THE STOCK MARKET GAME™

Ethics in the Stock Market

Suggested Grade and Mastery Level

High School – all levels

Project Overview

This project focuses on the importance of ethics in the stock market, particularly the quality of accounting audits, the issue of insider trading, and the role of regulation enforcement. Students will gain an understanding of how investors rely on the ethical disclosure of information to make the financial markets fair.

There are a variety of activities to involve students in considering ethical issues related to the managing of their SMG portfolios

Teacher Background

Regulatory agencies such as the SEC and auditors are in place to protect the investing public. Recently a lack of ethics by a few financial business managers on Wall Street have increased the awareness of the importance of full disclosure in financial reporting, as well as the unfairness of insider trading. A few examples are Martha Stewart, Tyco, Rite Aid, Enron and WorldCom.

Various on-line sites are available to help teach this lesson. To read an article about the accounting errors of Enron collapse titled *Bigger Than Enron* visit:

http://www.pbs.org/wgbh/pages/frontline/shows/regulation

This article can be printed and given to students if you do not have a reliable Internet connection. A copy of this article can also be ordered from **http://www.pbs.org** .

Additional information about insider trading is available at

- Securities and Exchange Commission (SEC) - **http://www.sec.gov/answers/insider.htm**
- Investopedia - **http://www.investopedia.com/articles/03/100803.asp**.

Vocabulary:

Ethics: The study of the general nature of morals and the specific choices to be made by a person.
Code of Ethics: A set of rules or principals of personal or professional conduct.
Securities and Exchange Committee (SEC): A federal agency that regulates the U.S. financial markets. The SEC also oversees the securities industry and promotes full disclosure in order to protect the investing public against malpractice in the securities markets.
Accountability: Taking responsibility for one's actions and the use of resources entrusted to one's stewardship.
Conflict of interest: Exercising decision-making capacity in matters involving a personal financial interest, when one's position is to serve the financial interests of the larger group.
Disclosure: Revealing or uncovering
Due Diligence: The care a reasonable person is expected to exercise in the examination and evaluation of risks affecting a business transaction.

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Whistle blower: One who reveals wrongdoing within an organization to the public or to those in positions of authority?
Insider trading: The illegal buying or selling of securities on the basis of information that is unavailable to the public.

Performance Objectives:

Students will be able to:

- Identify and analyze ethical and unethical financial practices.
- Identify the consequences of unethical financial practices
- Recognize the importance of accurate disclosure in financial transactions.
- Identify agencies an their role in protecting the investor.

Subject Area

Economics, Business, Social Studies, Math, English / Language Arts

Materials

- Computers with spreadsheet and word processing programs.
- Computers with Internet access.

Springboard Activity

State the following to your students:

> As high school seniors who have worked hard for the last twelve years to graduate, I have some bad news. Mr. Jones, the principal here at Smith High for the past ten years falsified test scores for the past three years. He has been removed from his position, but to make matters worse your scores have been thrown out and you will not receive credit for the past three years. Students will not be allowed to graduate until all tests are retaken and resubmitted.

ASK

- How does this make you feel?
- Do you feel like an innocent victim?
- Why are you being penalized for another person's unethical behavior?
- Should Mr. Jones be punished? How much?
- Who can you go to for help?

After the discussion, be sure to tell your students that the story you told was hypothetical and is not intended to represent an actual school situation.

Activities: Enron Case Study

Activity 1

Present the following to your students:

> Imagine now, you have worked hard for a company such as Enron for thirty years. Instead of receiving the pension you have always counted on, the senior managers and accounting managers have been falsifying the financial statements for years. The

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auditing firm, Arthur Anderson, who was responsible for verifying the accuracy of the financial statements, was convicted of obstruction of justice. Enron is broke and goes out of business along with your pension. The managers have made multi-millions while the investors are left with nothing.

ASK:

- How would this make you feel after working so hard?
- Are you being penalized for another person's actions?
- Should the managers and auditors be punished in this case?

Inform your students that Enron is not the only instance of unethical behavior in corporate America; Tyco, Enron, Rite Aid, WorldCom, and Sunbeam each have committed an unethical acts. Have students research one of the companies listed and determine the effect on the company stock before during and after the scandal

Students can use these sites to begin their research:

- **http://www.forbes.com/2002/07/25/accountingtracker_print.html**
- **http://www.msnbc.msn.com/id/3032230/**
- **http://www.slate.com/?id=2068382**
- **http://www.sec.gov/divisions/enforce.shtml**

Activity 2

ASK:

- Do you believe that not telling the "whole truth" is dishonest? Why? Why not?

Present the scenario below to your students:

> Last night John went over Greg's house for five minutes and then the two of them when to see a concert for three hours. When John's parents asked, "where did you go last night?" If John told his parents, "I was over Greg's house last night." Is that full disclosure or is that only half of the truth? Is he telling the whole story or only part of the story?

Have each team go to this site to read in the article titled *Bigger Than Enron:*
http://www.pbs.org/wgbh/pages/frontline/shows/regulation/

ASK:

- How would the story of John and Greg be similar to Enron's financial statements?
- Did Enron tell the whole story or only part of the story?
- Discuss the relationship between lack of disclosure and fraud.

Activity 3

Have each team read the "Congress and the Accounting Wars" section of the article, *Bigger Than Enron* at

http://www.pbs.org/wgbh/pages/frontline/shows/regulation/

Have students write a description of the battles that took place between Congress and the Big Five Accounting firms.

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Activities: Who are the Regulators?

Have your SMG teams visit the following Web sites and Have each team research what the following organizations or regulators do to protect the investor from fraud:

Securities and Exchange Commission - **http://www.sec.gov**
State Attorney General - **http://www.oag.state.ny.us/press/2003/mar/mar12a_03.html**
Anti-Fraud and Corporate Responsibility Center -
http://www.aicpa.org/antifraud/homepage.htm

Have teams create a poster illustrating the job of each of these regulators.

Activities: Insider Trading

Have your students read *Insider Trading-What did Martha do?* at:
http://economics.about.com/cs/finance/a/insider_trading.htm

ASK:

- What does the article state Martha did wrong?
- Do you believe Martha did something illegal? Why or why not?
- Why does the government have a law against "insider trading"?

Have your students create a T Chart that gives examples of actions that are and are not insider trading. Give examples of actions by SMG students, which could be considered "insider trading". Discuss establishing rules that prohibit SMG "insider trading".

Authentic Assessment

Letter to the Editor

Select one of the big five accounting firms referred to in the Enron/Arthur Anderson scandal and prepare a letter to the editor which discusses the company's ethics and its impact on the market regulations.

Frontline Commentary

Write a personal commentary in Frontline site under the section titled *Join The Discussion about the Enron / Arthur Anderson* scandal. Follow the example of the other commentaries already presented.

Industry Research

Select a company from your portfolio and review recent news and press releases about the industry sector in which it belongs. Look for examples of questionable ethics. How was the company and/or industry held responsible for their behavior? Note the effect of any unethical activity on the stock price and then advise your group about whether you want to sell the stock or not, giving reasons for your position. This could be included in your SMG journal.

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