“CA: Computer Associates or Creative Accounting? How corporate culture can influence unethical behavior”

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SECTION 4. Practitioner’s corner

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CA: Computer Associates or Creative Accounting? How corporate culture can influence unethical behavior

Abstract

This paper examines the establishment of a pattern of unethical behavior using Computer Associates as a case study. By incorporating their own self-interests into the firm’s corporate culture, top level managers at Computer Associates used Machiavellian techniques in order to support an unethical corporate culture. In addition, the establishment of unethical individual and group norms allowed employees a rationale for their unethical behavior. This unethical behavior was exposed when the federal government started a criminal investigation of Computer Associates. The initial allegations were that Computer Associates allowed monthly sales to be booked for up to 35 days representing a month in violation of Securities and Exchange Commission requirements. The former CEO was charged and was found guilty of securities fraud and obstruction of justice. Computer Associates disassociated themselves from the actions of the unethical managers who left the company and started with a clean slate, which included changing their name to CA.

Keywords: Computer Associates, corporate culture, Machiavellian, ethics, fraud, group norms.

JEL Classification: M14.

“Scum-sucking competitor”

Computer Associates co-founder Charles Wang’s description of one of its rivals.

Introduction

Corporate culture is defined as the shared values and beliefs of individuals within an organization (Stanwick and Stanwick, 2009). Corporate culture is an important concept to examine when researchers attempt to explain unethical behavior within an organization. Previous research in the area has primarily focused on the positive aspects culture can have related to firm performance (Deal and Kennedy, 1982; Peters and Waterman, 1982; Denison, 1990). However, it is also important to consider the negative impact corporate culture can have on a firm’s operations if the culture supports unethical and illegal activities. This study will examine how one company, Computer Associates, developed a culture, which resulted in unethical and illegal actions by the top managers within the firm.

1. Computer Associates and corporate culture

Computer Associates is a business software manufacturer formed in 1976. Co-founder Charles Wang had absolute control over the decisions made by the executives at Computer Associates. In addition, Wang established a “culture of fear” within Computer Associates to enhance his power. Furthermore, he promoted inexperienced employees to positions, which they were not qualified for in order to guarantee that Wang would not have any hostile challenges to his ideas (Kessler, 2007).

This type of absolute control and manipulation is a clear example of a Machiavellian approach to management. Previous research has concluded that managers who focus solely on their own self-interests and who will manipulate anyone in order to achieve their own established goals will use unethical and potentially illegal actions in order to obtain those goals (Hegarty and Sims, 1979; Singhapakdi and Vitell, 1990; Granitz, 2003)

2. Computer Associates and group norms

In February 2002, Computer Associates’ stock dropped 17 percent to $20.91 after it was announced that federal authorities stated that they had started a formal investigation on Computer Associates’ accounting practices. This announcement came after a previous disclosure by The New York Times in April 2001 that questioned the accuracy for the firm’s revenue and net income calculations. By May 2002, the Securities and Exchange Commission and the Justice Department announced that the investigation had deepened pertaining to Computer Associates’ accounting transactions. One new action that was included in the investigation was the payment of $1.1 billion in 1998 in stock given to three top executives at Computer Associates based on the performance of its stock price.

The $1.1 billion payout is based on the condition that the stock price stayed above $53.33 for more than 60 days over any 12-month period. The 60 day limit was achieved in May 21, 1998 and exactly two months later Computer Associates released a profit warning which resulted in the stock price falling steeply (Anonymous, 2002). In 1998, based on the financial performance of the company, Sanjay Kumar was given a $330 million bonus (de la Merced, 2006). This $330 million bonus was Kumar’s share of the $1.1 billion in stock that was divided among co-founder and CEO, Charles Wang.
President and Chief Operating Officer, Kumar, and Computer Associates other co-founder, Russell Arztk. The amount of $1.1 billion nearly equaled the total profits of Computer Associates for 1998. After investors filed numerous lawsuits, the three executives returned $250 million leaving only $850 million left to be split three ways (Varchaver, 2006).

The manipulation of the financial statements and the awarding of self-bonuses not only fortified the Machiavellian aspects of Computer Associates’ top-level managers, but it highlights the impact leadership and peer norms have on the decision process. Previous research (Arlow and Ulrich, 1988; Brenner and Molander, 1977) found that the leadership of the management dictates the type of behavior by the individual. As a result, a management driven by unethical leadership would support actions that were unethical and illegal by the firm.

