CHAPTER 1

# AN OVERVIEW OF ETHICS

## QUOTE

*Man, when perfected, is the best of animals, but when separated from law and justice, he is the worst of all.*

—Aristotle

## VIGNETTE

### Parent Company of Philip Morris Strives for Integrity

"Nothing is more important than our commitment to integrity—no financial objective, no marketing target, no effort to outdo the competition. Our commitment to integrity must always come first," said Louis C. Camilleri. Coming from the CEO of Altria Group, the parent company of Philip Morris of tobacco fame, such a statement might give pause to many Americans. Yet, Camilleri was referring to a massive initiative to establish a corporate code of conduct among Altria enterprises.

Led by Camilleri, the board of directors, and senior officers, the Altria Compliance and Integrity program has searched for ways to ensure that the code filters down to its employees at all levels. Employees receive customized handbooks that are translated into their native languages and cover information they need to know. Managers receive much more information about the code than their workers. Online courses focus on specific risks and on-the-job scenarios. Employees also watch skits staged with professional actors, answer questions, and engage in discussions with managers and othe workers.

At the same time, Altria encourages employees to report violations of the code. Not only can employees approach the Human Resources Department and other departments, they can call a 24-hour Integrity Helpline and voice concerns anonymously. The helpline provides translation services for more than 100 languages. Altria's policy states that employees can be disciplined and even fired for retaliating against anyone who has made a complaint in good faith.

Altria conducts annual audits to determine risk and review best practices. Compliance and Integrity managers have also met with more than 150 employees to help shape the content of their code, which includes such goals as producing accurate records, protecting company assets, and dealing with customers honestly. Altria appears committed to implementing this code. Yet one goal—responding to society's expectation of Altria—may prove increasingly challenging to a company whose products include a carcinogen known to cause approximately 87 percent of all lung cancer deaths in the United States.[1,2,3]

## LEARNING OBJECTIVES

**As you read this chapter, consider the following questions:**

1. What is ethics, and why is it important to act according to a code of principles?
2. Why is business ethics becoming increasingly important?
3. What are corporations doing to improve business ethics?
4. Why are corporations interested in fostering good business ethics?
5. What approach can you take to ensure [redacted] decision making?
6. What trends have increased the risk of using information technology unethically?



## WHAT IS ETHICS?

Each society forms a set of rules that establishes the boundaries of generally accepted behavior. These rules are often expressed in statements about how people should behave, and they fit together to form the **moral code** by which a society lives. Unfortunately, the different rules often have contradictions, and you can be uncertain about which rule to follow. For instance, if you witness a friend copy someone else's answers while taking an exam, you might be caught in a conflict between loyalty to your friend and the value of telling the truth. Sometimes, the rules do not seem to cover new situations, and you must determine how to apply the existing rules or develop new ones. You may strongly support personal privacy, but in a time when employers track employee e-mail and Internet usage, what rules do you think are acceptable to govern the appropriate use of company resources?

The term **morality** refers to social conventions about right and wrong that are so widely shared that they become the basis for an established consensus. However, one's view of what is moral may vary by age, cultural group, ethnic background, religion, and gender. There is widespread agreement on the immorality of murder, theft, and arson, but other behaviors that are accepted in one culture might be unacceptable in another. For example, in the United States it is perfectly acceptable to place one's elderly parents in a managed care facility in their declining years. In most Middle Eastern countries, however, elderly parents would never be placed in such a facility; they remain at home and are cared for by other family members.

Another example concerns attitudes toward the illegal copying of software (piracy), which range from strong opposition to acceptance as a standard approach to business. In 2003, 36 percent of all software in circulation worldwide was pirated, at a cost of $29 billion to software vendors. The highest piracy rates were in Vietnam and China, where 92 percent of the software was pirated. In the United States, the piracy rate was 22 percent.[4]

Even within the same society, people can have strong disagreements over important moral issues—in the United States, for example, issues such as abortion, the death penalty, and gun control are continuously debated, and both sides feel their arguments are on solid moral ground.

### Definition of Ethics

**Ethics** is a set of beliefs about right and wrong behavior. Ethical behavior conforms to generally accepted social norms, many of which are almost universal. However, although nearly everyone would agree that lying and cheating are unethical, what constitutes ethical behavior on many other issues is a matter of opinion. For example, most people would not steal an umbrella from someone's home, but a person who finds an umbrella in a theater might be tempted to keep it. A person's opinion of what represents ethical behavior is strongly influenced by a combination of family influences, life experiences, education, religious beliefs, personal values, and peer influences.

As children grow, they learn complicated tasks—walking, riding a bike, writing the alphabet—that they perform out of habit for the rest of their lives. People also develop habits that make it easier to choose between what society considers good or bad. **Virtues** are

habits that incline people to do what is acceptable, and vices are habits of unacce behavior. Fairness, generosity, honesty, and loyalty are examples of virtues, while greed, envy, and anger are considered vices. People's virtues and vices help define their value system, the complex scheme of moral values by which they live.

## The Importance of Integrity

Your moral principles are statements of what you believe to be rules of right conduct. As a child, you may have been taught not to lie, cheat, or steal or have anything to do with those who do. As an adult who makes more complex decisions, you often reflect on your principles when you consider what to do in different situations: Is it okay to lie to protect someone's feelings? Can you keep the extra $10 you received when the cashier mistook your $10 bill for a $20 bill? Should you intervene with a coworker who seems to have an alcohol or chemical dependency problem? Is it okay to exaggerate your work experience on a résumé? Can you cut some corners on a project to meet a tight deadline?

A person who acts with integrity acts in accordance with a personal code of principles—integrity is one of the cornerstones of ethical behavior. One approach to acting with integrity is to extend to all people the same respect and consideration that you desire. Unfortunately, this consistency can be difficult to achieve, particularly when you are in a situation that conflicts with your moral standards. For example, you might believe it is important to do as your employer requests and that you should be fairly compensated for your work. However, if your employer insists that you not report recent overtime hours due to budget constraints, a moral conflict arises. You can do as your employer requests or you can insist on being fairly compensated, but you cannot do both. In this situation, you may be forced to compromise one of your principles and act with an apparent lack of integrity.

Another form of inconsistency emerges if you apply moral standards
ing to the situation or the people involved. To be consistent and act with integrity, you
apply the same moral standards in all situations. For example, you might consider it mor-
ally acceptable to tell a "little white lie" to spare a friend some pain or embarrassment, but
would you lie to a work colleague or customer about a business issue to avoid
unpleasantness? Clearly, many ethical dilemmas are not about right versus wrong but
involve choices between right versus right. For example, it is right to protect the Alas
wildlife from being spoiled, and it is right to find new sources of oil to maintain
reserves, but how do you balance these two concerns?

The remainder of this chapter provides an introduction to ethics in the business
It discusses the importance of ethics in business, outlines what businesses can do to improve their ethics, points out that good ethics is not always good business, provides advice for creating an ethical work environment, and suggests a model for ethical decision making. The chapter concludes with a discussion of ethics as it relates to information technology (IT) and provides a brief overview of the remainder of the text.



## IN THE BUSINESS WORLD

Risk is the product of multiplying the likelihood of an event by the impact of occurrence. Thus, if the likelihood of an event is high and its potential negative impac large, the risk is considered great. Ethics has risen to the top of business agendas becau the risks associated with inappropriate behavior have increased, both in their likelihood their potential negative impact

Several corporate trends have increased the likelihood of unethical behavior. Firs greater globalization has created a much more complex work environment that spa diverse societies and cultures, making it much more difficult to apply principles and codes of ethics consistently. For example, numerous U.S. companies have garnered neg publicity for moving operations to third-world countries where employees work i conditions that would not be acceptable in most developed parts of the world.

shareholders, and regulatory agencies are increasingly sensitive to viol
standards, failures to disclose substantial changes in business con
tions to investors, nonconformance with required health and safety practices, and production of unsafe or substandard products. Such heightened vigilance raises the risk financial loss for businesses that do not foster ethical practices or run afoul of required standards. For example, Enron's accounting practices hid the real value of the firm, and late 2001 the energy company was forced to file for bankruptcy. The case was notorious but many other recent scandals have occurred in IT companies in spite of safeguards th were enacted as a result of the Enron debacle:

