Big Oil versus Big Ideals

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In writing this case, our goal is to provide a window into the life of a whistleblower, showing the long, often torturous path a whistleblower may follow. Although we do provide a time line for the events in his life, it is not our aim to document the detailed chronology of the court case. Indeed, we have obscured some facts and purposely omitted others, including the identity of the whistleblower and the company he worked for.

The Case

Part I:

After graduating from a large southwestern university in 1995 with a degree in accounting, George began his career at a Big-4 public accounting firm. He worked his way up to audit senior manager before taking a position in the spring of 2005 at a Fortune-500 company (“the Corporation”) as Director of Technical Accounting Research and Training. George was directly responsible for supervising, evaluating, and improving technical research and training for the entire finance and accounting (“F&A”) organization. During his job interview, the Corporation’s Senior Vice President and Chief Accounting Officer (CAO) emphasized that the Corporation had recently faced questions about its accounting practices and needed to ‘clean up’ its accounting. They were looking for someone to keep abreast of SEC and FASB rules and train their in-house accountants at locations throughout the world. George was aware of the negative

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publicity surrounding the Corporation's accounting practices, and was wary of their offer. Despite his concerns, based on the CAO’s statements, George thought the job sounded like a great opportunity to ‘fix a company in need.’ Besides, although George did not know them personally, several other former auditors from his firm worked at the Corporation.

Similar to a consultation partner in the national office of a public accounting firm, George was the ‘go-to’ person for questions about proper application of GAAP at the Corporation. His job took him across the globe. Some of his presentations focused on accounting for joint ventures, while others taught proper application of GAAP in revenue recognition. His technical presentations were well-received by the Corporation’s accountants, who were eager to learn about appropriate treatment of unique, industry-specific transactions and FASB developments. Individual accountants at the Corporation came to George with their questions and he felt that they valued his opinion.

In summer 2005, George reviewed the Bill-and-Hold decision tree the Corporation used to determine timing of revenue recognition. (The decision tree actually violated the Corporation’s written policy on revenue recognition.) George concluded they were recording revenue prematurely, based on an improper application of GAAP (the SEC’s SAB104 and EITF-0021). In short, as part of service contracts with their clients, the Corporation was required to manufacture custom-designed equipment in order to actually perform the required services for their customers. The equipment was manufactured in advance by the Corporation and stored in their warehouses until the service was performed. The Corporation recorded the sale of the equipment when it was manufactured and placed in the warehouse, before it was used in the service.
George considered this treatment to fit the characteristics of a classic Bill–and-Hold scheme, which can result in improper acceleration of revenue recognition. Prior year emails and documents from Internal Audit raised concerns that this practice did not comply with company policy. The same documents made it clear the Corporation responded by adding a clause to their purchase orders in an effort to evidence the passing title of such manufactured repair equipment to the customer at the time the purchase order was issued, although the company’s policy was never changed. Thus, accounting practice remained out of compliance with GAAP. In fact, the passage of title or risk of loss is only one of the seven bill-and-hold criteria, all of which must be met in order to recognize revenue. In addition, the title passage clause did not change prior contracts, whose revenue had already been recorded. George did some additional research and found an article on Bill-and-Hold in the industry, written by a manager at the Corporation’s external audit firm.

Based on his understanding of company practices and his research, George published an internal memo describing his findings; he also sent a copy to the audit firm’s engagement team. The Corporation responded by conducting a survey to analyze the materiality level of the questionable transactions. According to George, they found the issue was widespread and material, as it was 20-25% of total revenue. The third quarter was coming to a close and the external auditors were onsite. George discussed the issue with both the Chief Accounting Officer and the audit engagement manager. Both assured him the Corporation would restate revenue and correct the error. However, when the quarterly financial statements were issued, there was no correction or restatement. George was surprised, but received no explanation. The controller, George’s boss, left the Corporation soon after and the CAO refused to meet with George to discuss the matter.
Faced with a dilemma, George considered his choices. He could go along with the Corporation’s treatment and let the issue drop. In other words, he could ‘take no action,’ keep his job, and continue to train the Corporation’s accounting staff. He could resign and find work at a different organization, leaving the Corporation to continue to file what George felt were inaccurate statements to the public. Alternatively, George could continue working within the Corporation, trying to gain support for his concerns internally. Last, George could pursue the issue and report his concerns externally, either to a regulatory body or to the media.

