present* AICPA Code. This prompts us to consider *why* the present Code has not resulted in the ethical behavior that its promoters envisioned in 1986. In the discussion that follows, we suggest at least three reasons why the present Code may not be effective: (1) the Code itself provides ineffective and confusing guidance, (2) practicing auditors do not routinely employ principles-based reasoning, and (3) the ethical culture of accounting firms may defeat the efficacy of the Code. We also consider the prognosis for principles-based accounting standards.

The Present AICPA Code

The AICPA Code of Professional Conduct presently contains general statements of principles and specific rules. The rules are enforceable, but the principles are not (Moriarty, 2000). By placing the "public interest" and other principled guidance in the unenforceable section of the Code, the AICPA strongly signaled to its membership that these principles are unimportant, or at least less important, than the specific rules. Accountants whose reasoning is predominantly focused on rewards and punishments would be especially likely to reach this conclusion. Moreover, the rules are not logically derived from the principles. The thirteen "old" rules were reorganized into eleven rules in the restructured Code, but the content was largely unchanged (Shaub, 1988). Lindblom & Ruland (1997) point to this logical disconnect between the principles and rules in the Code, to the unenforceability of the principles, and to other "semantic defects" which may prevent professional accountants from deriving any ethical guidance at all from the Code.

Reasoning of Practicing Auditors.

The recent clamor for more ethical behavior on the part of accountants seem consistently to be calling for higher levels of reasoning: placing the public interest above person interest and ahead of the rules. To the extent that practicing auditors reason at conventional levels, this may be asking them to do the impossible. As mentioned above, Ponemon's (1990) study received extensive attention when he reported that position level within an auditing firm was inversely related to cognitive moral development. A later study with a larger sample confirmed his earlier finding, that practicing auditors generally do not employ post-conventional moral reasoning (Ponemon, 1992). Numerous subsequent studies have reported similar findings (see Louwers, et al. (1997) for a summary of this research). This empirical regularity, taken together with our results, suggest that simply changing the form of the Code to be more principles-based will not be effective in promoting higher levels of ethical behavior. If we want public accountants to make the public interest their highest priority, we need to better develop their capacity to reason at post-conventional levels.

Ethical Culture of Public Accounting Firms

Ponemon (1992) also utilized longitudinal and experimental methods that provided evidence of a "selection-socialization" process in which audit firm managers promote those whose ethical reasoning is closest to their own. He concluded that the ethical culture of accounting firms may hinder the development of higher levels of ethical reasoning. A substantial body of anecdotal evidence supports this conclusion.

Most models of ethical decision-making in business organizations identify the organization's ethical culture as a dominant factor. In Weber's (1993) model, the organizational code of ethics serves primarily as a written manifestation of the organization's values and beliefs. If the code is not 'in sync' with the organizational value system, it will have little effect on employee behavior. Somers (2001) considered the influence of *both* corporate and professional codes of ethics on the ethical behavior of management accountants in organizations. He found that a *professional* code of ethics may have little effect on employees' ethical behavior, while a *corporate* code of ethics does influence behavior. One interpretation of Somers' results may be that an organization's ethical values may overshadow the professional code.

Trevino (1986) proposed a model in which cognitive moral development interacts with moderating factors to influence decisions. Of the eleven moderators in her model, eight are derived from the environment of the firm. As she observes, " . . . most managers will look outside themselves for cues about what is right (appropriate) behavior and what is wrong (inappropriate) behavior" (p. 608). This would be especially true for managers who reason at conventional levels, who by definition look to others to help them define what is right and wrong in a given situation.