- The U.S. Securities and Exchange Commission (SEC) filed fraud charges against WorldCom in June 2002 for inflating its earnings by $11 billion. The stock peaked at $64.50 in June 1999 and dropped to less than $1 per shar three years later. WorldCom eventually became the largest bankruptcy in U.S. history after Chairman Bernard Ebbers resigned and the extent of the fraud wa (It since has emerged from bankruptcy under the name MCI Inc. to become the object of an acquisition war between Qwest and Verizon Communications, which Verizon eventually won.) Under a judgment released in May 2003 by a U.S. District Court in New York, MCI was required to pay a civi penalty of $1.51 billion to defrauded shareholders and bondholders, although the amount was reduced to $500 million under terms of a bankruptcy settlement.[5] Ebbers was convicted in March 2005 of helping to orchestrate the massive accounting fraud.[6] In addition, 10 members of the WorldCom board of directors avoided trial by agreeing to pay a total of $18 million on top of the $250 million they lost when the stock collapsed.[7]
- Qwest Communications International Inc., the primary local phone provider in 14 western states, had been under investigation by the SEC since 2002. On the same day that Ebbers was convicted, the SEC charged former Qwest CEO Joseph Nacchio and six other executives with orchestrating massive financial fraud from April 1999 to March 2002. In 2000, the company allegedly misstated that $3 billion from a one-time sale was a recurring revenue in order to ensure a merger with US West. Qwest executives allegedly reaped tens of millions of dollars in profit while hiding the scheme from investors and the public.[8]

- In 2004, Adelphia Communications Corp. founder John Rigas and his son Timothy were convicted in federal court on charges of conspiracy, bank fraud, and securities fraud. They were charged with hiding $2.3 billion in debt at the cable company, deceiving investors, and stealing company cash to line their own pockets. Although most of the fraud took the form of hidden debt, the trial provided examples of excessive extravagance that has marked other white-collar trials. The prosecutor alleged that Rigas ordered 17 company cars and the company purchase of 3600 acres of timberland for $26 million to preserve the pristine view outside his Coudersport home.[9]
- Several former Computer Associates (CA) executives pleaded guilty to civil and criminal fraud and obstruction of justice for systematically recording sales revenue before contracts were finalized, inflating CA's financial results by about $2.2 billion during 2000 and 2001. The scandal eventually led to the resignation of Sanjay Kumar, the company's CEO, in April 2004.[10] In May 2005, the company said that a continuing review of its accounting practices turned up more improperly recorded transactions from 1998 through 2001. This required CA to restate its financial reports again, reducing revenue in prior periods by up to $110 million in aggregate.[11] (For more on the CA scandal, see the Cases section at the end of the chapter.)

These cases have led to an increased focus on business ethics. Read the following Legal Overview to find out more about one attempt by the U.S. Congress to improve business ethics.

**LEGAL OVERVIEW**

### The Sarbanes-Oxley Act

The U.S. Public Company Accounting Reform and Investor Protection Act of 2002—better known as the Sarbanes-Oxley Act or simply SOX—was enacted in response to public outrage over several major accounting scandals, including those at Enron, WorldCom, Tyco, Adelphia, Global Crossing, and Qwest, plus numerous restated financial reports that clearly demonstrated a lack of oversight within corporate America. The sponsors, Senator Paul Sarbanes (D-Maryland) and Representative Michael Oxley (R-Ohio), wanted to renew investors' trust in corporate executives and their financial reports.

**Sarbanes-Oxley Act Section 404**, Management Report on Internal Control over Financial Reporting, states that annual reports must contain a signed statement by the CEO and CFO attesting that the information in any SEC filing is accurate. The company must also submit to an audit to prove that it has controls in place to ensure accurate information. The penalties for false attestation can include up to 20 years in jail and significant monetary fines for senior executives. As a result, CEOs and CFOs, their staff, and others spend significant time and energy to document and test internal control processes. The average company spends an estimated 0.1 percent of annual revenues to conform to SOX; for example, a company with annual sales of $10 billion will spend about $10 million, including employee time, fees for outside resources, and software.

*continued*



A key provision of the act was the creation of the Public Company Accounting Oversight Board (PCAOB). The PCAOB provides oversight for auditors of public companies, including establishing quality control standards for company audits and inspecting the quality controls at audit firms under its oversight. The PCAOB is made up of five full-time appointed members and is overseen by the SEC.

The act attempts to ensure that internal controls or rules are in place to govern the creation and documentation of financial statements. However, it is not specific; for example, it does not define a required set of internal control practices or specify how a business must store records. It simply describes which records to store and for how long. The legislation not only affects the financial side of corporations, it affects IT departments that must store a corporation's electronic records. The act specifies that a firm must have adequate controls, but not necessarily automated controls. Thus, a company can decide whether to make a significant investment in technology that automates its manual processes or make a smaller investment in additional people to double-check everything manually. The SEC set a deadline of November 15, 2004, for the rule to take effect, but problems didn't surface until companies began to file their annual reports and 10K reports in the first quarter of 2005. On March 2, the SEC extended the deadline to July 15, 2006, for small and midsized companies and foreign firms.

In November 2004, SunTrust Banks Inc. became one of the first companies to report an accounting problem that made it impossible to meet its SOX reporting requirements. The firm said an internal audit had found numerous errors in the loan loss allowance calculations for its first and second quarters that were not immediately investigated and corrected. Additional problems revealed inadequate internal control procedures, insufficient validation and testing, and a failure to detect errors in the allowance calculations. The bank had to restate its first- and second-quarter 2004 financial results, and three employees were fired.

In March 2005, more than a dozen companies reported deficiencies with their internal accounting controls, forcing them to delay the filing of annual reports to regu[illegible]. The share prices of most of these companies dropped substantially after they disclosed that they needed more time to file audited financial reports with the SEC. These companies joined some 500 others that told shareholders they couldn't ensure their financial reports were accurate and reliable under the new rules.

Because IT systems are used to generate, change, store, and disseminate data, the IT organization must build controls that ensure the information stands up to audit scrutiny. Critical elements include controls that ensure the overall performance and integrity of financial systems, business process applications, and other applications. The audit emphasizes segregation of duties to avoid potential fraud—for example, the same person cannot generate a purchase order and approve its payment—and limiting the authorization to perform critical functions to a few people; for example, only people in quality control should be able to release products that are placed on hold, pending the results of quality tests. The audit also requires companies to document who performs specific roles within the system. In the future, the SEC might revise its interpretation of SOX, creating additional work for IT organizations.[12,13,14,15,16,17,18]

## Why Fostering Good Business Ethics Is Important

Corporations have at least five reasons for promoting a work environment in which they encourage employees to act ethically when making business decisions:

1. To gain the goodwill of the community
2. To create an organization that operates consistently
3. To produce good business
4. To protect the organization and its employees from legal action
5. To avoid unfavorable publicity

### Gaining the Goodwill of the Community

Although organizations exist primarily to earn profits or provide services to customers, they also have some basic responsibilities to society. Many corporations recognize these responsibilities and make a serious effort to fulfill them. Often, they declare these responsibilities in a formal statement of their company's principles or beliefs. Their socially responsible activities include making contributions to charitable organizations and nonprofit institutions, providing benefits for employees in excess of any legal requirements, and choosing economic opportunities that might be more socially desirable than profitable.

The goodwill that socially responsible activities create can make it easier for corporations to conduct their business. For example, a company known for treating its employees well will find it easier to compete for the best job candidates. On the other hand, companies viewed as harmful to their community may suffer a disadvantage. For example, a corporation that pollutes the air and water (see Figure 1-1) may find that adverse publicity reduces sales, impedes relationships with some business partners, and attracts unwanted government attention.

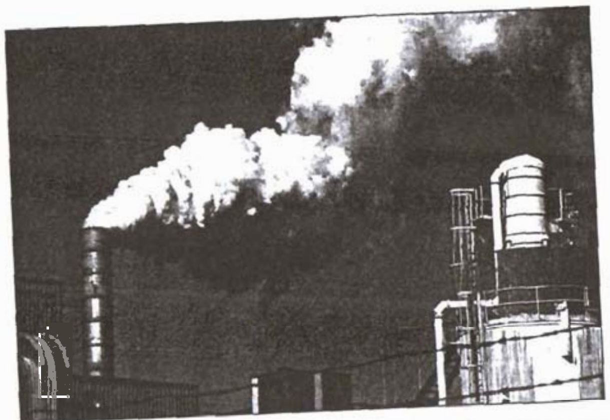


**FIGURE 1-1** Companies that harm a community can harm themselves

### Creating an Organization That Operates Consistently

Organizations develop and abide by values to create a consistent approach that meets the needs of their stakeholders—shareholders, employees, customers, suppliers, and the community. They need to emphasize workplace issues that affect their corporate strengths, weaknesses, opportunities, and threats. Although each company's value system is different, many share the following values:

- Operate with honesty and integrity, staying true to corporate principles.
- Operate according to standards of ethical conduct, in words and action.
- Treat colleagues, customers, and consumers with respect.
- Strive to be the best at what matters most to the company.
- Accept personal responsibility for actions.
- Value diversity.
- Make decisions based on facts and principles.

### Good Ethics Can Mean Good Business

In many cases, good ethics can mean good business and improved profits. Companies that produce safe and effective products avoid costly recalls and lawsuits. Companies that provide excellent service maintain their customers instead of losing them to competitors. Companies that develop and maintain strong employee relations suffer less turnover and enjoy better employee morale. Suppliers and other business partners often prefer to work with companies that operate in a fair and ethical manner.