George carefully weighed his options. He had not faced a dilemma this serious in the past. His actions would affect his career, his family, the Corporation, and even the investing public. He took his wife and children on a short trip. He thought about the situation and asked himself, “What would my dad do?” In his heart, he just wanted the company to change its accounting practice, but he had been unsuccessful at this. In addition, the external audit manager knew of the situation, agreed with George, and still the audit firm gave the statements a clean opinion. George made a decision.

**Required:** Complete the following questions before proceeding with the case.

**Prevention**

1. Discuss how each of the following questions might have alerted George to the corporate culture of the organization when he was interviewing for the job. Could George have predicted ahead of time how the organization would react if he challenged their accounting practices?

    a. How is the company perceived in the media?

    b. How do employees describe the organization’s culture? What could George have done to investigate the “mood in the middle” and the “buzz at the bottom”?

    c. Is it enough to know that others from your current firm work there?
d. Do you have any information about how the firm has handled prior whistleblowing reports? For instance, have they required whistleblowers to sign arbitration agreements either before or after a whistleblower has made a report?

Choices

1. Professional guidance:
   a. Consult the AICPA Code of Professional Conduct. What components might guide a CPA working in a corporate environment?
   b. Consult the IMA Statement of Ethical Professional Practice. Describe how this case presents a conflict between Confidentiality and Integrity.

2. If you were in George’s position, whom would you talk to at the company? Outside the company?

3. Complete the Ethical Dilemma Resolution Framework, contained in the Appendix.
Part II:

George’s position:

George continued in his attempts to persuade the Corporation to modify their practices, to no avail. Finally, in November 2005, after the Corporation had filed its third-quarter financial statements with no revised revenue recognition policies, George sent a confidential email to the SEC and the PCAOB, outlining his concerns and implicating the CAO and external auditors. The SEC interviewed George about the Bill-and-Hold practice. After the Corporation filed their 2005 annual financial statements, the SEC opened an inquiry into their reporting practices. According to George, the SEC also encouraged him to contact the Corporation's audit committee. On February 4, 2006, George learned the Corporation had been contacted by the SEC and so he sent what he believed would be a confidential email, outlining his concerns, to the audit committee via a link on the company’s webpage. George was not prepared for what happened next.

The Corporation hired a law firm to investigate the Bill-and-Hold practices; after approximately 5-6 months, they reported that any issues with improper revenue recognition were immaterial to the company’s financial statements. The SEC also closed their case.

Meanwhile, contrary to promises made on the website, the legal department, rather than the Board of Directors, was first to receive George’s email. The General Counsel forwarded the email to the Chief Financial Officer, who shared it with others including the VP of Investor Relations, the Chief Accounting Officer, and the external audit partner. The CAO then sent emails to others in the company identifying George and his complaints to the SEC and company hotline; he further instructed his staff to investigate whether George had violated the company’s Code of Business Conduct by contacting the SEC. The audit committee eventually also received the email. When the SEC notified the Corporation they were opening an investigation of
accounting practices, the General Counsel sent out an email notifying key individuals the SEC was investigating “George’s complaint”; this email was shared widely throughout the organization.

Disclosure of George’s email to these parties resulted in retaliation in many forms. George was shunned by Corporation employees. The Corporation’s executives excluded him from all meetings with the external auditor, removed him from major projects and, worst, they took away his training responsibilities. With his job decimated, he asked to go on administrative leave.

Stunned by the Corporation’s actions, George sent the SEC a 50 page report with over 100 exhibits detailing the accounting practices he felt were questionable. He supplied his estimates of the amount in question, which he later found out were much larger than those the Corporation had reported to the SEC. George did not meet with the SEC until March 28, 2006. About the same time, April 1, 2006, George agreed to a 6-month administrative leave of absence from Corporation.

