BY RANDALL TURK ◆ Photos by Robert Taylor

A Question of Ethics

Can business colleges teach ethical behavior to future corporate executives and their accountants —or is it much too late for that?

The public perception of ethics, business and the relationship between the two crystallized last year when a succession of respected companies crumbled, their undoing revealed as a breach of ethics and perhaps violations of law.

Thousands of employees vested in company pension programs and 401(k) plans lost their lifetime savings in Enron, Adelphia, Global Crossing, WorldCom and other companies.

An analysis of the country's economy demonstrates that the crisis cannot all be attributed to the September 11, 2001, tragedies in New York and Washington, D.C. Securities markets ebbed to a level not seen since the period between 1939, the nadir of the Great Depression, and 1941, the eve of World War II. From March 2000 through December 2002, investors saw $7.4 trillion in wealth evaporate from the 5,000 largest domestic companies.

Initially, politicians blamed the threat from abroad for the country's economic ills. Months after September 11, with the collapse of Enron and distressing signals from other institutions, the government turned to examining the crisis of principles within the corporate culture. The consensus: Corporate institutions were perched on the shifting sands of ethical ambivalence and obfuscated laws that government itself had manufactured. The answer: More law.

The far-reaching consequences of these corporate scandals were much worse than mere embarrassment. Many hapless and blameless employees of bankrupt companies found themselves unemployed, unable to pursue careers cut short by corporate malfeasance. Since September 2000, more than three million jobs have been lost.

When issues become melodrama in the public eye, the government responds. In this instance, new legislation was hastily drawn to cover loopholes in the law and restore truth to accounting principles and corporate balance sheets. Whether the government's involvement was timely and just or too little, too late or too much, too soon, remains to be experienced and debated.

While laws governing business are being built and repaired, the procedure for restoring or possibly reinventing business ethics is a task much more elusive.

The evolution of ethics from academic models to the corporate boardroom begins with instruction. For many years, the application of ethics to business decisions has been a priority at the University of Oklahoma's Price College of Business.

Price College does not teach ethics per se—the values that some say are developed in the first five years of life. Rather, this business school helps students draw from their own resources to create ethical models that can be applied to emerging circumstances in a business world that grows more sophisticated and complex with each passing day. Over the past two years, Price College has reinforced substantially its ethics component and hired several eminent academicians to weave the study of ethics throughout most of the curriculum. A priority in the college's newly developed strategic plan is to "strive to introduce more ethics content into all courses."

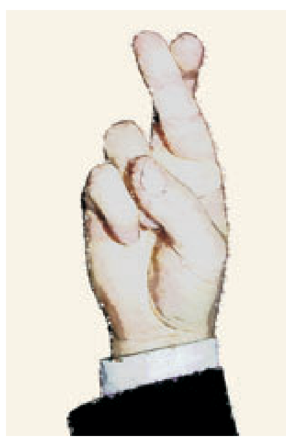
Among the newest faculty is Dennis Logue, Fred E. Brown Chair and dean of Price College. Prior to joining OU in summer 2001, Logue was the Steven Roth Professor at the Amos Tuck School of Business at Dartmouth College, where he had served since 1974. Pragmatic in his approach to business, Logue is a staunch advocate of ethical reforms. Among his credentials is an undergraduate degree in English, with minors in philosophy and theology.

At an ethics symposium held on the OU campus in November, Logue admitted that business ethics involve greed. "A certain amount of greed is good," he said. "The controlled greed of the 1950s through the '70s had a bounteous outcome for the economy. But unchecked greed is problematic."

An authority on corporate governance, Logue applauds much of the Sarbanes-Oxley Act, a law passed in summer 2002 that specifies in great detail the duties of corporate boards, chief executives, auditors and government regulators. But he chafes under the law's vague definition of who is qualified to lead a company. "I have a Ph.D. in finance and taught it for many years," he says. "But under Sarbanes-Oxley, I'm not a financial expert."

In the realm of corporate reform, Logue wryly suggests 12 principles as an ethical model for board members and chief executives. In essence, these principles incorporate the "Boy Scout Law." (See box on page 5.)

While the Sarbanes-Oxley Act may force companies to report more accurately their financial conditions, Logue believes that the new law, like its predecessors, could be sidestepped by unethical managers. To keep fraudulent accounting practices in check, Logue long has recommended reviving corporate dividends and relaxing government's policy to tax them twice [the tax on both corporate and investor income]. Dividends lost their luster during the extended bull market of the '90s, when investors favored growth stocks, which were credited for quickly building wealth without dividends.