Likewise, bad ethics can lead to bad business results. For example, many employees can develop negative attitudes if they perceive a difference between their own values and the values stated or implied by an organization's actions. In such environments, employees often act to defend themselves against anticipated punishment or retaliate against poor treatment. A bad ethical environment destroys employee commitment to organizational goals and objectives, creates low morale, fosters poor performance, erodes employee involvement in corporate improvement initiatives, and builds indifference to the organization's needs.

### Protecting the Corporation and Its Employees from Legal Actions

In 1991, the U.S. Justice Department published sentencing guidelines that suggested more lenient treatment for convicted executives if their companies had ethics programs. Fines for criminal violations can be lowered by up to 80 percent if the organization has implemented an ethics management program and cooperates with authorities. These measures are covered in Chapter Eight of the Federal Sentencing Guidelines for Organizations.[19]

The following list briefly describes the key features an organization must implement to show it has an effective program of compliance and ethics.

- Identify its core beliefs, which need to include a commitment to complying with the letter and spirit of the law and ethical conduct.
- Understand the strengths and weaknesses of its culture and organizational capacities.

- Scan its business environment, presumably on an enterprise-wide basis, to determine what pressures the organization faces, especially the risk of criminal conduct and violating other applicable laws, and more broadly, to gather benchmarking data to compare to industry standards and best practices.
- Determine, relative to its goals and objectives and baseline data of its prior performance, what outcomes should be expected of the program.
- Identify targets and measurable indicators of expected program outcomes.
- Design, implement, and enforce a program that will "exercise due diligence to prevent, detect, and report criminal conduct and otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with all applicable law."
- Regularly evaluate its program to determine if it is effective, and capture what the organization learns along the way.[20]

### Avoiding Unfavorable Publicity

The public reputation of a company strongly influences the value of its stock, how consumers regard its products and services, the degree of oversight it receives from government agencies, and the amount of support and cooperation it receives from business partners. Thus, some companies are motivated to build a strong ethics program to avoid negative publicity. If an organization is perceived as operating ethically, customers, business partners, shareholders, consumer advocates, financial institutions, and regulatory bodies will regard it more favorably.

Companies that operate unethically often suffer negative consequences and bad publicity. A recent example involves the Federal National Mortgage Association (Fannie Mae), which helps low-income and middle-income Americans finance home mortgages. The Office of Federal Housing Enterprise Oversight (OFHEO) began investigating Fannie Mae in September 2004 and found serious accounting problems, including earnings manipulation and poor internal controls. The SEC ordered Fannie Mae in December 2004 to restate its earnings back to 2001, a correction estimated at $9 billion. In February 2005, the OFHEO reported additional problems with accounting for securities and loans and improper practices to spread the impact of income and expenses over time. As a result, several Fannie Mae executives were forced out by the board of directors and changes were made in its staff of 1400 information systems and services workers.[21] Fannie Mae stock dropped below $58 per share on the New York Stock Exchange (NYSE) by March 2005, their lowest level in more than four years and 30 percent below a high of nearly $80 in March 2004.[22]

## Improving Corporate Ethics

The risks of unethical behavior are increasing, so the improvement of business ethics is becoming more important. The following sections explain some of the actions corporations can take to improve business ethics.

### Appointing a Corporate Ethics Officer

Corporate ethics can be broadly defined to include ethical conduct, legal compliance, and corporate social responsibility. The primary functions of a corporate ethics policy include setting standards, building awareness, and handling internal reports—tasks that are either not consolidated or handled well in many organizations. As a result, many organizations pull these functions together under a corporate officer to ensure that they receive sufficient emphasis and cohesive treatment.

The corporate **ethics officer** is a senior-level manager who provides vision and direction in the area of business conduct. Ethics officers come from diverse backgrounds such as legal staff, human resources, finance, auditing, security, or line operations.[23] Their role includes "integrating their organization's ethics and values initiatives, compliance activities, and business conduct practices into the decision-making processes at all levels of the organization."[24] Typically, the ethics officer tries to establish an environment that encourages ethical decision making through the actions described in this chapter. Specific responsibilities include "complete oversight of the ethics function, collecting and analyzing data, developing and interpreting ethics policy, developing and administering ethics education and training, and overseeing ethics investigations."[25]

The presence of a corporate ethics officer has become increasingly common. There is even a professional association, the Ethics Officer Association (EOA), for managers of ethics, compliance, and business conduct programs. "The EOA provides ethics officers with training and a variety of conferences and meetings for exchanging best practices in a frank, candid manner."[26] As of March 2005, there were more than 700 EOA member companies, including the well-known IT companies shown in the following list.

| | |
|---|---|
| Adelphia Communications Group | Intel |
| AOL Time Warner | MCI |
| AT&T | Microsoft |
| BAE Systems | Oracle |
| British Telecom | QUALCOMM |
| Cingular Wireless | Qwest |
| Computer Associates, International | Sprint |
| Dell Computer | Sun Microsystems |
| Hewlett-Packard | Texas Instruments |

However, simply naming a corporate ethics officer does not automatically improve ethics; hard work and effort are required to establish and provide ongoing support for an organizational ethics program.

### Ethical Standards Set by Board of Directors

The board of directors is responsible for the careful and responsible management of an organization. In a for-profit corporation, the board's primary objective is to oversee the organization's business activities and management for the benefit of all stakeholders, including shareholders, customers, suppliers, and the community. In a nonprofit corporation, the board reports to a different set of stakeholders, particularly the local communities that the nonprofit serves.

The board fulfills some of its responsibilities directly and assigns others to various committees. The board is not normally responsible for day-to-day management and operations; these responsibilities are delegated to the organization's management team. However, the board is responsible for supervising the management team.

Directors of the company are expected to conduct themselves according to the highest standards of personal and professional integrity. Directors are also expected to set the standard for company-wide ethical conduct and ensure compliance with laws and regulations.

As you learned earlier in this chapter, the passage of Sarbanes-Oxley led to significant reforms in the content and preparation of disclosure documents by public companies. Section 406 of the act requires public companies to disclose whether they have codes of ethics and to disclose any waivers of those codes for certain members of senior management. The SEC also approved significant reforms by the NYSE and NASDAQ that, among other things, require companies listed on these exchanges to have codes of ethics that apply to all employees, senior management, and directors.

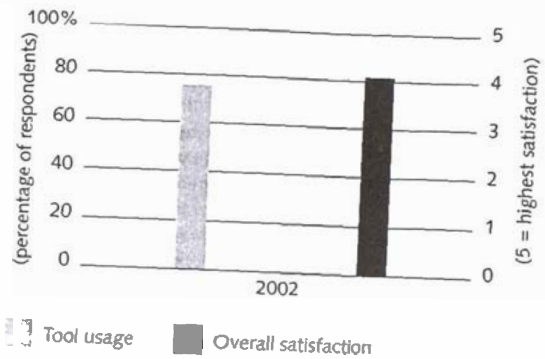
## Establishing a Corporate Code of Ethics

A **code of ethics** highlights an organization's key ethical issues and identifies the overarching values and principles that are important to the organization and its decision making. The code frequently includes a set of formal, written statements about the purpose of the organization, its values, and the principles that guide its employees' actions. An organization's code of ethics applies to its directors, officers, and employees. The code of ethics should focus employees on areas of ethical risk relating to their role in the organization, provide guidance to help them recognize and deal with ethical issues, and provide mechanisms for reporting unethical conduct and fostering a culture of honesty and accountability in an organization. The code of ethics helps ensure that employees abide by the law, follow necessary regulations, and behave in an ethical manner.

A code of ethics cannot gain company-wide acceptance unless it is developed with employee participation and fully endorsed by the organization's leadership. It must also be easily accessible by employees, shareholders, business partners, and the public. The code of ethics must continually be applied to a company's decision making and emphasized as an important part of its culture. Breaches in the code of ethics must be identified and treated appropriately so that its relevance is not undermined.

Establishing a code of ethics is an important step for any company, and a growing number have done so. Figure 1-2 shows that almost 80 percent of surveyed companies have developed a code of ethics and are very satisfied with it.






Source: Rigby, Darrell, "Management Tools," www.bain.com/management_tools/tools_ethics.asp?groupcode=2, March 17, 2005.

**FIGURE 1-2** *Corporate satisfaction with their codes of ethics*

In March 2005, *Business Ethics* magazine rated U.S.-based, publicly held companies using a statistical analysis of corporate service to seven stakeholder groups—employees, customers, community, minorities and women, shareholders, the environment, and non-U.S. stakeholders. The top IT company, based on performance between 2000 and 2004, was Intel Corporation, the world's largest computer chip maker. Intel's code of ethics is summarized in the following paragraph.

