ETHICS
A Flexible Framework

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What is “ETHICS”?

- Dullest class of the entire seminar series?
- The snoozer/loser” session?
- Best time to check messages and return telephone calls?

- **NO!**

- From the Greek word “ETHOS” meaning CHARACTER
- Study of moral behavior

What is "ETHICS"?

- Codify the "Golden Rule"
- INPUT your specific "Facts and Circumstances"
- OUTPUT goes into the proper pigeon hole

- What happens if you don't have enough pigeon holes?

- You suffer "The Chauffer and the Professor Syndrome"

What is the Solution?

- More pigeon holes?
- **NO!** Who wants to memorize hundreds upon thousands of more pigeon holes?
- Need a "flexible framework" to use for the analysis of any situation

Flexible Framework
3 Questions

- 1. Is there a DUTY?
- 2. Is there a BREACH of that DUTY?
- 3. How much does it COST to fix it?

(As explained by a retired Federal Judge)

1. Is there a DUTY?
Sources

- Government Agencies – federal, state & local
  i.e. IRS, SEC, DOL, FinCEN, U.S. Tax Court, OTC, OESC
- Statutes and ordinances
- Administrative Regulations
- Professional Associations
- Common Law (often overlooked)

1. Is there a DUTY?
Sources

- Often interwoven and overlapping
- If in doubt, use the strictest interpretation
- Pay attention to the "burden of proof" standards
  - Civil – preponderance of the evidence
  - Criminal – beyond a reasonable doubt
  - Split decision in O.J. Simpson's criminal and civil trials
- Example of different standards are like expectations for Football coaches
  - OU – Win the Big 12 Championship, be a national contender
  - OSU – Beat OU! Keep T. Boone Pickens happy!
  - TU – Can we go BOWLING this year?

1. Is there a DUTY?
Recipients

To Whom is the DUTY owed?

- Client
- Client's employees
- Independent Contractors
- Employer i.e. Internal Auditors
  - *Extraordinary Circumstances* by Cynthia Cooper describes the WorldCom debacle – an accounting whodunit
  - The AJEs had over 3 million lines of corrections
  - Yeah, Bernie knew what was going on

1. Is there a DUTY?
Recipients

To Whom is the DUTY owed?

- Shareholders
- Government Agencies
- Banks and other lenders
- Other 3rd Parties that rely upon your work

1. Is there a DUTY?
Recipients

Hypothetical Example

- Chauffer negligently collides with another car filled with dynamite, causing an explosion
  - A is on a nearby sidewalk and is killed
  - B is sitting in a window across the street and is injured
  - C is sitting in a window 1 block away and is injured
  - D is sitting in a window 10 blocks away and is injured
  - D drops a baby he is holding
- To whom is a DUTY owed? A? B? C? D? Baby?

1. Is there a DUTY?
Helen Palsgraf

- *Palsgraf v. Long Island Railroad Co.*, 248 N.Y. 339, 162 N.E. 99 (N.Y. 1928)
- 2 Italian passengers trying to board the train as it pulls out of the station
- The 1st Italian makes it okay, the 2nd Italian starts to fall
- The 1st Railroad Guard pulls the tipsy Italian while the 2nd Railroad Guard pushes – the 2nd Italian successfully boards
- BUT, the commotion causes a package to drop onto the tracks
- The package contains fireworks which EXPLODES – KA-BOOM!

1. Is there a DUTY?
Helen Palsgraf

- The shock from the explosion knocks over a set of scales 10-25 feet away which falls onto Helen Palsgraf while holding her ticket
- Her 2 daughters are okay
- Helen Palsgraf injuries are not physical
- Helen Palsgraf has a nervous disorder
- Helen Palsgraf sues the Long Island Co. for NEGLIGENCE

1. Is there a DUTY?
Helen Palsgraf

- What do YOU think?
- Smells like NEGLIGENCE
- Jury and Trial Judge say YES (1 Yea)
- Appellate Court says YES (3 Yea's, 2 Nay's)
- Supreme Court say NO (2 Yea's, 4 Nay's)
- 7 of 13 Judges favor Palsgraf – the majority
  BUT she still loses her case
- The Supreme Court is not final because they are right
  They are right because they are final