Our study deals specifically with the effect of non-audit services on independence. At one time, non-audit services were closely related to audit practice and were justified primarily by the synergy between the two. But in recent years the scope of the large firms' non-audit practices has expanded to include investment banking, legal services, and strategic business planning; revenues from these services often exceed those from audits:

> In their zeal to emphasize the array of services that CPA's offer, audit firms and the AICPA scarcely acknowledge auditing services in the public images that they portray. This serves to exacerbate the independence issue and to down play the importance of auditing. (Public Oversight Board, 2000, 115)

Professional employees of the largest accounting firms no longer include the "CPA" designation on their business cards. The Panel on Audit Effectiveness reported that focus group participants, survey respondents, and engagement teams interviewed consistently indicated that engagement partners and other key firm personnel often viewed the audit as having little value when compared with other services (Public Oversight Board, 2000). While the Sarbanes-Oxley Act does forbid nine nonaudit services from being performed *for SEC audit clients*, the idea that audit firms will no longer focus on these lucrative nonaudit services is naïve. Bazerman, Lowenstein & Moore (2002) argue that threats to auditor independence are endemic to a system where clients hire and fire the auditor. They point to several studies revealing *unconscious* bias, which they believe will only be eliminated through fundamental reform. The only real solution, they argue, is to eliminate auditors' interest in pleasing clients. Whether such radical changes are warranted is beyond the scope of this study. But this much seems to be true: to the extent that the "tone at the top" in audit firms is focused more on growth and profit than on audit quality, it is unlikely that the professional values of independence, objectivity, and integrity will be reinforced within the firms.

While the results of this study do question the validity of moving towards principles-based ethical standards in accounting, this finding -- coupled with prior research supporting the importance of the firm's value system in guiding ethical behavior – suggests that perhaps the focus should be on providing guidance to firms in developing effective *firm* values and codes of conduct, rather than on changing the form and content of external codes of conduct used in regulatory efforts.

The Prognosis for Principles-Based Standards

As discussed above, there is a growing movement toward abandoning rules-based accounting standards in the U.S., in favor of principles-based standards (Schipper 2003). While this study deals with ethical judgments, application of accounting principles also requires a judgment with ethical dimensions. Consistent with our results, both survey and experimental studies provide evidence that aggressiveness in financial reporting judgments increases (conservatism decreases) with the amount of discretion allowed by the relevant reporting standard (see Nelson (2003) for a summary of this research). Our results suggest the possibility that the moral reasoning of accountants, an element not considered by these studies of financial reporting decisions, may be an explanatory factor when the situation has a significant ethical component. Although popular wisdom seems to be that principles-based standards will be the panacea for the accounting profession's ills, our results indicate that this might not be so.

LIMITATIONS AND FUTURE RESEARCH

For the reasons discussed above, it was necessary to use students as participants in order to enhance internal validity. However, this limits the generalizability of our results. While our participants had mean *P* scores similar to prior studies using auditors, students lack both the familiarity and experience possessed by practicing auditors who routinely make decisions involving the Code. Future research should attempt to examine the moderating effects of the discretion of the Code and moral development on practicing auditors, though doing so will be difficult given the compounding effect that existing knowledge of the Code they would likely have. Similarly, the experimental nature of this study does not replicate the risk and career implications inherent in real life client acceptance decisions, though participants did recognize the importance of this decision to their careers in this case. While the case necessarily focuses on the single issue of independence and non-audit services, the experimental setting cannot replicate the competing pressures imposed by the environment of the firm.

We use the DIT-2 *P* score to control for participants' moral reasoning level. But it is important to recognize that it is neither a comprehensive measure of cognitive moral development nor an absolute predictor of ethical behavior. We needed to distinguish between participants with principles-based reasoning and those who reason at a conventional level. While the *P* score indicates the extent of a participant's principles-based reasoning, it does not distinguish between conventional and pre-conventional reasoning. Some studies (e.g., Weber & Green, 1991) have found that many college students reason at stages 1 and 2. Our results may be influenced by the extent to which our participants reason at *pre*-conventional levels.

It is also important to acknowledge the limitations inherent in Kohlberg's framework and in the DIT *P* score itself. Some scholars have alleged that Kohlberg's model reflects a systematic gender bias (Gilligan, 1982). Fisher & Sweeney (1998) find that the DIT score can be influenced by political ideology, reflecting aspects not related to moral judgment. Their results suggest that, given the conservative orientation of many accountants, the DIT may systematically understate the moral reasoning levels of practicing accountants. As Cushing (1990) points out, the terms "moral" and "ethical" are not synonyms. While we believe that our results demonstrate the usefulness of the DIT *P* score to *control* for participants' style of moral reasoning, it would be a mistake to conclude that those with low scores are somehow morally or ethically deficient.