In September, the Corporation notified George his leave would expire at the beginning of October and they expected him to return to work. George believed the Corporation had not provided the SEC with enough evidence about the case, and that the SEC’s decision to close the case was based on incomplete evidence. The Corporation refused to allow George to have access to their final report to the SEC. On October 17, 2006 George submitted his resignation and retained his own counsel. In his letter of resignation, George stated, “I have every reason to believe that the Corporation intends to persist in violating securities laws and filing inaccurate and misleading financial information. Professionally and ethically, I cannot return to active employment under these conditions.”
The Corporation had informed him that when he returned to work in October, he would be reporting to someone at his own level. In addition, the conditions that existed before his leave would persist. He would not be placed back on projects, he would continue to be excluded from meetings, and he would not be able to train in-house accountants. He would not be able to meet with the external auditors, who George was told refused to include him in their meetings, which precluded him from carrying out his responsibilities as the company contact person in regard to accounting policy. George believed all of these changes were retaliation for his whistleblowing actions.

The Corporation’s Position:

Although company personnel initially did not disagree with George’s concerns, they did ask for further analysis of the issue in the fall of 2005. Because the person to whom he reported, the CAO, felt George had invested too much time and effort on this one accounting issue, they asked a senior accounting manager to perform the analysis (who did not consult George during this process) and this individual arrived at a conclusion opposite to George’s position. George’s superiors were also concerned about George’s leadership, stating that he was not collaborative or acting in the best interest of the company.

The Corporation further investigated the accounting issue by asking their internal lawyer (from the U.K.) to consider the issue. That attorney concluded the accounting treatment met revenue recognition requirements.

The SEC investigated George’s claim and formally notified the Corporation in September of 2006 that no enforcement action was being recommended. The Audit Committee’s investigation likewise concluded that no changes in the company’s accounting practices were needed.
Epilogue

Between May 2006 and September 2011, George pursued his cause through the US Court system. The Sarbanes-Oxley Act (SOX) was the prevailing regulation protecting whistleblowers at the time. Under SOX, George claimed he whistle blew in good faith and the Corporation retaliated against him. The retaliation included the disclosure of his identity to other employees and constructive discharge from his job. George lost his initial case and the Department of Labor (DOL) Administrative Law Judge dismissed his appeal.

After these losses, George’s attorney gave up, but George did not. He put together a petition for review and submitted it to the DOL Administrative Review Board (ARB). In September 2011, the ARB ruled that George was protected under SOX, and the Corporation did retaliate against him. They remanded the case back to the lower court. After more back-and-forth between the courts, he was notified in early 2013 of the appeal courts’ finding in his favor. This was a landmark decision that took George years to reach.

George has also moved on professionally; he is employed as an accountant again and despite his long and arduous journey, feels he has been able to effect positive change for future whistleblowers.

While you may never come across as serious a situation as George has, you will likely encounter situations where accounting judgments and decisions appear unclear. You may have to make a choice to stay, go, or whistle blow. It is beneficial to consider what you might do in such a situation, before the situation presents itself. Below are some discussion questions and exercises that can help you develop a strategy and perhaps lessen the chance you will find yourself in a dilemma like George’s.
Required: Complete the following questions.

Protection and the Regulatory Environment

1. What is the SEC authority for and policy on investigating financial statement misstatement?

2. Read the whistleblower provisions of the Sarbanes Oxley Act (SOX) – note that some provisions address required hotlines and others address retaliation against those who use the hotlines. Now, search the business press for articles and opinion pieces on these provisions. Based on your research, discuss whether SOX has sufficiently increased the likelihood an individual will report fraudulent financial reporting. Examples of questions you might address include: What real protection does SOX offer whistleblowers? How are whistleblower retaliation reports investigated under this law? Is the law producing its intended effect?

3. Read the section of the Dodd-Frank Act of 2010 related to whistleblowers. How does this newer act change protections and motivations for corporate whistleblowers? Search the business press for articles and opinion pieces on these provisions – describe the provisions and contrast them to those of SOX. Based on your research, discuss whether the Dodd-Frank Act of 2010 is likely to be more effective than SOX.

4. Based on your research, is there evidence whistleblowers are not equally protected and taken seriously across industries, company types (public/private), or levels of authority (their own) in the organization? Consider the reactions of the SEC and the PCAOB to George – did each organization react as you would have expected?