1. Is there a DUTY?
Helen Palsgraf

- Chief Justice Benjamin Cardozo authored the majority opinion (Future U.S. Supreme Court Justice)
- Long Island RR Co. owes a DUTY to the 2nd Italian
- Long Island RR Co. DOES NOT owe any DUTY to anybody else including Helen Palsgraf
- Injury not "Reasonably Foreseeable"
- Never should have gone to the jury
- Adding insult to injury, cold-hearted Cardozo imposes the costs upon Helen Palsgraf!

1. Is there a DUTY?
BONUS ROUND

- *Kinsman Transit Co.*, 338 F.2nd 708 (2nd Cir. 1964) - #1
- *Kinsman Transit Co.*, 388 F.2nd 821 (2nd Cir. 1968) - #2
- The first boat operated by the Kinsman Transit Co. was improperly moored
- During a storm, it broke free and crashed into a 2nd ship which also broke free
- Both boats crashed into a bridge which collapsed and blocked the river
- The river flooded the adjacent land and prevented any traffic from traversing the river until wreckage cleared

1. Is there a DUTY?
BONUS ROUND

Is there a DUTY owed by Kinsman Transit Co. …

- To the property owners adjacent to the river?
- To the boat and cargo owners unable to move until the river was cleared?

What do YOU think?

The COURT said …

- YES to the property owners
- NO to the boat and cargo owners able to move until the river was cleared

Knowledge ≠ Understanding

- Know the 3 Questions
- Let's Understand through Practical Application
  - Identify
  - Analyze
  - Decide
  - Repeat

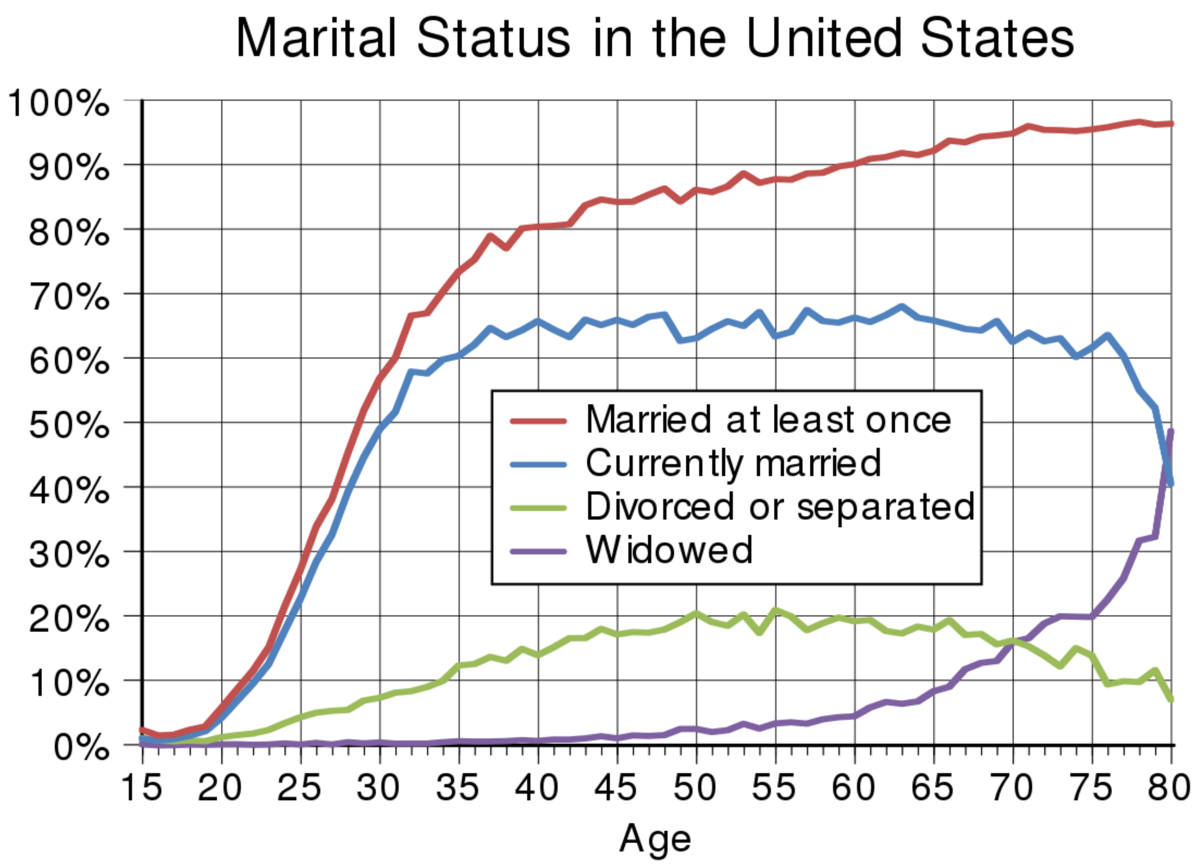
- Backwards Brain Bicycle – Smarter Everyday #133
  https://youtu.be/MFzDaBzBlL0