As Conger and Kanugo (1998) warned, leaders who are narcissistic have a flawed vision of the world. By rewarding themselves at extreme monetary levels, the top management at Computer Associates reinforced the unethical corporate culture by supporting their own self-interests instead of the interests of the firm’s stakeholders. Furthermore, the rationale of awarding large values of bonuses to themselves highlights how the group norms at the top management level at Computer Associates had been infected with unethical reasoning. As Miller and Thomas (2005) state, peer pressure of colleagues within the same work group would support and reinforce unethical behavior even if it is in violation of the individual’s own personal code of ethics. Therefore, the corporate culture of Computer Associates supported by the group norms at the top level not only did not object to the manipulation of financial statements and the awarding of high-level bonuses, but also provided a supporting culture, which gave the individuals a “legitimate” rationale for their actions.

3. The 35 day month

In April 2004, CEO and Chairman Sanjay Kumar resigned from his positions at Computer Associates and accepted a demotion to “chief software architect”. Kumar left Computer Associates completely in June 2004. The resignation came after Computer Associates former CFO, Ira Zar, former Vice President of finance, David Rivard, and former division Vice President of Finance, David Kaplan, had plead guilty to securities fraud and conspiracy to obstruct justice. As part of their plea bargain, the Computer Associates executives admitted that senior executives knew about the 35 day month booking cycle (Farrell, 2004). It was alleged that fraudulent accounting started at Computer Associates by its co-founder Charles Wang in the 1980s and the 1990s. It was alleged that Mr. Wang directed and approved backdating contracts for several days after the end of a quarter. Known internally as “35 day months”, this allowed Computer Associates to book revenue in the previous quarter even though it was actually earned in the next quarter. Mr. Wang also instructed Sanjay Kumar to book the revenue for the contracts after the quarter has closed. It was alleged that in July 1999, Mr. Wang ordered Kumar to fly to France in order to close a $32 million deal in which the revenue was improperly recorded in the previous quarter’s results. During the same quarter, it was alleged that Computer Associates had improperly recognized revenue of $1.75 billion based on 165 contracts. The $1.75 billion was equivalent to 29 percent of the firm’s total revenue for 1999 (Bulkeley and Forelle, 2007). Kumar took over the CEO position from Wang in 2000.

It was also revealed during the three executives’ plea bargain agreement that executives at Computer Associates would do whatever it took to cover up the 35 day month practice from its external auditors. Executives at Computer Associates would tamper with the documents pertaining to license agreements by removing the license agreement facsimile stamps and other date notions to conceal the true contract date (Farrell, 2004). It was alleged that Kumar lied to the FBI and its own lawyers regarding the 35 day month practice. In addition, Kumar allegedly approved a $3.7 bribery payment to a potential witness so that the witness would keep quiet about the 35 day practice (de la Merced, 2006).

It is critical within any corporate culture that a support system is in place to support the current values and norms and resist changes to those norms. Furthermore, company leaders, such as the CEO and the founder, establish the corporate culture and subsequently revise the culture, if needed, to satisfy their own vision. As a result, Charles Wang believed that the financial reporting is just a technical requirement needed by the firm in order to remain a publicly traded entity. As a result, he was able to rationalize to himself and to the new CEO, Sanjay Kumar, that even though this may be “technically” incorrect, there is no harm in allowing an extra 5 days of booking. This rationalization is supported by Dunn and Ginsberg (1986) and Sirsi, Ward and Reingen (1996) who stated that groups sharing the same norms would eventually develop the same shared frames of references. As a result, the 35 day month became entrenched into the mindset of the top level executives and it no longer became an issue in which the ethical merits of the action were questioned.

4. The beginning of the end

In September 2004, the SEC charged Computer Associates with securities fraud for backdating con-
tracts related to the 35 day months. Both Sanjay Kumar, Stephen Richards, former head of Worldwide Sales, and Steven Woglin, former General Counsel, were charged with securities fraud, obstruction of justice and conspiracy to obstruct justice. From 1998 to 2000, CA kept its books open to record revenue after the quarter had finished. It was estimated that Computer Associates had booked $2.2 billion in premature revenue for 2000 and 2001 and more than $1.1 billion in the years before 2000. Computer Associates agreed to pay $225 million to avoid corporate criminal prosecution in the accounting fraud scandal. In addition, Computer Associates agreed to make changes in their corporate governance and financial accounting control mechanisms.

The net result of a corporate culture that supports unethical actions was that the individuals, who developed, maintained and supported this type of culture, would not be penalized for their actions. The top executives at Computer Associates were “caught” when the information presented externally could not be reconciled with the information that was available internally. Again, this disconnect should not be surprising since the internal information was supported by an unethical culture. Therefore, the “reality” of the information was supported by the corporate culture but the same internal information could not be supported beyond the firm’s internal culture. Bass and Steidmeier (1999) stated that the leader of the firm can manipulate the beliefs of the subordinates into believing in an altered state of reality. This could explain why Computer Associates was “surprised” with the criminal investigation since they did not believe that they had done anything wrong.