Logue and others believe that cash, in the form of old-fashioned dividends, is more reliable than income statements in presenting the company's true condition to stockholders and potential investors. A plan to end the double taxation of dividends is part of a $670 billion economic stimulant package that President George W. Bush submitted to Congress in January.

The collapse of Enron and similar companies shared one commonality: management strategies that relied on accepted accounting standards to yield short-term fortunes. Accounting professor Chris Knapp witnessed firsthand the 1980 Penn Square Bank crisis in Oklahoma City, followed by the multibillion dollar savings and loan bailouts that burdened taxpayers, and the more recent series of corporate crises. He says Congress and the accounting profession must share blame for such developments.

These striking tableaux of succeeding failures provide the context for *Contemporary Auditing*, a textbook authored and recently revised by Knapp. The book has been adopted by more business schools throughout the country than any other auditing text. Knapp teaches the prerequisite financial accounting course and a graduate auditing course at Price College.

He observed that Enron's practice of unloading debt from its balance sheets by investing funds in some 3,500 unconsolidated companies and partnerships is "nothing new." In comments last year he said that, indeed, such debt-shifting practices had been condoned by government regulators.

The succession of bank failures touched off by the collapse of Penn Square Bank and the massive S&L failures that followed were symptoms of government policy, he insists. "Congress permitted

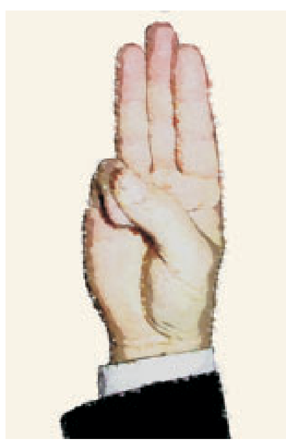
Chris Knapp, left, and Carol Knapp

Nim Razook, left, and Dan Ostas

them to use regulatory accounting practices, not generally accepted accounting principles. That allowed bankrupt institutions to keep operating and keep carrying bogus assets on their balance statements."

Knapp asserts that many of the problems we have witnessed in recent years within the financial reporting domain stem from the failure of the accounting profession's rule-making bodies to resist the lobbying efforts of outside parties, principal among them the executives of major corporations. For example, corporate interests recently squelched a proposal by the Financial Accounting Standards Board to require public companies to book compensation expense for large stock option grants made to corporate insiders.

A visiting professor of accounting, Carol Knapp is part of the new team commissioned to enlarge the breadth of ethics study at Price College. The wife of Chris Knapp, she is on leave of absence from the University of Central Oklahoma, where she is a tenured associate professor in accounting. At OU, she holds the McLaughlin Chair in Business Ethics, endowed in 1997 by OU alumnus Glenn McLaughlin, of Saratoga, California. [In addition, the $10,000 McLaughlin Prize is awarded annually



for the most outstanding research paper on accounting ethics. The competition involves distinguished scholars from throughout the world.]

Carol Knapp provides students with a decision-making model, based on ethical principles that students use to analyze ethical dilemmas. She also teaches an accounting course that concentrates on realistic ethical situations confronting accountants today. She has examined classic fraud examples such as the Lincoln Savings & Loan case of the 1980s, in which Lincoln CEO Charles Keating diverted insured deposits into high-risk real estate investments. But she says ethical issues have grown more ambiguous with the growth of international companies. "We don't all have the same ethical code," she says. "There has been globalization of the business economy. People from other countries have different business ethics."

Two Price College professors, each with degrees both in law and business, agree that changes in law will not provide the ultimate solution to problems with business ethics. Nim Razook, Price College professor of legal studies, for years has taught a core graduate course in law and ethics, and an undergraduate ethics course. He observes that ethical considerations can be just as complex as legal ones and that sometimes the two become the shareholders, the means chosen must be ethically defensible."

Mark Sharfman, left, and Robert Zmud

Price College Dean Dennis Logue

confusingly entangled. His topics have included such legal and ethical tragedies as the Dow Chemical explosion that killed hundreds in Bhopal, India, and the medical complications arising from the use of Johnson & Johnson's Tylenol.

Razook believes there is some "wiggle room" in most law that captures students' attention, but that ethical considerations must be defined and exercised much more precisely. He says that students want to take ethical questions head on. "Students want to see professors arrive at conclusions."