Leading Cause of Divorce?

MARRIAGE !

Unless you are in Kansas

Americans Believe in Marriage



Americans Believe in Divorce

- Researchers estimate that 40% to 50% of all first marriages will end in divorce
- Researchers estimate that 60% of second marriages will end in divorce
- Most Americans (70%) believe that divorce, in general, is a morally acceptable choice

Odds are, you will deal with this type of ETHICAL dilemma in your career

Types of Changes in Marital Status

- Single to Married (traditional or common-law)
- Single to Remarried
- Married to Separated
- Married to Divorced
- Married to Abandoned (no common-law divorce)
- Married to Deceased
- Still Divorcing (NY State record is 21 years; married for 16)
- Repeated Divorce Filings

Flexible Framework & Fun Facts

- 1. Is there a DUTY?
- 2. Is there a BREACH of that DUTY?
- 3. What does it COST to fix it?

Glynn "Scotty" Wolfe, a Baptist Preacher from Blythe, CA, holds the world's record for largest number of monogamous marriages for men – 29

Linda Wolfe holds the world record for largest number of monogamous marriages for women - 23

What Duties do we owe our Clients?

- Confidentiality
- Loyalty
- Not create a conflict-of-interest
- Not act against client's best interest without informed written consent
- Timely communication
- Competence
- Ethical, zealous representation within the bounds of the law

Financial Issues – Marriage & Divorce

- Separate Property
- Separate Debts
- Community Property
- Community Debts
- Spousal Support (aka Alimony)
- Child Support (in OK, use statutory guidelines)

Financial Issues - Assets

- Homestead
- Rental Real Estate (Schedule E)
- Farm or Ranch (Schedule F)
- Oil & Gas Interest / Mineral Interest (Schedule E)
- Financial Investments & Retirements Accounts (1099-DIV, 1099-INT, 1099-R)
- Life Insurance

Financial Issues - Debts

- Secured Debt
  - Mortgage
  - Car Loans
  - Boat Loans
  - Business Loans
  - Credit Cards from Mortgage Company or Bank
  - Taxes

Financial Issues – Debts (continued)

- Unsecured
  - Credit Cards
  - Family & Friends
  - Taxes
- Priority
  - Student Loans
  - Taxes

Exercise #1

- Adam, son of a client, is graduating from OSU with a Master's Degree in Business Administration
- Adam is engaged to his high school sweetheart, Eve, and they plan to get married later this summer
- Eve is graduating from the University of Tulsa, School of Law

Exercise #1 – Issues

- Is Adam your client?
- Is Eve your client?

- Taxes?
- Credit Cards?
- Student Loans?