5. A new beginning

In November 2004, Computer Associates hired John Swainson as its new CEO. Swainson previously was the head of IBM’s software sales. Swainson took over from Kenneth Cron who was interim CEO after Sanjay Kumar had resigned his CEO position in April 2004 (Reuters, 2004). One year later, in November 2005, Computer Associates changed their name to CA to try and send the message to investors that the company was starting anew. CA also presented their new slogan, “Believe Again” (Cowley, 2005).

The purging of an unethical culture can only take place when the facilitators of the unethical culture leave the firm. Sinclair (1993) states that the firm’s culture should be examined to identify the origins of the unethical behavior and should also be used as part of the solution to correct the unethical behavior of the firm. As a result, in order to establish a new corporate culture, a new beginning must take place with a new CEO and a new company focus.

In November 2006, Sanjay Kumar was sentenced to 12 years in federal prison and was ordered to pay an $8 million fine for securities fraud and obstruction of justice. The judge had warned Kumar that he could have received a much longer sentence of 80 years, which would have been the equivalent to life in prison. Kumar is eligible to receive a reduction of 15 percent of his sentence (or two years) if he maintains good behavior during his incarceration. Kumar’s lawyers had argued that most of the revenue that CA had booked would have been recognized a few weeks after the fact anyway (Bulkeley, 2006).

In April 2007, Kumar agreed to pay almost $800 million in restitution for investors who were misled by the fraud at Computer Associates. Kumar was ordered to pay $52 million in 2007, which would equal most of Kumar’s net worth. The $50 million will be based on $20 million of his own assets (including: a $9 million house in New York state; a 57 foot Italian Azimut yacht; two Ferrari 550 Maranello cars; a Land Rover and a Volvo) and $30 million from the trusts that had been established for his wife and children. He was then ordered to pay 20 percent of his wages every year until his death after he is released from prison (Berenson, 2007). On the same day, a special committee of the board of directors of CA released a report in which they accused CA’s co-founder Charles Wang of fraudulent actions with a recommendation to have legal action taken against Wang. The committee had concluded that Wang was directly responsible and participated in the $2.2 billion fraud that occurred at Computer Associates.

Wang’s response was “I find it hard to understand how the Special Litigation Committee could believe the information they were given was credible, when their sources are those who perpetrated the crimes at issue and then lied about them to both internal company investigators and the government” (Reuters, 2007). The committee had recommended that Wang be sued for at least $500 million for his alleged illegal conduct (Bulkeley and Forelle, 2007). The committee also negotiated with Kumar to have him pay an additional $15.25 million in addition to the $52 million ordered by the judge to be given to CA stockholders (Reuters, 2007).

In August 2007, Sanjay Kumar began to serve his 12 year prison sentence for his role in the $2.2 billion accounting fraud. He was sent to a minimum security federal prison camp in Fairton, N.J (Reuters, 2007). Due to a 5 year statute of limitations of criminal charges, Charles Wang was never charged for his role in the accounting fraud.
As part of the corporate healing process, the employees at Computer Associates must understand their responsibility in guiding a positive ethical culture. In addition, the employees must understand what the consequences would be if they do not follow a positive ethical value system. The financial and prison penalties given to former CEO, Sanjay Kumar, highlighted that unethical behavior will not be tolerated at the new Computer Associates. Furthermore, the company also attempted to try and punish the originator of the unethical corporate culture, Charles Wang. Even though the statute of limitations did not allow Wang to be criminally prosecuted, the special investigation provided a valuable contribution for Computer Associates. By publicly denouncing Wang’s actions and severing all ties with Wang’s management vision, Computer Associates can successfully claim that they have started as a new firm without any association with the previous regime.

Conclusions

This case highlights a number of important concepts related to unethical behavior within corporations. The actions taken by the top executives at Computer Associates support the belief that unethical actions influence the corporate culture of the firm. Through the use of group norms at Computer Associates, unethical behavior was not discouraged by top level managers and was actually supported by the actions of the managers. As Trevino, Hartman, and Brown (2000) state, a top level executive must be both a moral person and a moral manager in order to develop an ethical leadership role within the firm. It is through both “talking the talk” (moral person) and “walking the walk” (moral manager) that top level executives can guide the ethical behavior of the individuals through the firm’s corporate culture. As a result, when a manager is not a moral person or a moral manager, as was the case with Charles Wang and Sanjay Kumar, the manager is considered an unethical manager by Trevino et al. (2000) and should no longer be part of the organization. As was shown in this example of Computer Associates, the only resolution to unethical management is the removal of the unethical managers and the subsequent punishment for their actions. This was certainly the case with Sanjay Kumar; however, Charles Wang was not criminally prosecuted due to the statute of limitations. However, Computer Associates was able to disassociate itself from Wang via its internal investigation and publicly served all ties with the former co-founder of Computer Associates.

References