Dan Ostas, also with degrees in law, business and public policy, is new to the Price College faculty. He holds the Harlow Chair in Business Ethics and Community Service and teaches both legal studies and ethics-related courses. Ostas notes that, while students know the difference between right and wrong, "they may be less well equipped to identify ethical issues presented in business settings and to think through the ethical implications of alternative business actions."

Ostas favors providing students with procedures grounded in "critical moral

"The Boy Scout Law" for Corporate Directors and Executives

OU Business Dean Dennis Logue's presentations to corporate boards of directors and their executives do not rely on complicated charts and graphs. Instead he reduces the rules of ethical behavior to a simple set of 12 principles based on "The Boy Scout Law."

A Good Director (or Executive) Should Be:

Trustworthy: Sensitive handling of inside information.
Loyal: Remember you work for shareholders. Become financially literate.
Helpful: Work with executives on areas where you have expertise. Do your homework. Be prepared to discuss, debate.
Friendly: Raise delicate issues privately with the CEO before raising them before a large group.
Courteous: Do not turn boardroom discussions into shouting matches. Respect others' views.
Kind: Management needs prodding, not beating. Ask problem questions gently; help the respondent learn.
Obedient: Learn and obey all corporate and securities laws. Seek outside counsel as soon as needed.
Cheerful: At least not too grumpy.
Thrifty: Remember it's the shareholders' money.
Brave: Do not be afraid to confront a CEO (privately at first) if you believe corporate activities are inappropriate.
Clean: Well, you know what this means.
Reverent: Never hesitate to ask for divine intervention.

reflection" that can guide them through ethical business decisions. He says business ethics instructors should help students recognize ethical norms validated by "widespread social agreement" and emphasize that business people are expected to follow these norms.

Ostas' view of applying the law appears to differ substantially from opinions held by many others practicing the adversarial legal profession. "It seems that using the letter of the law—or a loophole in the law—to frustrate the law's legitimate social purpose is virtually impossible to defend on ethical grounds," Ostas says. "Although managers are honor-bound to advance the interests of the shareholders, the means chosen must be ethically defensible."

Robert Dauffenbach, left, and Frances Ayres

While errors in the field of public accounting have dominated the public's attention, age-old ethical questions have followed into the newer business disciplines. Associate professor of strategic management Mark Sharfman believes ethical problems grow common when "human beings are removed from the equation."

Sharfman, whose undergraduate background also includes a degree in philosophy, teaches an undergraduate business capstone course that integrates management principles with a series of case studies involving ethical decisions. He also teaches an MBA elective relying on ethics for half the course. Often, problems thought to be related to ethics are more properly within the realm of law or management, he believes. "The Enron case isn't about ethics, but crime," he says. The issues that decimated Enron's auditor, Arthur Andersen, "are not ethics, but fraud. When you label things ethical problems, it relieves people from doing their jobs."

Still, Sharfman sees ethical dimensions to an increasing number of business decisions. Not only do his students examine the world's differing standards, but also the values seen as acceptable in their own environment.

Sharfman illustrates with this example: A vendor for a company where one is employed as a purchasing agent furnishes private jet travel to a football game, lodging, meals and gifts worth $25,000. Is there an ethical decision to be made here? Most of his students would accept the gifts, Sharfman says.

"Instead, what if the vendor offers 25 one-thousand-dollar bills? Accounting students tell us the IRS would treat both situations the same. But most students say they wouldn't take the $25,000 cash. We have interesting discussions about the intentions of the vendor. A lot of those people up there in the skyboxes at football games are in the same situation."

The growth of technology has dehumanized many questions, removing people from the equation, Sharfman feels. The result is that human values become one step removed from business decisions. "In finance, should you design investment vehicles no human can understand?"

The more technology abounds, "the easier it is for people to perpetrate unethical opportunities," agrees Robert Zmud, who directs Price College's management information systems division. Zmud recently was involved in a dissertation that explored the likelihood of computer "hackers" embedding false information in the database at an Air Force installation. "The safety of our technical data is a real national issue," he says.

Zmud maintains that the nature of computer software, the safety of sensitive data, public trust and the right to personal privacy all carry ethical implications that both MIS professionals and the public must understand. "Cyberspace is not as safe a world as we would think it is," he observes.