This study considers the efficacy of principles-based versus rules-based professional codes of conduct. However, many have advocated principles-based accounting standards, as well. Future research should examine whether accountants' style of moral reasoning also affects their judgments on accounting issues. Also, future research might attempt to measure the ethical culture of audit firms and how that ethical culture affects interpretation of different forms of the Code. Our results suggest that the most conservative decisions are made by HI-P subjects using the principles. Therefore, researchers should also consider questions such as whether ethical training – at the university or firm level – might increase auditors' levels of ethical reasoning, thereby making a principles-based Code more effective. Research is also needed on the extent to which a firm's value structure overrides an individual's moral reasoning, and what might be done to enhance that interaction.

Another factor that remains to be examined is the importance of *context* in accountants' ethical judgments. Most models of ethical decision making agree, to some extent, that ethical decisions are affected by the decision maker's level of moral development, awareness of relevant professional standards, and contextuality, defined as the interaction between issue characteristics and person characteristics (Wright, Cullinan, & Bline, 1997). This study used a nonaudit services context – at a time when nonaudit services were receiving much attention – and did not vary the context or scenario in which the Code was applied. To build on our findings, future research is needed to examine whether the interaction of the generality of the Code and level of moral reasoning holds across contexts or perhaps interacts with the context.

Our results suggest that principles-based standards may not be the panacea sought by the accounting profession. But the goal of improving auditors' ethical judgments remains worthy of both academic and professional pursuit.

[1] The three schemas (Rest at al., 1999a) are an updated perspective on the three stages (Kohlberg, 1969) of moral development. For simplicity, the term "schema" and "stages" will be used interchangeably when discussing levels of moral development.

[2] DIT *P* scores do not directly measure one's level of moral development. Rather, the *P* score represents one's propensity to reason at Stages 5 and 6 (Post-Conventional), based on how often one ranks Stage 5 and 6 factors as being important to the ethical dilemmas in the instrument. In other words, higher *P* scores mean that one is more prone to be reasoning at higher stages, but lower *P* scores do not mean that one is reasoning at progressively lower stages. However, for simplicity in this study, those with lower *P* scores are referred to as having lower levels of moral development, and the phrases "level of moral development" and "propensity to reason at higher levels" will be used interchangeably.

[3] Louwers, Ponemon, & Radtke (1997) provide a good overview of this research.

[4] We use the term *conservative* in the sense of being prudent or cautious, to reflect an attitude of avoiding undue risk in the face of uncertainty.

[5] We are not advocating that the profession provide multiple forms of the Code, suiting each person's level of moral development. Given (1) the call to abandon rules and (2) the propensity of accountants to reason at lower levels, these hypotheses predict what may happen if rules are not provided to guide behavior. To be complete, we are also examining the second mismatch situation where one who reasons at higher levels do not have principles available.

[6] Other sections of the Principles, such as Responsibilities, The Public Interest, Integrity, or Scope of Services, have no direct counterpart in the Rules.

[7] Consistent with prior research comparing principles versus rules, H1 and H2 compare the principles-only and rules-only conditions of CODE. Since the current Code presents both

principles and rules, this third combined condition is included in the analysis of H3 and H4 since these hypotheses examine "matches" between the form of the Code and level of moral development. The combined Code provides a "match" for all participants.

8 Principles included: ET sections 51.02, 54.01-54.03, 55.01, 55.03, 57.01-57.02, and 57.03 (second bullet), as well as the preambles (in italics) to sections 54, 55, and 57. Rules included: ET sections 101.01, 101.05 (first paragraph), 101.05 (paragraph labeled "General Activities"), and 101.11 (paragraph labeled "Other Considerations," excerpted as it applies to the case in the experiment). The AICPA Code of Professional Conduct is available at www.aicpa.org/about/code/index.htm.