> Honest and ethical conduct, including the ethical handling of actual or perceived conflicts of interest between personal and business relationships, is our rule every day and for all that we do. If we are to maximize the value we create for our stockholders, it is the personal responsibility of each of us to: (1) comply with applicable laws (including statutes, controlling case law, agency regulations and orders, and other administrative directives) and Intel guidelines, (2) employ technical excellence and integrity to do the best we can to provide timely, accurate and understandable reporting of actual and forward-looking financial information, (3) employ our business processes and guidelines to do the best we can to base our business decisions on sound economic analysis (including a prudent consideration of risks), and (4) safeguard and utilize our physical, financial, and intellectual property assets to the best and most prudent effect.[27]

A more detailed version of Intel's code of ethics is spelled out in a 22-page document that offers employees guidelines designed to deter wrongdoing, promote honest and ethical conduct, and comply with applicable laws and regulations. Intel's code of ethics also expresses its policies regarding the environment, health and safety, diversity, nondiscrimination, supplier expectations, privacy, and business continuity.

## Conducting Social Audits

An increasing number of companies conduct social audits of their policies and practices. In a **social audit**, companies identify ethical lapses they committed in the past and set directives for avoiding similar missteps in the future. For example, each year Intel sets social

responsibility goals and tracks results against those goals. Intel's annual report on its social responsibility efforts shares the information with employees, shareholders, investors, analysts, customers, suppliers, government officials, and the communities in which Intel operates. Here are a few highlights from its 2003 report:

- Intel contributed more than $100 million in cash gifts worldwide.
- Global waste recycling teams exceeded their goals by recycling more than 66 percent of chemical waste and 74 percent of solid waste worldwide. These totals represented 40,000 tons of materials recycled.
- Intel has trained more than 1.5 million teachers in 33 countries to use technology effectively and improve student learning.
- Intel remained at world-class levels of health and safety performance.[28]

### Requiring Employees to Take Ethics Training

The ancient Greek philosophers believed that personal convictions about right and wrong behavior could be improved through education. Today, most psychologists agree with them. Lawrence Kohlberg, the late Harvard psychologist, found that many factors stimulate a person's moral development, but one of the most crucial is education. Other researchers have repeatedly supported these findings—people can continue their moral development through further education that involves critical thinking and examining contemporary issues.

Thus, a company's code of ethics must be promoted and continually communicated within the organization, from top to bottom. Organizations should show employees examples of how to apply the code of ethics in real life. One approach is through a comprehensive ethics education program that encourages employees to act responsibly and ethically. Such programs are often presented in small workshop formats in which employees apply the organization's code of ethics to hypothetical but realistic case studies. For example, Procter & Gamble requires all its employees to take a workshop on the topic of **principle-based decision making**, based on principles in the corporate code of ethics. Workshop participants must decide how to best respond to real-life ethical problems, such as giving honest and constructive feedback to an employee who is not meeting expectations. Employees are also given examples of recent company decisions made using principle-based decision making. Not only do these courses make employees more aware of a company's code of ethics and how to apply it, the courses demonstrate that the company intends to operate in an ethical manner. The existence of formal training programs can also reduce a company's liability in the event of legal action.

### Including Ethical Criteria in Employee Appraisals

Employees are increasingly evaluated on their demonstration of qualities and characteristics that are stated in the corporate code of ethics. For example, many companies base a portion of their employee performance evaluations on treating others fairly and with respect, operating effectively in a multicultural environment, accepting personal accountability to meet business needs, continually developing themselves and others, and operating openly and honestly with suppliers, customers, and other employees. These factors are considered along with more traditional criteria used in performance appraisals, such as an employee's overall contribution to moving the business ahead, successful completion of projects, and maintenance of good customer relations.

## When Good Ethics Result in Short-Term Losses

Operating ethically does not always guarantee business success. Many organizations that operate outside the United States have found that the "business as usual" climate in some foreign countries can place them at a significant competitive disadvantage.

For example, a major global telecommunications company faced significant competitive disadvantages by consistently applying its corporate values to its South American business. Although the organization's code of ethics prohibited the practice of financially "influencing" decision makers on project bids, its competition did not play by the same rules. As a result, the company lost many projects and millions of dollars in revenues. Senior management argued in favor of integrity and the consistent application of corporate ethics, reasoning that situational ethics was wrong and that the practice could be hard to stop once it was started. Their hope was that good ethics would prove to be good business in the long term.

## Creating an Ethical Work Environment

Most employees want to perform their jobs successfully and ethically, but good employees sometimes make bad ethical choices. Employees in highly competitive workplaces often feel pressures from aggressive competitors, cutthroat suppliers, unrealistic budgets, minimum quotas, tight deadlines, and bonus incentives for meeting performance goals. Employees may also be encouraged to do "whatever it takes" to get the job done. Such environments can make some employees feel pressure to engage in unethical conduct to meet management's expectations, especially if there are no corporate codes of conduct and no strong examples of senior management practicing ethical behavior. Table 1-1 shows how management's behavior can result in unethical employee behavior, and Table 1-2 provides a manager's checklist for establishing an ethical workplace; to each question in the latter table, the preferred answer is *yes*.

Employees must have a knowledgeable and potent resource with whom they can discuss perceived unethical practices. For example, Intel expects employees to report suspected violations of its code of ethics to a manager, the Legal or Internal Audit Departments, or a business unit's legal counsel. Employees may also report violations anonymously through an internal Web site dedicated to ethics. Senior management at Intel has made it clear that any employee can report suspected violations of corporate business principles without fear of reprisal or retaliation.

**TABLE 1-1** How management can affect employees' ethical behavior

| Managerial behavior that can encourage unethical behavior | Possible employee reaction |
|---|---|
| Set and hold people accountable for meeting "stretch" goals, quotas, and budgets | "My boss wants results, not excuses, so I have to cut corners to meet the goals my boss has set." |
| Fail to provide a corporate code of ethics and operating principles to guide decision making | "Because there are no guidelines, I don't think my conduct is really wrong or illegal." |
| Fail to act in an ethical manner and set a poor example for others to follow | "I have seen other successful people take unethical actions and not suffer negative repercussions." |

TABLE 1-1 How management can affect employees' ethical behavior (continued)

| Managerial behavior that can encourage unethical behavior | Possible employee reaction |
|---|---|
| Fail to hold people accountable for unethical actions | "No one will ever know the difference, and if they do, so what?" |
| When employees are hired, put a 3-inch binder titled "Corporate Business Ethics, Policies, and Procedures" on their desks. Tell them to "read it when you have time and sign the attached form that says you read and understand the corporate policy." | "This is overwhelming. Can't they just give me the essentials? I can never absorb all this." |

TABLE 1-2 Manager's checklist for establishing an ethical work environment

| Questions | Yes | No |
|---|---|---|
| Does your company have a corporate code of ethics? | ___ | ___ |
| Was the corporate code of ethics developed with broad input from employees at all levels within the organization, and does it have their support? | ___ | ___ |
| Is the corporate code of ethics concise and easy to understand, and does it identify the values you need to operate consistently and meet the needs of your stakeholders? | ___ | ___ |
| Do all employees have easy access to a copy of the corporate code of conduct, and have they all signed a document stating that they have read and understood it? | ___ | ___ |
| Do employees participate in annual training to reinforce the values and principles that make up the corporate code of ethics? | ___ | ___ |
| Do you set an example by communicating the corporate code of ethics and actively using it in your decision making? | ___ | ___ |
| Do you evaluate and provide feedback to employees on how they operate with respect to the values and principles in your corporate code of ethics? | ___ | ___ |
| Do you seek feedback from your employees to ensure that their work environment does not create conflicts with the corporate code of ethics? | ___ | ___ |
| Do employees believe that you are fair, and do they seek your advice when they see coworkers violating the company's code of ethics? | ___ | ___ |
| Do employees have an avenue, such as an anonymous hotline, for reporting infractions of the code of ethics? | ___ | ___ |
| Are employees aware of sanctions for breaching the code of ethics? | ___ | ___ |



## Ethical Decision Making

Often in business, the ethically correct course of action is clear and easy to follow. Exceptions occur, however, when ethical considerations come into conflict with the practical demands of business. Dealing with these situations is challenging and can even be risky to one's career. How, exactly, should you think through an ethical issue? What questions should you ask, and what factors should you consider? This section lays out a seven-step approach that can help guide your ethical decision making; however, the process is not a simple, linear activity. Keep in mind that information you gain or a decision you make in one step may cause you to go back and revisit previous steps.

The seven steps are summarized in the following list and explained in the following sections:

- Get the facts.
- Identify stakeholders and their positions.
- Consider the consequences of your decision.
- Weigh various guidelines and principles.
- Develop and evaluate options.
- Review your decision.
- Evaluate the results of your decision.