The selling of personal information has grown common with the spread of computer technology, Zmud says. It is possible today to develop software that collects personal and financial information from unsuspecting victims and sell it to companies clamoring for such data. "The programmers who write these systems probably feel this work is unethical."

A company's promise to protect personal information in its database should be an area of genuine concern, Zmud feels. If a company goes bankrupt, its pledge to protect private information "goes out the window. Among a company's assets that can be sold is the information it has about its customers."

Zmud describes today's software, or the rules that define how data move through computer systems, as "so complex that when companies come out with

JUST HOW MUCH IS A CEO WORTH?

Most galling to the general public is the vast wealth accumulated by corporate chief executive officers—in good times and bad. Even as the value of companies plummet, their CEOs are seen escaping under golden parachutes crammed with cash and other valuable perks.

Two Price College experts in the field of corporate operations believe that free market forces and the rare skills possessed by top executives justify the considerable wealth they receive.

Frances Ayres, director of the Price College School of Accounting, and Robert Dauffenbach, associate dean for research and graduate programs and director of the college's Center for Economic Management and Research, also agree on another point: It is not how much these executives earn, but how they are paid that poses ethical hazards.

CEO salaries may be generous, but for many of them, options to purchase the company's stock at favorable prices comprise the greatest share of their remuneration. These CEOs are free to exercise their stock options at any time, often rustling the markets and driving down the value of their companies when they sell their stock.

The ethics of this practice become questionable when a corporate chief, in the best position to know the true financial condition of the company, sells his stock just before the enterprise's imminent disaster. Arguably, a CEO who guides his company to establish short-term gains before selling his stock at a higher price is just as compromised.

To amend this practice, Ayres suggests that CEOs and other top executives of the company should be paid for their performance "only if the pay relates to actual performance of the company. It should not be possible for an executive to lead a company to bankruptcy while pocketing millions—or even billions—of dollars."

Ayres believes that time and situation constraints should be imposed on the ability of chief executives to unload large blocks of company shares. "Large stock sales by executives can trigger declines in stock that damage shareholders," she maintains. "To the extent that stock sales lead to or coincide with stock declines, stock sales should be limited. One approach would be to require that stocks acquired through stock options be held for a period of at least one year."

Dauffenbach holds a similar view. To limit the "moral hazard" imposed by stock options, Dauffenbach calls for removing stock options from the realm of temptation. "Exercised options should be held as treasury shares by the company in the corporate official's name until the corporate official leaves the company," Dauffenbach recommends. The time constraint "gives the CEO and others receiving options a longer-term interest in the company's progress."

Ayres and Dauffenbach agree on another aspect of timing: Under all circumstances, the CEO's dealings in the company's stock should be promptly disclosed to shareholders.

"Disclosures about CEO pay need to be made more transparent to shareholders and potential shareholders," Ayres believes. "Information about the value of executive options and changes in the value should be clearly disclosed on a timely basis."

Dauffenbach notes the CEO's distinct advantage in terms of insider knowledge of the company. "Because corporate officials possess asymmetric information about how well the company is doing, their dealings in the company's stock should be made instantly available." He recommends cutting the deadline for notifying the SEC of stock sales "to the bare minimum," and making the transactions available on the Internet.

new versions, errors exist. Hackers find these errors for economic gain."

Computer fraud, often lucrative, is an ethics problem often dwarfed by its rewards, Zmud says. "How much are you paying a guy to protect your computer? How much does a guy who breaks into your computer walk away with? It's almost an uneven playing field. There are many people out there, extra-smart and nefarious at heart."

MIS also has been used to conceal pertinent data about a company, much as accounting techniques have hidden debt. Zmud urges students to realize unethical practices in the field, "take a hard principle stand," and "confront management with the facts."

Dean Dennis Logue acknowledges the vital relationship of ethics and business. Yet he expresses frustration with its regressive tax on the graduates of Price College and other schools who join the rank and file in today's business world.

Logue finds that the business environment leaves few choices to lower echelon employees troubled by ethical concerns. Says Logue: "The employee can quit, but the bad act goes undetected, and he loses his paycheck. If he voices a complaint to management, the board of directors or the SEC, he goes without a paycheck and is labeled a troublemaker. Or, he can show 'loyalty' and keep his mouth shut.

"One of the things educators struggle with is how to convince young students how far to go. What we have to try to do is verify the deepest ethical considerations that require decisions. What we have to try to teach is courage."