# Suggestions for Solving Cheating Scandals at Public Accounting Firms

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## ABSTRACT

*The purpose of this paper is to provide suggestions that may help to resolve problems that public accounting firms have experienced with employees cheating on the AICPA's ethics exam and on training exams, including Continuing Professional Education (CPE) exams. To form these suggestions, we analyzed the recent cheating scandal at Ernst & Young (EY) that was widely publicized in June 2022. Our suggestions include: (1) impose more effective penalties and deterrents; (2) redesign the ethics exam; (3) implement mandatory time for CPE and provide confidential outplacement services, and (4) rethink CPE requirements for the profession as a whole.*

**Subject Areas**: Accounting, Business and Society
**Article Type:** Viewpoint

## INTRODUCTION

On June 28, 2022, the Securities and Exchange Commission (SEC) announced that it had fined EY $100 million, the highest fine that the SEC has ever levied against an auditor (Securities and Exchange Act of 1934 release no. 95167, 2022). From 2017 to 2021, 49 EY employees had shared answer keys on the AICPA's ethics exam, which most states require for CPA licensure. Hundreds of employees had shared answer keys on continuing professional education (CPE) courses, some of which covered ethics. The firm had also misled the SEC's Division of Enforcement in 2019 about whether cheating was ongoing at the firm in response to a formal request from that division. In fact, EY had received a report about cheating on the ethics exam the same day that the division made its request. EY's subsequent investigations determined that the report was accurate, but EY did not notify the SEC.

EY also failed to disclose to the SEC that more than 200 employees cheated from 2012 to 2015 via a software bug that would allow them to earn a passing score on CPE, even if they had answered only one question correctly (Securities and Exchange Act of 1934 release no. 95167, 2022). In addition to paying the $100 million fine, SEC mandated EY to hire two independent contractors to (1) review EY's policies and procedures on ethics and (2) evaluate EY's failure to report prior cheating violations to the SEC. The SEC emphasized the irony that EY's employees cheated on ethics.

Unfortunately, this cheating scandal was not an isolated event, earlier in February 2022, the Public Company Accounting Oversight Board (PCAOB) fined and censured PwC Canada, a member of PwC Global, for violating its quality control standards (PCAOB Release No. 105-2022-002, 2022). Over 1200 employees ranging from partners to junior staff members had shared answers to internal training tests, mainly related to assurance training, from at least 2016 to early 2020. Methods used to share answers included the firm's share drive, email, hard copies of answers, and in-person communication during the tests. Because PwC Canada voluntarily reported this information when it learned about the cheating and was cooperative with the PCAOB's investigation, the fine was set at $750,000. PCAOB also directed the firm to launch or modify applicable polices and procedures within 90 days.

Just three years before the EY scandal, the SEC fined Klynveld Peat Marwick Goerdeler (KPMG) $50 million for extensive cheating on internal training courses (Securities and Exchange Act of 1934 release no. 86118, 2019). The approaches to cheating were often similar to those at EY. Employees, including partners, shared answer keys with other partners and other employees. They also adjusted computer coding so that they could lower the minimum scores required to pass internal training. Unlike EY, KPMG had also corrected audit working papers after the fact to improve the outcome of its PCAOB inspection. The firm had obtained confidential information about which files the PCAOB planned to inspect from an outgoing PCAOB employee who KPMG subsequently hired.

We believe that remedying cheating at public accounting firms is paramount for several reasons. Broadly speaking, the scandals may erode the public's confidence in the accounting profession, which itself serves as a lynchpin for establishing trust in the integrity of financial markets. At another level, it is possible that the cheating both symptomatizes and perpetuates organizational cultures that accept (1) professional incompetence---which may stem from lackadaisicalness about professional education---and (2) compromised ethical behavior that trickles down from cheating on professional education to lapses in integrity when conducting actual professional engagements. Gaming PCAOB inspections (Securities and Exchange Act of 1934 release no. release no. 86118, 2019) and recent accounting scandals (e.g., Wirecard AG, Luckin Coffee Inc.) lend at least some credence to these concerns.