Exercise #2

- Same facts as #1
- Adam is your client
- Eve owes $1,000 in delinquent taxes
- Eve owes $9,000 in credit cards
- Eve owes $90,000 in student loans

- Neither Adam or You know about Eve’s debt

Free Credit Report

- AnnualCreditReport.com
- Search "free annual credit report"; look for the result that ends in ".gov" (https://consumer.ftc.gov) and follow the link

- Equifax
- Experian
- Trans-Union

Tax Return Info

- Provide copies of prior year tax returns
- IRS Form 4506-T Request for Transcript
- IRS Form 2848 Power of Attorney and Declaration of Representative
- Personally visit the local IRS and OTC offices

- Does the IRS Form 4506-T create a client relationship
- Does the IRS Form 2848 create a client relationship since it is a POA?

Student Loans

- Harder to independently verify
- IRS Form 1098-E Student Loan Interest Statement
- IRS Form 1098-T Tuition Statement (May have been used on parents' income tax return)

- Who cares what the answer is?
- Is the situation a valid predictor of how the "happy" couple will handle future financial issues and conflicts?
- Sit back and watch the FIREWORKS?

Exercise #3

- Same facts as Exercise #1 and #2
- Eve is also your client
- You are aware of Eve's debt
- But, you have not been requested to do anything yet

Exercise #4

- Same facts as Exercises #1 to #3
- Adam and Eve have requested copies of their prior year returns
- Applying for a car loan
- Eve requests that you not disclose her debts to Adam
- Eve promises "to take care of it" – Eve's new job will pay her a signing bonus and pay-off her student loans after completing 5 years of employment

Exercise #5

- Same facts as Exercises #1 to #4
- Adam was "visiting" an ex-girlfriend from Kansas to break the news of his engagement to Eve – things did not go well – Eve doesn't know about the trip
- Adam has a $12,000 out-of-state judgment against him
- Adam requests that You not disclose to Eve the existence of this debt
- Adam and Eve are applying for a mortgage so they can buy a house
- Adam's Dad calls and wants to know if YOU know why Adam is so "glum" lately

Exercise #6

- Same facts as Exercises #1 to #5
- Adam and Eve were happily married last summer
- Adam and Eve bought a new car and house
- Since you timely filed their extensions, Adam and Eve brought their tax info to you on September 30th
- Eve is pregnant with twins (due January 1st), and medical complications may impair her future employment
- Adam's "out-of-state" judgement was for alimony even though never married

Highlights of Exercises #1 to #6

- Know when you have a “client” relationship
- Your “DUTY” does not begin until you have this relationship
- Be careful about expanding your role beyond that of a CPA
- Clients don’t always tell you the WHOLE truth
- Things don’t always work out as planned
- You must continually evaluate your client relationship
- You must continually evaluate your client relationship
- You must continually evaluate your client relationship

Identify Potential Financial Issues

- Birthdate of twins will determine eligibility of child credits
- Eve’s medical condition could significantly reduce her earning capacity
  - Car loan
  - Home loan
  - Student loan
  - Extraordinary medical expenses
- Disability? (temporary or permanent)
- Estate planning
- ☺ How is that “SOUL MATE” thing working out?

Exercise #7

- Meet Clyde – a banking consultant that works out of his home
- Meet Bonnie – a school teacher
- His and Her adult kids
- Married for 10 years
- They have agreed to an "uncontested" divorce
- Clyde has always handled the finances, tax return preparation, etc. What little information is available, Clyde keeps locked away in his office

Exercise #7 (continued)

- House owned by Bonnie before she was married to Clyde
- During the marriage, Bonnie made all the mortgage payments from her separate income
- Clyde and Bonnie have agreed to let you "organize" their financial information for their uncontested divorce
- Bonnie explained all of this to you during your first appointment with her

Exercise #7 – Recommendations

- Determine the tax liability
- Determine the credit card liability
- Determine the mortgage liability
- Determine other financial issues
- Do you accept the engagement

Exercise #8

- Same facts as Exercise #7
- Clyde has been completely unresponsive
- You have had no communication back from Clyde
- Taxes – delinquent for past 2 years; current year not filed
- Credit bureau reports
  - Clyde's credit score so bad, he has no credit cards
  - Bonnie has $20,000 in credit card debt in her name; she only recognizes one account which she had before they were married
- All payments made to you, drawn on Clyde's business checking account

Exercise #8 - Questions

- Who is your client?
- Does "payment" automatically make someone your client?
- What about filing the income tax returns?
- What filing status should Bonnie & Clyde use?
- What about credit cards? Call and cancel?
- What about the credit bureaus?