Individual Exercises

1. Research a recent (past 2 years) whistleblower case. Summarize the details of the case, including its resolution, if known. Identify and discuss key factors that influenced the whistleblower’s actions. Consider the individual’s personal characteristics, the corporate culture, and the subject of the whistleblower’s report.

2. Visit the SEC and PCAOB websites. Locate each agency's confidential hotline and analyze and evaluate their policies regarding their hotline use.
Case Learning Objectives and Implementation Guidance

In Part I of this case, we describe an actual ethical dilemma faced by an accountant and, in Part II, we discuss his actions and the resulting ramifications. Our goal is not to discourage whistleblowing - quite the contrary. However, it is important for accounting professionals and students to understand the possible consequences of corporate misconduct and regulatory failure by humanizing the discussion.

We divided the case into two parts in order to encourage students to think through the full array of possible actions available to "George," before they narrow their perspective by reading about the course George actually took. Possible solutions to the questions are provided in the Teaching Notes, although you may be surprised to find your students suggesting answers that you, and we, had not considered. Ethical dilemmas are a uniquely personal conundrum, and individuals must forge a solution that is satisfactory to their individual combination of ethical, religious, cultural, and social influences. However, the resolution framework (see Appendix A) encourages them to pay particular attention to laws, regulations, and codes of conduct to which they may be subject.

Our goal is to stimulate thought and discussion among accounting students, as an aid to ethical reasoning development. While this case is based on actual events, we write primarily from the whistleblower's perspective. We do not assert that "George" was correct in every evaluation he made regarding the actions of the Corporation and regulators - that is for the courts to decide.¹

¹ The press covered the actual lawsuit. Related news stories and legal filings are located online. It is possible that students may locate these items and bring them into class discussions.
We provide questions compatible for either in-class discussion or outside completion. To develop research and critical thinking skills, we include questions requiring students to form opinions based on news stories and published articles. Our students have greatly enjoyed discussing the case both in groups and in an open class setting. We wrote the case to address primarily ethical decision-making, which is accounting issue-neutral. However, for those instructors who would like their students to delve more deeply into Bill-and-Hold, we suggested they refer students to the related article accessible at http://www.trinity.edu/rjensen/BillandHold.pdf.

If you would like the Teaching Notes to this case, please contact either of the authors.

Classroom Experiences

This case is purposely ambiguous with respect to management’s accounting decision, as real-world situations often involve areas requiring professional judgment and have no clear answers. Coverage of the Bill-and-Hold accounting issues is not an objective of this case. Instead, our use of the case has been for the purpose of discussing ethical dilemmas in accounting classes.

Over 200 undergraduate and graduate students have worked the case. The case has been completed outside of class over a 2 week period for a grade, and as an in-class case. In all instances, we have had extensive in-class discussion. Students found the case to be interesting, commenting on the realism. Students were able to complete all questions asked.
Additionally, the Ethical Dilemma Resolution Framework has been used by one of the authors for a number of years in several types of courses. Students find the requirements of step 6, identifying the possible consequences of their actions, to be the most challenging.

References and additional resources:

Appendix A:

Ethical Dilemma Resolution Framework*

1. Determine the facts and identify the ethical dilemma involved

   **Facts:** List the facts relevant to the ethical dilemma - describe the situation and how the person or firm got into the situation.

   **Dilemma:** Identify from whose perspective you are analyzing the case and explain the ethical dilemma the person or firm is facing.

2. Determine the affected parties and identify their rights

   For each party currently affected by the problem or who could be affected by the solution, describe their interest and identify their rights in regard to this situation. (Note: Just because someone may want or prefer something, doesn't mean it is their right to have it.)

3. Determine the party with the most important rights

   Identify who you feel has the most important (prevailing) rights. Obviously, if you are resolving the situation, you will be the one determining the most important rights - recognize in your write-up that this is only one person's opinion.