9 The DIT-2 was developed in the late 1990s as an updated version of the DIT. The DIT-2 is thought to be preferable to the DIT because it is shorter, has more streamlined instructions, purges fewer participants for unreliability, and produces slightly stronger trends on validity and reliability (Rest & Narvaez, 1998).

10 Two participants were currently enrolled in an auditing course, and two participants had previously completed an auditing course. Tests were run both with and without these four participants, and results were not substantially affected. Given that the particular auditing course involved does not cover the Code in a *detailed* fashion, the participants were assumed to not have expert knowledge of the Code and were retained in the study.

11 Since p-scores measure the propensity to reason at post-conventional levels, lower p-scores indicate a propensity to reason at conventional or pre-conventional levels. Four participants' p-scores equaled 38 (the median). The hypothesis tests were conducted (a) with these four participants in the HI-P group and (b) excluding these participants altogether. Results were not substantively different than reported, thus those participants were retained in the LO-P group.

[12] Lampe & Finn, 1992, mean=39.8; Ponemon, 1995, mean=39.06 to 39.43; Lord & DeZoort, 2001, mean=39.6; Gaa, 1992, summarizing several studies. Means of staff auditors split into high and low p-score groups in Lord & DeZoort (2001) were 24.9 and 53.3, respectively

[13] The study was conducted in late March and early April 2002.

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APPENDIX A

Gilligan Case

Gilligan Construction

You are a licensed CPA and a member of the AICPA. You started your own accounting practice about three years ago, and its growth has been slow but steady. You have established a pretty good niche in tax and accounting work, but you would really like to start doing some small business audits to better compete with other accounting firms in your region.

One of your first clients was Gilligan Construction. The owner, Mildred Gilligan, had been a friend of your family for many years. During the past three years, you have done some consulting, most of the bookkeeping, and the tax returns for Gilligan Construction. This client has proven to be profitable for your practice, and many other clients have been referred to you by Ms. Gilligan. Ms. Gilligan often calls you before she makes any major business decisions, and she frequently asks you to attend board of directors meetings.

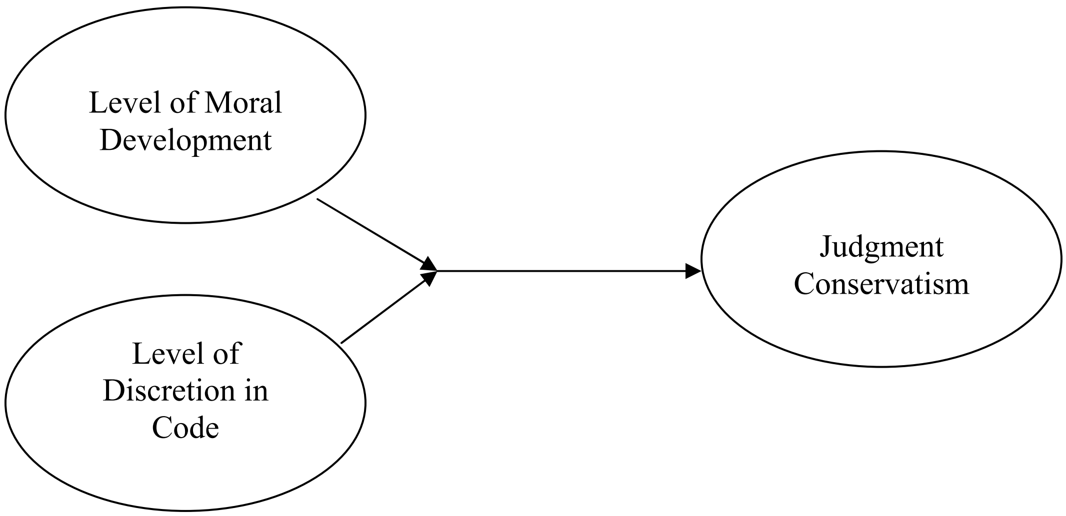
Recently, you accompanied Ms. Gilligan to the bank when she was seeking a loan. She jokingly introduced you to the loan officer with this statement: "I have my three business partners—my board, the government, and my CPA, but the CPA is the only one that is on my side." The banker seemed pretty content with the loan application so far, but suggested that the bank's loan committee would really like to see some audited financials. "That should be no problem," said Mildred. "My CPA here already knows my business inside and out."