Our analysis is particularly focused on the EY scandal due to its recency, magnitude, and continuation of the earlier episodes at PwC and KPMG that may have appeared to have been resolved. Our analysis has yielded four suggestions that we believe will help to resolve cheating problems at public accounting firms.

## SUGGESTION 1: IMPOSE MORE EFFECTIVE PENALTIES AND DETERRENTS

EY made efforts to stop employees from cheating during each wave of the scandal, although we believe that adopting and consistently enforcing a policy of automatic termination for cheating might have been more effective (Securities and Exchange Act of 1934 release no. 95167, 2022). In some cases, the firm took (unspecified) disciplinary actions; it issued multiple reminders, including statements that cheating violates the firm's code of conduct; it added warnings about cheating to CPE exams. However, the cheating continued. The SEC points out that 91 EY employees cheated or attempted to cheat following the firm's announcement about the SEC's settlement with KPMG. Other EY professionals failed to report cheaters, which is a breach of EY's code of conduct.

We conclude that EY's extensive efforts were not sufficient deterrence, nor do we believe that the SEC's fine at the firm level is likely to have a sufficient impact on individual behavior. Instead, we suggest that harsh penalties need to be enacted at the individual level. Such punishments send stronger signals to others not to cheat because bystanders will witness cheaters suffering either career-damaging or career-ending repercussions. In addition to providing deterrence, these offenders will be punished appropriately so that future potential victims will be protected.

The SEC has stated that its investigation is ongoing, and it has not announced whether any actions have been taken against individuals involved in the scandal (SEC Press Release, 2022).
However, the following are examples of the kind of action, we hope that the SEC is considering or will consider in the short run:

- Issuing a public administrative order naming all offenders and describing their role in the scheme. This same order should ban cheaters on the ethics exam from auditing publicly traded companies and from serving as officers or board members of publicly traded companies for at least five years.
- Forwarding the proposed administrative order referenced above to applicable state boards of accountancy, with an offer to provide all supporting documentation. The state boards should revoke or deny the initial licensure of those who cheated on the ethics exam. The state boards should evoke the harshest penalties related to cheating on CPE allowed under their regulations.

In the long-term, it may be beneficial to expand the SEC's enforcement powers. Currently, the SEC is limited to taking civil and administrative actions (SEC, 2007). Fines and, on some occasions, imprisonment may result from violating some of the SEC's civil orders, such as failure to comply with injunctions. However, sophisticated offenders may believe that stiffer enforcement of white-collar crimes is less likely because the SEC must refer criminal investigations and enforcement either to other federal agencies, such as the Department of Justice, or to state agencies. Consequently, staffing the SEC with its own criminal investigators who are able and willing to prosecute criminal offenders directly may be a more effective deterrent and punishment for audit failure, when criminal enforcement is warranted. The increased possibility of criminal penalties for white-collar crimes, in turn, might also reaffirm the seriousness of professional education in the minds of accounting professionals.

Finally, we note that fines may not be particularly punitive for firms like EY that have deep pockets, even though the recent $100 million fine is the largest one against an auditor in history. Consider that EY has an estimated 3500 partners (Statista, 2022). Each partner would be liable for only $28,571 if the partners had to cover the $100 million fine out of pocket, rather than depending on their professional liability insurance or other contingency reserves. This amount is only about 61% of the price of a new car, paid for out of a 6- or 7-figure salary (Glassdoor, 2022; Preston, & Bartlett, 2022). Jointly the SEC and PCAOB can issue numerous types of sanctions that extend as far as suspending or revoking firms' registrations (PCAOB, 2004). We believe that sanctions are more likely to be effective deterrents at the firm level.