### Getting the Facts

Innocent situations can often become unnecessary controversies because no one bothers to check the facts. For example, you might see your boss receive what appears to be an employment application from a job applicant and then throw the application in the trash after the applicant leaves. This would violate your company's policy to treat each applicant with respect and to maintain a record of all applications for one year. You could report your boss for failure to follow the policy or you could take a moment to speak directly to your boss. You might be pleasantly surprised to find out that the situation was not as it appeared. Perhaps the "applicant" was actually a salesperson promoting a product for which your company had no use, and the "application" was marketing literature.

### Identifying the Stakeholders and Their Positions

A **stakeholder** *is someone who stands to gain or lose from how a situation is resolved.* Stakeholders often include others besides people who are directly involved in an issue. Identifying the stakeholders helps you better understand the impact of your decision and could help you make a better decision. Unfortunately, it may also cause you to lose sleep from wondering how you may affect the lives of others. You may recognize the need to involve stakeholders in the decision and thus gain their support for the recommended course of action. What is at stake for each stakeholder? What does each stakeholder value, and what outcome does the stakeholder want? Do some stakeholders have a greater stake because they have special needs or because the company has special obligations to them? To what degree should they be involved in the decision?

### Considering the Consequences of Your Decision

You can view the consequences of a decision from several perspectives. Often, your decision directly affects you, although you must guard against thinking too narrowly and focusing on what is best for you. Another perspective is to consider the harmful and beneficial effects your decision might have on the stakeholders. A third perspective is to ask whether your decision will help the organization meet its goals and objectives. Finally, you should consider the decision's impact on the broader community of other organizations and institutions, the public, and the environment. As you view problems and proposed solutions from each of these perspectives, you may gain additional insights that affect your decision.

### Weighing Various Guidelines and Principles

Do any laws apply to your decision? You certainly don't want to violate a law that can lead to a fine or imprisonment for yourself or others. If the decision does not have legal implications, what corporate policies or guidelines apply? What guidance does the corporate code of ethics offer? Will any of your personal principles affect your decision?

Philosophers have developed many approaches to deal with moral issues. Four of the most common approaches, which are summarized in Table 1-3 and discussed later in this section, provide a framework for decision makers to reflect on the acceptability of their actions and evaluate moral judgments. People must find the appropriate balance between all applicable laws, corporate principles, and moral guidelines to help them make decisions. (For a more in-depth discussion of ethics and moral codes, see Appendix A.)

**TABLE 1-3** Philosophical theories for ethical decision making

| Approach to dealing with moral issues | Principle |
|---|---|
| Virtue ethics approach | The ethical choice best reflects moral virtues in yourself and your community |
| Utilitarian approach | The ethical choice produces the greatest excess of benefits over harm |
| Fairness approach | The ethical choice treats everyone the same and shows no favoritism or discrimination |
| Common good approach | The ethical choice advances the common good |

**Virtue ethics approach.** Virtue ethics focuses on how you should behave and think about relationships if you are concerned with your daily life in a community. It does not define a formula for ethical decision making, but suggests that when faced with a complex ethical dilemma, people either do what they are most comfortable doing or what they think a person they admire would do. The assumption is that people are guided by their virtues to reach the "right" decision. A proponent of virtue ethics believes that a disposition to do the right thing is more effective than following a set of principles and rules and that people should perform moral acts out of habit, not introspection.



Virtue ethics can be applied to the business world by equating the virtues of a good businessperson with those of a good person. However, businesspeople face situations that are peculiar to business, so they may need to tailor their ethics accordingly. For example, honesty and openness when dealing with others is generally considered virtuous; however, a corporate purchasing manager who negotiates a multimillion dollar deal might need to be vague in discussions with competing suppliers.

A problem with the virtue ethics approach is that it doesn't provide much of a guide for action. The definition of virtue cannot be worked out objectively; it depends on the circumstances—you work it out as you go. For example, bravery is a great virtue in many circumstances, but in others it may be foolish. The right thing to do in a situation depends on which culture you're in and what the cultural norm dictates.

**Utilitarian approach.** This approach to ethical decision making states that you should choose the action or policy that has the best overall consequences for all people who are directly or indirectly affected. The goal is to find the single greatest good by balancing the interests of all affected parties.

Utilitarianism fits easily with the concept of value in economics and the use of cost-benefit analysis in business. Business managers, legislators, and scientists weigh the benefits and harm of policies when deciding whether to invest resources in building a new plant in a foreign country, to enact a new law, or to approve a new prescription drug, respectively.

A complication of this approach is that measuring and comparing the values of certain benefits and costs is often difficult, if not impossible. How do you assign a value to human life or to a pristine wildlife environment? It can also be difficult to predict the full benefits and harm that result from a decision.

**Fairness approach.** This approach focuses on how fairly actions and policies distribute benefits and burdens among people affected by the decision. The guiding principle of this approach is to treat all people the same. However, decisions made with this approach can be influenced by personal biases toward a particular group, and the decision makers may not even realize their bias. If the intended goal of an action or policy is to provide benefits to a target group, other affected groups may consider the decision unfair.

**Common good approach.** This approach to decision making is based on a vision of society as a community whose members work together to achieve a common set of values and goals. Decisions and policies that use this approach attempt to implement social systems, institutions, and environments that everyone depends on and that benefit all people. Examples include an effective education system, a safe and efficient transportation system, and accessible and affordable health care.

As with the other approaches to ethical decision making, there are complications. People clearly have different ideas about what constitutes the common good, which makes consensus difficult. In addition, maintaining the common good often requires some groups to bear greater costs than others—for instance, homeowners pay property taxes to support public schools, but apartment dwellers do not.

### Developing and Evaluating Options

In many cases, you can identify several answers to a complex ethical question. By listing the key principles that apply to the decision, you can usually focus on the two or three best options. What benefits and harm will each course of action produce, and which alternative will lead to the best overall consequences? The option you choose should be ethically defensible and should meet the legitimate needs of economic performance and the company's legal obligations.

### Reviewing Your Decision

Is the decision consistent with your personal values as well as those of the organization? How would coworkers, stakeholders, business partners, friends, and family regard your decision if they knew the facts of the situation and the basis for your decision? Would they see it as right, fair, and good? If you belonged to any of the other stakeholder groups, would you be able to accept the decision as fair?

### Evaluating the Results of Your Decision

After the organization implements the decision, monitor the results to see if it achieved the desired effect and observe its impact on employees and other affected parties. This evaluation will allow you to adjust and improve the process for future decisions.

## ETHICS IN INFORMATION TECHNOLOGY

The growth of the Internet, the ability to capture and store vast amounts of personal data online, and greater reliance on information systems in all aspects of life have increased the risk of using information technology unethically. In the midst of the many IT breakthroughs in recent years, the importance of ethics and human values has been underemphasized—with a range of consequences. Here are some examples that raise public concern about the ethical use of information technology:

- Today's workers might have their e-mail and Internet access monitored while at work, as employers struggle to balance their need to manage important company assets and work time with employees' desire for privacy and self-direction.
- Millions of people have used peer-to-peer networks to download music and movies at no charge and in apparent violation of copyright laws.
- Organizations contact millions of people worldwide through unsolicited e-mail (spam) at an extremely low cost.
- Hackers break into databases of financial institutions and steal customer information, then use it to commit identity theft, opening new accounts and charging purchases to unsuspecting victims.
- Students around the world have been caught downloading material from the Internet and plagiarizing content for their term papers.
- Web sites plant cookies or spyware on visitors' hard drives to track their Internet activity.



This book is based on two fundamental tenets. First, the general public has not realized the critical importance of ethics as they apply to IT; too much emphasis has been placed on the technical issues. However, unlike most conventional tools, IT has a profound effect on society. IT professionals need to recognize this fact when they formulate policies that will affect the well-being of millions of consumers and have legal ramifications.

Second, in the corporate world, important technical decisions are often left to the technical experts. General business managers must assume greater responsibility for these decisions, but to do so they must be able to make broad-minded, objective, ethical decisions based on technical savvy, business know-how, and a sense of ethics. They must also try to create a working environment in which ethical dilemmas can be discussed openly, objectively, and constructively.

Thus, the goals of this text are to educate people about the tremendous impact of ethical issues in the successful and secure use of information technology; to motivate people to recognize these issues when making business decisions; and to provide tools, approaches, and useful insights for making ethical decisions.

## An Overview of This Text

The remaining chapters in this book cover a range of topics that relate to ethics in information technology:

- Chapter 2 discusses how ethics is important to IT professionals and IT users.
- Chapter 3 addresses computer crime, an area of growing concern to networked IT users.
- Chapter 4 covers the important issues of personal data privacy and employee monitoring.
- Chapter 5 deals with the ethical issues raised by Internet communications and freedom of expression.
- Chapter 6 covers the protection of intellectual property rights through patents, copyrights, and trade secrets.
- Chapter 7 addresses ethical issues raised by the software development process.
- Chapter 8 covers the use of nontraditional employees, the ethical dilemmas it can cause, and the implications of whistle-blowing.
- Chapter 9 addresses the impact of IT on society.