Adapted from Arens & Loebbecke (2000, 107)

FIGURE 1

Predictive Interactive Effects of Moral Development and Level of Discretion

Panel A: Diagram Presentation



Panel B: Graphical Presentation

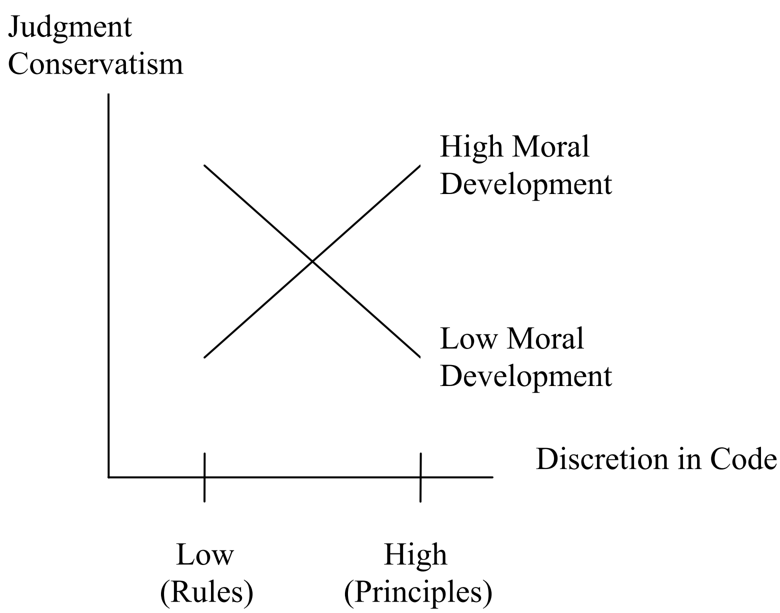
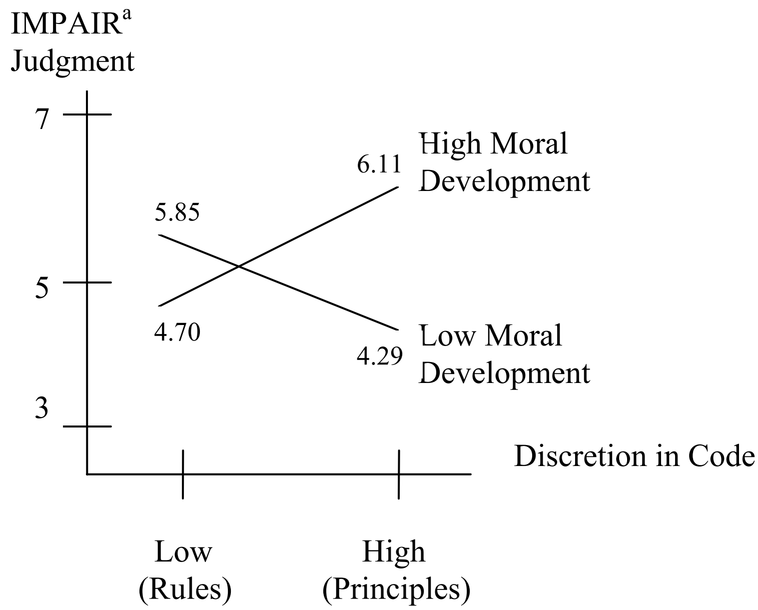