Exercise #9

- Bonnie filed all 3 years of income tax returns as "Married Filing Separate" since Clyde did not provide any tax-related information
- Clyde has agreed to repay the $20,000 of credit card debt to Bonnie as part of their property settlement
- Clyde has been talking to a bankruptcy attorney and needs to be current on his income tax returns
- Clyde would like YOU to help him file his income tax returns since you are already familiar with his situation and he has finally "found" his paperwork

Exercise #10A

- Rhett and Scarlett have been married for 30 years
- Rhett is a Lawyer/CPA; Scarlett is a Nurse
- Rhett takes care of all the finances, tax return filings, etc.
- Scarlett just got notice that her license could not be renewed because of an outstanding balance with the OTC
- Scarlett shows YOU the paperwork at church and asks if you can help her get her license renewed

Exercise #10B

Scarlett comes to your office

- Telephone call to the OTC reveals:
  - All the income tax returns have been filed
  - $100,000 is owed for the past 10 years

- Telephone call to the IRS reveals
  - All the income tax returns have been filed
  - $500,000 is owed for the past 10 years

Exercise #10C

- Account Transcript shows bankruptcy filing in 2015
- IRS-provided copy of tax return shows Scarlett is the only W-2 wage earner
- Scarlett has no recollection of ever seeing or signing anything related to the taxes
- Louis Tully (a NYC transplant), a CPA in Rhett’s firm, always prepared the income tax returns

Exercise #10D

- Copy of bankruptcy petition shows a 401k plan with $600,000 (How is this possible if Rhett is an "independent contractor"?)
- Rhett and Scarlett own a 2nd home on Grand Lake
- Rhett and Scarlett own a 20-foot inboard/outboard boat
- Bankruptcy case originally filed as a Chapter 7
- Bankruptcy case originally filed as a Chapter 13
- After Chapter 13 Plan not confirmed, case was dismissed

Exercise #10E

- Scarlett files for divorce
- Rhett represents himself in the divorce
- Rhett awarded the houses, boats and debt
- Scarlett awarded the 401K plan now totaling $750,000 as a property settlement
- Scarlett awarded $2,000/month in spousal support (alimony) for 15 years
- After divorce decree finalized, it is discovered that Rhett moved the 401K to another broker
- After moving the 401K plan, Rhett withdrew $350,000

Exercise #10 - Questions

- Have you acted "ethically"?
- Are you sure?

- Do you have a DUTY to report Rhett?
- Do you have a DUTY to report Louis Tully?
- Do you have a DUTY to report Rhett's firm for allowing an independent contractor to participate in the 401K plan for employees?
- Do you have a DUTY to go on vacation?

Quotes

- Students look up for inspiration; look down in desperation; and left and right for information
- I've had a lot of worries in my life, most of which never happened.
  – Mark Twain
- Ethics are so annoying. I avoid them on principle.
  – Darby Conley
- Ethically, she couldn't cause the suffering of any living thing. Logically, bacon cheeseburgers were delicious.
  – Thomas Quackenbush, *We Shadows*

Bonus Round #1

- Bonnie's adult children called; before the divorce was final, Bonnie was killed in a weather-related accident
- The $250,000 life insurance policy provided by her employer named Clyde as the beneficiary
- Since you knew about the life insurance (excess premium payments reported on her IRS Form W-2), why didn't you encourage her to change the named beneficiary?
- Bonnie's adult children would like copies of her prior year tax returns
- Clyde called and would like copies of Bonnie's prior year tax returns
- Clyde would like your help amending the returns to "Married Filing Joint"

Bonus Round #2

- Scarlett's parents called
- Scarlett is in the hospital on life-support, and Rhett is her health care proxy and is anxious to stop all heroic measures before the end of the month
- Upon her death, Rhett won't have to pay anymore alimony
- Why didn't you encourage her to update her estate plan?

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