## Summary

1. What is ethics, and why is it important to act according to a code of principles?

   Ethics is a set of beliefs about right and wrong behavior. A person who acts with integrity acts in accordance with a personal code of principles. Integrity is one of the cornerstones of ethical behavior.

2. Why is business ethics becoming increasingly important?

   Ethics in business is becoming more important because the risks associated with inappropriate behavior have grown in number, complexity, likelihood, and significance.

3. What are corporations doing to improve business ethics?

   Corporations can appoint a corporate ethics officer, set ethical standards at a high organizational level, establish a corporate code of ethics, conduct social audits, require employees to take ethics training, and include ethical criteria in employee appraisals.

4. Why are corporations interested in fostering good business ethics?

   Corporations want to protect themselves and their employees from legal action, to create an organization that operates consistently (because good ethics can be good business), to avoid negative publicity, and to gain the goodwill of the community. Being ethical, however, does not always guarantee business success.

5. What approach can you take to ensure ethical decision making?

   One approach involves seven steps: get the facts of the issue, identify the stakeholders and their positions, consider the consequences of the decision, weigh various guidelines and principles, develop and evaluate various options, review the decision, and evaluate the results. This is not a linear process; some backtracking and repeating of previous steps may be required.

6. What trends have increased the risk of using information technology unethically?

   The growth of the Internet, the ability to capture and store vast amounts of personal data online, and greater reliance on information systems in all aspects of life have increased the risk of using information technology unethically. In the midst of the many IT breakthroughs in recent years, the importance of ethics and human values has been underemphasized—with a range of consequences.

## Self-Assessment Questions

**NOTE**

The answers to the self-assessment questions are listed at the back of the book.

1. Habits that incline people to do what is acceptable are called ________________.
2. Integrity is a cornerstone of ethical behavior and is the practice of acting in accordance with one's own code of principles. True or False?
3. Increased corporate globalization is one of several trends that have made it more difficult to apply principles and codes of ethics consistently. True or False?
4. Which of the following companies has *not* been charged with serious accounting irregularities?
   a. Qwest
   b. MCI
   c. Adelphia
   d. Intel
5. Corporations need to operate consistently so that they can promote an ethical work environment by encouraging employees to act ethically when making business decisions and by supporting them when they do. True or False?
6. The sentencing of organizations for violating federal law changes periodically and is now covered in Chapter Eight of the Federal Sentencing Guidelines for Organizations, which provides for lesser punishment if the organization can demonstrate that it had an "effective compliance and ethics program." True or False?
7. The ________________ highlights an organization's key ethical issues and identifies the overarching values and principles that are important to the organization and its decision making.
8. In a ________________, companies set goals for social responsibility, define improvement programs, and track progress toward meeting their goals.

## Review Questions

1. Define the word *ethics* and the term *value system.*
2. What trends have increased the need for organizations to foster an ethical environment?
3. In what ways do good ethics engender good business?
4. Briefly summarize the key provisions of Section 404 of the Sarbanes-Oxley Act. How might it affect the accounting practices of an organization?
5. What are the key reasons that corporations need to promote an ethical work environment?
6. The goodwill that socially responsible activities create can make it easier for corporations to conduct their business. Explain what this means, and provide an example.
7. Identify specific actions that corporations can take to improve business ethics.
8. What is the purpose of a corporate code of ethics?
9. What is meant by principle-based decision making?
10. What pressures might be placed on employees that make it difficult for them to perform ethically?
11. Outline and briefly discuss a seven-step approach for ethical decision making.
12. Identify several areas in which the increased use of IT has raised ethical concerns.

## Discussion Questions

1. Can you recall a situation in which you had to deal with a conflict in values? What was it? How did you resolve this issue?
2. Is every action that is legal also ethical? Can you describe an action that is legal but ethically wrong? Is every ethical action also legal? Is the law, not ethics, the only guide that business managers need to consider? Explain.
3. What is the role of the board of directors in establishing an ethical workplace?
4. Do you think it is easier to establish an ethical work environment in a nonprofit organization? Why or why not?
5. This chapter discusses four approaches to dealing with moral issues. Identify and briefly summarize each one. Do you believe one perspective is the most important? Why or why not?
6. Is it possible for an employee to be successful in the workplace without acting ethically?
7. What are the key elements of an effective corporate ethics training program?
8. Identify and briefly discuss a recent example that illustrates the negative impact of using IT unethically.

## What Would You Do?

Use the seven-step approach to ethical decision making to analyze the following situations and answer the questions.

1. You and your 10 project team members are working on a new information system for your firm. You have heard a rumor that when the project is completed, the system's ongoing maintenance and support will be outsourced to another firm. The original implementation plan called for at least three team members to work full time on system support and maintenance. Should you break this news to your team? What should you do?
2. You are the customer service manager for a small software manufacturer. The newest addition to your 10-person team is Aubrey, a recent college graduate. She is a little overwhelmed by the volume of calls, but is learning fast and doing her best to keep up. Today, as you performed your monthly review of employee e-mail, you were surprised to see that Aubrey is corresponding with employment agencies. One message says, "Aubrey, I'm sorry you don't like your new job. We have lots of opportunities that I think would much better match your interests. Please call me and let's talk further." You're shocked and alarmed. You had no idea she was unhappy, and your team desperately needs her help to handle the onslaught of calls generated by the newest release of software. If you're going to lose her, you'll need to find a replacement quickly. You know that Aubrey did not intend for you to see the e-mail, but you can't ignore what you saw. Should you confront Aubrey and demand to know her intentions? Should you avoid any confrontation and simply begin seeking her replacement? Could you be misinterpreting the e-mail? What should you do?
3. While mingling with friends at a party, you [illegible] on a recent promotion that has put you in charge of evaluating bids for a large computer hardware contract. A few days later, you receive a dinner invitation at the home of an acquaintance who also attended the party. Over cocktails, the conversation turns to the contract you're managing. Your host seems remarkably well-informed about the bidding process and likely bidders. You volunteer information about the potential value of the contract and briefly outline the criteria your firm will use to select the winner. At the end of the evening, the host surprises you by revealing that he is a consultant for several companies in the computer hardware market. Later that night your mind is racing. Did you reveal information that could provide a supplier with a competitive advantage? What are the potential business risks and ethical issues in this situation? Should you report the conversation to someone? If so, who should you talk to and what would you say?
4. You have just completed interviewing three candidates for an entry-level position in your organization. One candidate is the friend of a coworker who has implored you to "give his friend a chance." The candidate is the weakest of the three but has sufficient skills and knowledge to adequately fill the position. Would you hire this candidate?
5. A coworker calls you at 9 a.m. at work and asks for a favor. He is having trouble this morning and will be an hour late for work. He explains that he has already been late for work twice this month and that a third time will cost him four hours pay. He asks you to stop by his cubicle, turn his computer on, and place some papers on the desk so that it appears he is "in." You have worked on some small projects with this coworker and gone to lunch together. He seems nice enough and does his share of the work, but you are not sure what to tell him. What would you do?

## Cases

### 1. Is There a Place for Ethics in IT?

On March 15, 2005, Michael Schrage published an article in *CIO* magazine entitled "Ethics, Schmethics" that stirred up a great deal of controversy in the IT community. In the article, Schrage proposed that "CIOs should stop trying to do the 'right thing' when implementing IT and focus instead on getting their implementations right." *Ethics*, Schrage argued, had become a buzzword much like *quality* in the 1980s, and that the demand for ethical behavior interferes with business efficiency.

Schrage gave a few scenarios. For example, a company is developing a customer relationship management (CRM) system, and the staff is working very hard to meet the deadline. The company plans to outsource the maintenance and support of the CRM once the system is developed. There is a good chance that two-thirds of the IT staff will be laid off. Would you disclose this information? Schrage answered, "I don't think so."

Schrage asked readers in another scenario, "How about deliberately withholding important information from your boss because you know that its disclosure would provoke his immediate counterproductive intervention in an important project?" Schrage said he would do it; business involves competing values, he argued, and trade-offs must be made to keep business operations from becoming paralyzed.

Schrage was hit with a barrage of responses accusing him of being dishonorable, shortsighted, and lazy. Other feedback provided new perspectives on his scenarios that Schrage hadn't considered. For example, Kathleen Dewey, an IT manager at Boise State University, argued that doing the right thing is good for business. Not disclosing layoffs, she argued, is a trick that only

works once. Remaining employees will no longer trust the company and pursue jobs where they can feel more secure. New job applicants will think twice before joining a company with a reputation for exploiting IT staff. Other readers responded to the scenario by suggesting that the company maintain loyalty by offering incentives for those who stayed or providing job placement services for departing employees.