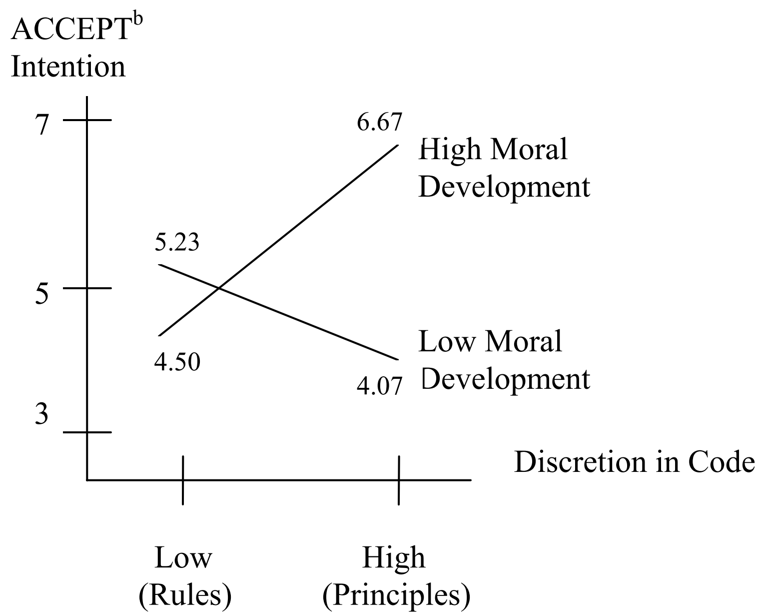
Figure 2

Graphical Presentation of H1a(1b) and H2a(2b) Results

Panel A: H1a (1b)



Panel B: H2a (2b)



[a] Response to question "Based on your understanding of the Code of Professional Conduct, do you think your independence is impaired with respect to Gilligan Construction?" on a scale of 1 (independence not at all impaired) to 7 (independence is definitely impaired).

[b] Response to question "If Ms. Gilligan asks you to conduct the audit of the annual financial statements, would you accept that engagement?" on a scale of 1 (definitely accept) to 7 (definitely not accept).

TABLE 1

Kohlberg's Stages of Moral Development and Rest's Ethical Schemas

Kohlberg's Stages of Moral Development[a]	**Rest's Ethical Schemas**[b]
PRE-CONVENTIONAL LEVEL - *Focus is self* Stage 1: Obedience to avoid punishment.	
Stage 2: Instrumental egotism and simple exchange to consider the cost and/or benefits to oneself. **CONVENTIONAL - *Focus is relationships*** Stage 3: Interpersonal concordance to cooperate with those in your environment	**PERSONAL INTERESTS – *Focus is consequence of actions*** Justify decisions by appealing to personal stake in consequences of action.
Stage 4: Law and duty to the social order, obligated to and protected by the law; to cooperate with society in general.	**MAINTAINING NORMS -- *Focus is normative rules*** Normative rules are necessary to provide stability, predictability and coordination. Society-wide system of cooperation and law applies to all. Maintaining norms is one's duty. Obey authority out of respect for the social system.
POST-CONVENTIONAL - *Focus is personally held principles* Stage 5: Social consensus, consider fairness of the law or rule, equity and in the process of developing the rule Stage 6 Nonarbitrary social cooperation, fairness of the law or rules derived from general principles of just and right as determined by rational people	**POST-CONVENTIAL – *Focus is on sharable ideals*** Social norms can be set up a variety of ways and follow from the moral purpose behind the convention. There is an idealized way humans can interrelate that is sharable by all. Social norms should not be biased in favor or against a group.

[a] *Adapted from Rest (1979) by Arnold & Ponemon (1991)*
[b] *Adapted from Rest et al., (1999a) and (1999b)*

TABLE 2

Participant Demographics

Age	Mean (Median)	24 (22)
Gender	Male Female	n=35 n=34
Major	Accounting Finance Other	n=64 n=2 n=3
Academic Classification	Junior Senior Post-Bacc	n=38 n=28 n=3
Number of College Ethics Courses	Mean (st. dev.)	1.1 (1.1)

TABLE 3

Cell Means for Hypotheses 1a (1b) and 2a (2b)

Panel A: Cell Means for H1a and H1b (IMPAIR[a])