   You must pick only one party here. Two parties typically have at least some rights in conflict and you cannot give the two conflicting rights equal status. Thus, when selecting

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* Rights are having a claim or title to an item or a particular behavior. Many individual rights arise from basic human rights, such as life, liberty and the pursuit of happiness. Beliefs about such rights may differ among individuals; for example, one person may believe that individuals have a right to gainful employment, while others may view this as a privilege. Additionally, laws and moral obligations confer rights upon a person, such that individuals have the right to meet their obligations or legal responsibilities. The critical point here is that individuals affected by this dilemma have ‘rights’ that could be impeded by our decision regarding resolution of the dilemma. Additionally, one person’s rights can conflict with another’s rights, and the individual with the ethical dilemma must first recognize all rights, and then prioritize them.
your solution strategy, you must know whose interests must prevail when those interests are mutually exclusive.

4. Identify the applicable laws or codes of conduct

For each law or rule, completely identify its origin. Then describe what the rule or law is and why it is applicable to this particular case. It must be applicable to the person or firm having the ethical dilemma (identified in Step 1).

5. Develop alternative courses of action

This is a brainstorming process. List all the options available to the individual or firm with the ethical dilemma. Do not evaluate the options at this point, but do completely explain each.

Then use the results of your brainstorming to create 3 or 4 possible courses of action. These should be mutually exclusive. Additionally, when you pick the best alternative in step 8, you can pick only one of the courses of action you list here; thus, each must be complete as to the process.

Example: it may be that a person is violating company policy. Two options are to speak to the person about it or to report them. Therefore, one course of action might be to first speak to the person, and if they don't correct their behavior, you will report them to their superior. An alternative course of action would be to report the violation, without taking the step of speaking to the person first.

Note: In resolving an ethical dilemma, you can only decide on your own actions; you cannot decide on the actions of others. Others may or may not act as you desire, therefore you must build contingencies into your plan. You also cannot change what has already occurred, you can only plan for what will happen in the future.

6. Determine the possible consequences of each proposed course of action.

Again, this is a brainstorming process. For each possible course of action, list ALL of the possible consequences to each affected person for each alternative. Some may not be very probable, but now is not the time to eliminate them. An incomplete solution to this step is a common cause of unsatisfactory resolution of a dilemma. Then, organize your brainstorming ideas. Consider each of the affected parties in finalizing your list of possible consequences.
7. Assess the likelihood of each possible consequence of each proposed action.

For each possible consequence you listed in step 6 above, assess the likelihood of the consequence occurring, if the individual or firm with the ethical dilemma takes that course of action.

8. Decide on the appropriate course of action

Based on your analyses in steps 1 through 7, select one of the alternatives as your solution strategy. This should be an action favoring the party with the most important rights, as identified in step 3. If there are multiple steps you would like to take, they must be completely contained within one alternative in step 5. For example, if you want to talk with management and then withdraw if they don't agree to your recommendations, then this must be completely explained in one alternative in step 5.

*Note: Why can we not select two alternatives? The reason lies with the possible consequences of the alternatives. Consequences of possible courses of action should significantly impact your selection of the most appropriate course of action. Unfortunately, when you string two courses of action together, the first action may change the consequences of the second action, compared to taking only the second action alone.

*Example: You win $25,000. Possible courses of action include: (1) buying a pool table, (2) buying a car, (3) investing for retirement, (4) paying off credit cards. Each is less than $25,000, so any one course of action alone is possible. But, if you buy a car and then invest for retirement, the investment you could make would be significantly less than if you chose this as your initial and only option. Thus, the first action has changed the scenario for the second.

*Example: You get stopped by the police for running a yellow light. Your possible courses of action include: (1) scream at the officer for inconveniencing you, (2) explain to the policeman the sun was in your eyes and you couldn't see, (3) tell him the person behind you was going so fast that you thought they might rear-end you if you didn't go on through the light, (4) take the ticket and pay it. Alternative 3 may be very productive and result in a positive solution, depending on how convincing you are. However, if you take course of action 1 (screaming) before taking action 3, you probably won't care for the ultimate outcome. Taking action 1 changes the possible consequences and the likelihood of those consequences for action 3. Although this is an extreme example, there are many parallels in the business world.

* This framework is derived from that presented in Rittenberg, Johnstone, and Grambling (2012). Alternative decision frameworks may be employed, including Rest (1986).