Addressing the second scenario, Dewey suggested that not giving the boss important information could backfire on the employee. "What if your boss finds out the truth? What if you were wrong, and the boss could have helped? Once your boss knows that you lied once, will he believe you the next time?"

Another reader, Gautam Gupta, had actually worked under an unproductive, reactive, meddling boss. He suggested confronting the boss about the problem at an appropriate time and place. In addition, as situations arose that required Gupta to convey important information that might elicit interference, he developed action plans and then made firm presentations to his boss. The boss, he assured Schrage, will adapt.

Gupta, Dewey, and others argued that CIOs must consider a company's long-term needs rather than just the current needs of a specific project. Others argued that engaging in unethical behavior, even for the best of purposes, crosses a line that eventually leads to more serious transgressions. Some readers suspected that Schrage had published the article to provoke outrage. Another reader, Maikel Marrero, agreed with Schrage, arguing that ethics has to "take a back seat to budgets and schedules" in a large organization. Marrero explained, "At the end of the day, IT is business."

### Questions:

1. Discuss how a CIO might handle Schrage's scenarios using the virtue ethics approach, the fairness approach, the utilitarian approach, and the common good approach.
2. Discuss the possible short-term losses and long-term gains in implementing ethical solutions to each of Schrage's scenarios.
3. Must businesses choose between good ethics and financial benefits? Explain your answer using Schrage's scenarios or your own examples.

## 2. Computer Associates Is Forced to Clean up Its Act

On July 5, 2000, Erika Miller of the Nightly Business Report announced, "While most of the nation was preparing for Fourth of July fireworks, Computer Associates quietly released a bombshell of its own." The company had issued a warning that its first quarter earnings for fiscal year 2001 would fall short of expectations. The forecast had been for a \$0.55 profit per share, but the company said it expected an actual profit of no more than \$0.16 per share. Stock prices dropped 43 percent, from \$51 to \$29.50, in a single day.

Miller reported, "The company blames the shortfall on weak European sales, a slowdown in its mainframe business, and delays in several large contracts," but the real reason was quite different and would plague the company for years to come.

According to the Securities and Exchange Commission (SEC), executives at Computer Associates (CA) practiced a fraudulent accounting method between January 1998 and September 2000. CA would keep the books open after the quarter ended and report revenue from contracts that had not yet been signed. This method, called the "35-day month," allowed them to meet quarterly earnings expectations and artificially raise stock prices. The SEC maintains that first, second, third, and fourth quarter earnings for fiscal year 2000 were inflated by 25 percent, 53 percent, 46 percent, and 22 percent, respectively. When CA changed auditors and came under increasing scrutiny, they altered their accounting methods, precipitating the July 2000 crash.

The conspiracy involved an array of CA employees from the Finance and Sales departments to top executives. As news of the scandal leaked, CA was pummeled with class actions, the Standard and Poor's Rating Service placed the company on its CreditWatch list, and the SEC indicted CA executives. What seems difficult to understand is why one of the world's largest software companies would sink to criminal practices.

The answer may lie in an earlier scandal. According to a 1995 agreement, founder Charles Wang, cofounder Russel Artzt, and former CEO Sanjay Kumar were to receive 20.25 million shares if stock prices closed at or above \$53.30 for 60 days within a 12-month period—by the end of the year 2000. The lure of this reward may have motivated the executives to conspire to maintain artificially high stock prices. Not only did CA institute a "35-day month," it engaged in other shady dealings that allowed it to meet estimated quarterly earnings. In early 2000, after the stock prices reached the required benchmark, the three tried to cash in their shares. Irate shareholders sued the company and forced the executives to return \$560 million.

The attempt to cash in these stock options brought CA and its accounting practices under closer scrutiny. In February 2002, pressure mounted and CA elected Walter Schuetze, former SEC Chief Accountant, to the Board of Directors. He led an independent investigation that initially concluded in September 2002 that CA had not violated accepted accounting principles. By 2003, however, the Sarbanes-Oxley Act (passed in July 2002) and increased media scrutiny aroused by the Enron scandal was affecting companies across the nation. Chief financial officers (CFOs) had to answer to the CEO and to stronger boards composed of independent directors. Companies were instituting more oversight and better controls. In October 2003, Schuetze revealed that—upon further investigation—his committee *had* discovered irregularities. CA's CFO was forced to step down, and Kumar himself later resigned. The board also asked other senior executives involved in the scandal to resign.

In the meantime, the SEC and the federal government are looking to prevent accounting fraud in the future by imposing the harshest measures possible on violators. In June 2005, the SEC expanded its charges against Kumar, accusing him of paying hush money in the form of a \$3.7 million contract to a CA client who had learned of CA's fraudulent accounting practices. The Sarbanes-Oxley Act provides for stiffer punishment—longer prison sentences and higher fines. CA may not see the end of the scandal for years to come, which could serve as a considerable disincentive for other companies to follow in CA's footsteps.

### Questions:

1. Why do you think Walter Schuetze reversed his initial finding that Computer Associates committed no accounting irregularities?
2. Research the Web to identify other accounting irregularities employed by Computer Associates beyond the use of a "35-day month."
3. Do you think a company can commit widespread accounting fraud without the knowledge of lower-level managers in the Accounting and Finance departments?

### 3. McKesson HBOC Accused of Accounting Improprieties

HBO (named for founders Huff, Barrington, and Owens) & Company was formed in November 1974. The company quickly made a name for itself by delivering cost-effective patient information and hospital data collection systems. Its premiere product, MEDPRO, was designed to be the most cost-effective system in the industry. MEDPRO helped hospital administrators track patient admissions, discharges, emergency room registrations, order communications and results reporting, scheduling, and data collection.

The company went public in June 1981 under the NASDAQ stock symbol HBOC. Its fast growth in sales and profits made it a favorite of investors throughout the 1990s, and its stock rose more than a hundredfold between October 1990 and October 1998. Much of its growth came through acquisitions of other companies.

On January 12, 1999, McKesson Corporation, one of the largest distributors of prescription drugs in the United States, completed a merger with HBO & Company by exchanging shares of common stock. At the time, the two companies had a combined market value of more than $23 billion.

Just three months after the merger, McKesson HBOC, Inc. announced that its auditors had discovered accounting irregularities at HBOC during a routine annual review. The problems were uncovered when McKesson's accounting firm, Deloitte & Touche, mailed a survey to several clients and asked them to report the actual amount of goods and services they had purchased from the company. Several of the amounts returned by clients did not match what HBOC had recorded. As a result, McKesson HBOC, Inc. had to restate earnings for the last four quarters. When the restatement of earnings was announced in April 1999, shares of the company plunged from $65 to $34 in a single day. The restated results were as follows:

| | REVENUE (IN MILLIONS) | | | NET INCOME (IN MILLIONS) | | |
|---|---|---|---|---|---|---|
| Quarter Ending | Originally Reported | As Restated | % Overstated | Originally Reported | As Restated | % Overstated |
| 3/98 | $393.1 | $376.8 | 4.3% | $64.9 | $45.6 | 42.3 % |
| 6/98 | $376.7 | $308.1 | 22.3% | $75.6 | $23.5 | 221.7 % |
| 9/98 | $399.6 | $330.5 | 20.9% | $83.7 | $16.5 | 407.3 % |
| 12/98 | $469.0 | $381.0 | 23.9% | $59.6 | $8.5 | 601.2 % |
| 3/99 | $431.9 | $402.6 | 7.3% | | | |

Some believed that certain HBOC managers, seeking to ensure that the company would meet or beat analysts' expectations for sales and profits, had used several innovative approaches to report financial results. Throughout 1998, it was alleged that HBOC allowed more than a dozen hospitals to buy HBOC software or services with conditional "side letters" that enabled the hospitals to back out of the sales. It was further alleged that these side letters were not shared with the auditors and that the associated sales were reported as complete, violating accounting rules. In at least one case, a hospital canceled a purchase HBOC had booked.

Additional allegations were made that, to bolster its results, HBOC agreed to questionable sales with two other large computer companies. In September 1998, two days before the end of HBOC's quarter and just weeks before HBOC and McKesson agreed to merge, HBOC signed to buy $74 million in software from Computer Associates (CA), supposedly for resale. CA, a software manufacturer for large companies, bought $30 million in HBOC software in return, also supposedly for resale. The deals were split into separate contracts, neither of which made reference to the other. In the two years following its purchase of HBOC's software, CA neither used nor distributed any of the $30 million in HBOC software products, according to a court indictment. Similarly, HBOC had sold only a fraction of the $74 million in CA software it bought.

It was also alleged that McKesson HBOC, Inc. and Data General, a computer hardware maker based in Massachusetts, had agreed to a similar deal in March 1999. Data General disclosed to auditors that what appeared to be a simple $20 million purchase of HBOC software had a side agreement that essentially ensured Data General would never have to pay for it.