		Principles		Rules		Both		Total	
		n	Mean (StDev)	n	Mean (StDev)	n	Mean (StDev)	n	Mean (StDev)
H1a:[c]	**LO-P**	14	4.29 (1.54)***	13	5.85 (1.21)***	9	5.22 (2.11)	36	5.08 (1.70)
H1b:[c]	**HI-P**	9	6.11 (0.93)**	10	4.70 (2.31)**	14	5.86 (1.23)	33	5.58 (1.64)
	Total	23	5.00 (1.60)	23	5.35 (1.82)	23	5.61 (1.62)	69	5.32 (1.68)

ANOVA F=2.55, p=.036

Panel B: Cell Means for H2a and H2b (ACCEPT[b])

		Principles		Rules		Both		Total	
		n	Mean (StDev)	n	Mean (StDev)	n	Mean (StDev)	n	Mean (StDev)
H2a:[c]	**LO-P**	14	4.07 (1.198)*	13	5.23 (2.05)*	9	5.33 (2.40)	36	4.81 (2.14)
H2b:[c]	**HI-P**	9	6.67 (0.50)***	10	4.50 (2.07)***	14	5.29 (1.77)	33	5.42 (1.80)
	Total	23	5.09 (2.02)	23	4.91 (2.04)	23	5.30 (1.99)	69	5.10 (1.99)

ANOVA F=2.30, p=.055

t-test significance levels

*	p≤.10
**	p≤.05
***	p≤.01

[a] Response to question "Based on your understanding of the Code of Professional Conduct, do you think your independence is impaired with respect to Gilligan Construction?" on a scale of 1 (independence not at all impaired) to 7 (independence is definitely impaired).

[b] Response to question "If Ms. Gilligan asks you to conduct the audit of the annual financial statements, would you accept that engagement?" on a scale of 1 (definitely accept) to 7 (definitely not accept).

[c] Hypotheses predict interactions between the two levels of discretion in the code (principles and rules) and the two levels of moral development (High and Low). The "Both" condition where participants received both principles and rules is provided for informational purposes only.

TABLE 4

Hypotheses H3, H4, and H5

Panel A: Cell Means for H3 and H4

		Matched[a]		**Unmatched[a]**		**Total**	
		n	Mean (StDev)	n	Mean (StDev)	n	Mean (StDev)
H3	**IMPAIR[b]**	45	5.78 (1.38)****	24	4.46 (1.86)****	69	5.32 (1.68)
H4	**ACCEPT[c]**	45	5.56 (1.87)***	24	4.25 (1.98)***	69	5.10 (1.99)

Panel B: Contingency Analysis

	Matched[a]		**Unmatched[a]**		**Total**	
	Count	% of Col	Count	% of Col	Count	% of Col
Reject Engagement[d]	35	81%	11	50%	46	71%
Accept Engagement[d]	8	19%	11	50%	19	29%
Total	43	100%	22	100%	65	100%

$X^2 = 6.935$, $p = .001$

t-test significance levels

*** p≤.01

**** p≤.001

[a] Participants were divided into two groups as follows. "Unmatched" participants were those in the LO-P group receiving only principles and those in the HI-P group receiving only rules. All other participants were included in the "matched" group.

[b] Response to question "Based on your understanding of the Code of Professional Conduct, do you think your independence is impaired with respect to Gilligan Construction?" on a scale of 1 (independence not at all impaired) to 7 (independence is definitely impaired).

[c] Response to question "If Ms. Gilligan asks you to conduct the audit of the annual financial statements, would you accept that engagement?" on a scale of 1 (definitely accept) to 7 (definitely not accept).

[d] Participants were divided into two groups based on responses to the following question: "If Ms. Gilligan asks you to conduct the audit of the annual financial statements, would you accept that engagement?" on a scale of 1 (definitely accept) to 7 (definitely not accept). Participants with responses of 5 or higher were the "reject engagement" group. Participants with responses of 3 or lower were the "accept engagement" group. Four participants responding at the midpoint on the question scale were not included in the contingency analysis.