## SUGGESTION 2: REDESIGNING THE AICPA ETHICS EXAM

The AICPA's ethics exam is currently an "open-book, take-home" test, meaning it is not proctored; notes and course materials can be used, and there is no time limit. This type of exam is ripe for cheating. In addition, we noted that downloadable pdfs of answer keys appear to be readily available on the Internet,[1] and at least one company provides flashcards that could be used as aids when taking the exam. Consequently, at a minimum, we suggest implementing online proctoring software to monitor test-takers. Randomizing test questions from a test bank so that each test is unique will eliminate the possibility of sharing answer keys. Setting a time limit on the exam may also be helpful in preventing cheating, because if test takers have sufficient time to submit responses only, they may lack time to cheat.

Prohibiting the use of any materials during the exam may prevent the use of answer keys that can be disguised as course materials or notes. This prohibition may also make it easier to proctor the exam online because there will be no need to ascertain what materials the test taker is using. An alternative could be to

[1]We have reported this information to the SEC.

have test takers go to a testing center, where a human proctor could provide only course materials to the tester.

The testing software should prevent printing questions and taking screenshots, and phones and cameras should be barred. Also, it is important that the test bank remain secure and not be released to vendors who may publish the test questions. The current requirement of a relatively high minimum score on the test, which is 90 percent in most states, might need to be reconsidered depending on how the exam is redesigned.

## SUGGESTION 3: IMPLEMENT MANDATORY TIME FOR CPE AND PROVIDE CONFIDENTIAL OUTPLACEMENT SERVICES

EY employees who cheated tended to explain that they did so because they had too many other professional responsibilities or because they had tried taking tests on their own and could not pass (Securities and Exchange Act of 1934 release no. 95167, 2022). Consequently, public firms should build mandatory time for CPE into their employees' schedules. Employees' work output should be evaluated based on completing their CPE independently, not just on billable hours.

At the same time, when employees experience extreme problems with juggling professional responsibilities and passing tests, these problems may indicate that they are in the wrong career. A career in accounting, especially public accounting, is highly demanding. Thus, all employees might be counseled in a supportive, non-judgmental way that if they feel they need to cheat because they cannot answer questions correctly on their own, it may be a sign that they need to consider another career. They should be given the opportunity to use high-quality, confidential, effective outplacement services for free.

## SOLUTION 4. RETHINK CPE REQUIREMENTS FOR THE PROFESSION AS A WHOLE

We also believe the problems that EY professionals had with completing CPE may have some legitimacy, although we would never condone cheating as a solution to these problems. There are exceptions in some states, but CPAs generally have to complete substantially more hours of education each year than lawyers and physicians (National Business Institute, 2021; CECENTRAL, 2023). Perhaps, it is time to start asking whether 40-hours of CPE is a worthy standard or whether it is counterproductive. We have observed that the 40-hour requirement often reduces learning: It can incentivize cutting corners and can lessen the information CPAs actually understand and retain. At an extreme, it could also encourage sharing answer keys.

Lengthy CPE course materials can be dense and lack readability. Consequently, CPAs may find themselves scanning text for answers to test questions, rather than reading the material thoroughly. For some CPAs, this tendency could, eventually, also lead to sharing answers. It might be time to set a new standard for more concise and clearer course materials.

In addition, computerized self-study CPE tests could easily be proctored online and questions can be drawn randomly from a larger pool of questions, so that not everyone has the same test or answer key. Alternatively, all courses could be administered online as webcasts to assure that CPE hours are fulfilled, with embedded attention checks in lieu of tests. As it is, it is simply too easy for people to share answers to CPE tests.

## CONCLUSION

The road to solving cheating at public firms will not be easy. One study concluded that nearly 21% of a sample of more than 64,000 undergraduates in the US and Canada self-reported that they have cheated on a test (McCabe, 2005). Such ingrained behaviors are likely to be difficult to change. However, we believe that our four suggestions offer some practical solutions for remedying problems with cheating at public accounting firms.

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