Investors and analysts had no idea these problems would be so costly. McKesson first said it had found $42 million in sales from its HBOC unit that had been improperly booked. Eventually, however, $327 million in overstated revenue and $191 million in overstated income were uncovered from 1997 to 1999.

In one of the drug industry's largest corporate shakeups, the board of McKesson HBOC, Inc. ousted some of its top executives over the accounting irregularities. In July 1999, the U.S. Attorney's Office for the Northern District of California and the SEC started investigations. In addition, 53 class actions, three derivative actions, and two individual actions were filed against the company and its current or former officers and directors. Two former top executives of HBOC were indicted in July 2000 and accused of costing investors more than $9 billion, one of the largest financial frauds in American history.

In October 2003, former HBOC president Albert Bergonzi pleaded guilty to two counts of securities fraud charges. In a plea agreement, prosecutors dropped nine other charges and Bergonzi agreed to cooperate in the government's case against another McKesson executive, Richard Hawkins. Bergonzi was the fourth former senior HBOC executive to plead guilty to charges stemming from the scandal. In January 2005, McKesson agreed to pay $960 million to settle a federal class action, but numerous other suits remain.

### Questions:

1. Make a list of the parties that were hurt by the use of nonstandard accounting practices at HBOC. Identify the harm suffered by each party.
2. As you read this case, was there a clear point at which ethical wrongdoings became legal wrongdoings? If so, when?
3. What would motivate HBOC managers to use nonstandard accounting procedures to report increased revenues and earnings?

## End Notes


[1] National Cancer Center Institute, www.cancer.gov/statistics.

[2] "Compliance and Integrity," Altria Web site, www.altria.com/responsibility/4_2_complianceandintegrity.asp.

[3] Weiss, Shari, "Case Study: Developing An Ethical Company, Compliance Pipeline," www.compliancepipeline.com/showArticle.jhtml?articleID=165701047, July 8, 2005.

[4] Weiss, Todd R., "Study: Global Software Piracy Losses Totaled $29B in 2003," *Computerworld*, www.computerworld.com, July 7, 2003.

[5] Lawson, Stephan, "MCI Settles Fraud Charges with SEC," *Computerworld*, www.computerworld.com, May 20, 2003.

[6] Eichenwald, Kurt, "Ebbers' Verdict A Sign: Juries Blame the CEO," *Cincinnati Enquirer*, page D1, March 16, 2005.

[7] Kadlec, Daniel, "A Wake-Up Call for Directors," *Time*, www.time.com, January 17, 2005.

[8] Shore, Sandy, "SEC Suit Charges Fraud at Qwest," *Cincinnati Enquirer*, page D2, March 16, 2005.

[9] Associated Press, "Adelphia Founder John Rigas Found Guilty," MSNBC News, www.MSNBC.com, July 8, 2004.

[10] Gross, Grant, "Update: Kumar Leaves CA," *Computerworld*, www.computerworld.com, June 4, 2004.

[11] Cowley, Stacy, "CA Shows Revenue Growth as Turbulent Fiscal Year Ends," *Computerworld*, www.computerworld.com, May 27, 2005.

[12] Full text of Sarbanes-Oxley Act, frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107_cong_reports&docid=f:hr610.107.pdf.

[13] "Sarbanes-Oxley Act," whatis.com at searchcio.techtarget.com, March 30, 2005.

[14] Bruno, Joe Bel, "Accounting Compliance Spurs Investors' Fears," *MSN Money*, news.moneycentral.msn.com, March 17, 2004.

[15] Hoffman, Thomas, "IT Managers Brace to Meet Ongoing Sarbanes-Oxley Compliance Demands," *Computerworld*, www.computerworld.com, August 2, 2004.

[16] Holder, Tony and Mindak, Mary, "Overall Analysis of Stock Price Reactions, Disclosure Level and Significant Issues Related to SOX 404," University of Cincinnati, March 17, 2005.

[17] Pham, Duc, "Sarbanes-Oxley: Technical Enforcement of IT Controls," *Computerworld*, www.computerworld.com, July 20, 2004.

[18] Weiss, Todd R., "Accounting Problem at SunTrust Could Delay Sarbanes-Oxley Filing," *Computerworld*, www.computerworld.com, November 16, 2004.

[19] Johnson, Kenneth, "Federal Sentencing Guidelines: Enterprise Risk Management," *Ethics Today Online*, www.ethics.org/today/, Volume 3, Issue 3, December 2004.

[20] Johnson, Kenneth W., "Federal Sentencing Guidelines: Enterprise Risk Management," Ethics Resource Center 2004-09, Article ID 864, www.ethics.org/resources/article_detail.cfm?ID=864.

[21] "Two Top Execs at Fannie Mae Forced Out," *SmartPros Accounting*, accounting.smartpros.com/x46295.xml, December 22, 2004.

[22] Gordon, Marcy, "New Problems Found in Fannie Mae Accounting," *MSN Money*, news.moneycentral.msn.com, February 23, 2005.

[23] "What is an Ethics Officer," Web site of Ethics Officer Association, www.eoa.org/Whatis.asp, March 17, 2005.

[24] "What is an Ethics Officer," Web site of Ethics Officer Association, www.eoa.org/Whatis.asp, March 17, 2005.

[25] Harned, Patricia, "A Word from the President: Ethics Offices and Officers," *Ethics Today Online*, www.ethics.org/today/, Volume 3, Issue 2, October 2004.

[26] *Home page of Ethics Officer Association*, www.eoa.org, March 17, 2005.

[27] Intel Web site, Corporate Compliance, www.intel.com/intel/finance/docs/CBP%20-%20Ethics%20and%20Compliance.pdf, March 19, 2005.

[28] Intel Press Release, "Intel Reports on Corporate Social Responsibility Performance," www.intel.com/pressroom/archive/releases, May 27, 2004.


### Sources for Case 1


Schrage, Michael, "Ethics, Shmethics," CIO, www.cio.com/archive/031505/ethics.html, March 15, 2005.

"Ethics, Shmethics, Readers Comments," CIO, www.cio.com/comment_list.html?ID=3308.


### Sources for Case 2


"Computer Associates' Earnings Warning Computes Big Losses On Wall St.," Nightly Business News Web site, www.nightlybusiness.org/transcript/2000/trnscrpt070500.htm, July 5, 2000.

"SEC Files Securities Fraud Charges Against Computer Associates International, Inc., Former CEO Sanjay Kumar, and Two Other Former Company Executives," Press Release 2004-134, U.S. Securities and Exchange Commission Web site, www.sec.gov/news/press/2004-134.htm, September 22, 2004.

Berniker, Mark, "Computer Associates Sacks Execs," Internetnews.com, www.internetnews.com/bus-news/article.php/3089691, October 9, 2003.

Cowley, Stacy, "Prosecutors Revise Indictment of Ex-CA CEO Kumar," Network World, www.computerworld.com/governmenttopics/government/legalissues/story/0,10801,96096,00.html, June 30, 2005.


### Sources for Case 3


Morrow, David J., "The Markets: Market Place; McKesson to Restate Earnings for 4 Quarters and Stock Falls 48%," www.nytimes.com, April 29, 1999.

Berenson, Alex, "Two Ex-Executives Are Indicted In Fraud Case," www.nytimes.com, September 29, 2000.

"Suit Contends Board of McKesson Knew of Problems at HBO," www.nytimes.com, November 15, 2000.

McKesson HBOC, Inc., Form 10-Q filed with Securities and Exchange Commission for quarter ended December 31, 2000, www.edgar-online.com.

McKesson HBOC, Inc., Form 10-K Annual Report for the year ended March 31, 1999, filed with Securities and Exchange Commission, www.edgar-online.com.

"Bergonzi Pleads Guilty to HBOC Fraud," Health Data Management, www.healthdatamanagement.com, June 30, 2005.

United States Attorney's Office, Northern District of California, www.usdoj.gov/usao/can/press/html/2003_06_04_mckesson.html, June 30, 2005.



CHAPTER 2

# ETHICS FOR IT PROFESSIONALS AND IT USERS

## QUOTE

*A professional is a man who can do his best at a time when he doesn't particularly feel like it.*

—Alistair Cooke, English-U.S. broadcast journalist

## VIGNETTE

### Cleveland State University Accuses PeopleSoft of Selling Vaporware

As the computer age reached universities, their admissions, financial aid, human resources, and other offices adopted new technologies that increased efficiency. By the mid-1990s, university information systems were a mess, a collection of disconnected systems that couldn't communicate with each other. So when PeopleSoft announced that it had developed an enterprise resource planning system (ERP), the universities jumped—and none higher than Cleveland State University.

In 1997, Cleveland State hired Klaudis Consulting Group to install PeopleSoft's ERP within a year. Then-president Claire Van Ummersen admits that she approved of the decision to hire Klaudis despite the fact that it had no prior experience installing PeopleSoft applications. Cleveland State thus became the first school to implement the student administration modules, and the results were disastrous.