

Current Developments in Managing Organizational Ethics and Compliance Initiatives*

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There are many reasons to develop the most effective organizational ethics and compliance program possible. First, organizations face significant threats from ethical misconduct and illegal behavior from employees and managers. Well meaning managers often devise schemes that appear legal, but are so ethically flawed they result in scandals and legal issues. There is a need to identify potential risks and uncover the existence of activities or events that relate to misconduct. There must be a plan and infrastructure to determine what is happening and deal with it as soon as possible rather than covering up, ignoring, and assuming that no one will ever find out about ethical and legal lapses. There is a need to discover, disclose, expose, and resolve issues as they occur. All firms have misconduct and discovering and dealing with these events is the only effective way to be successful in today's complex regulatory system. The existence of plaintiff friendly civil litigation can destroy reputation and draw intense scrutiny to a company.

Second, the Federal Sentencing Guidelines for Organizations (FSGO), which went into effect in 1991, with significant amendments in 2004, generally tie potential penalties for violations of the law to the quality of corporate ethics and compliance programs. The United States Sentencing Commission, which developed the guidelines, recommends strict and severe enforcement of existing regulations and statutory requirements, particularly in cases where companies have failed to take proactive actions

to promote ethics and compliance. Judges, courts, and regulatory agencies look for evidence of a proactive commitment to ethics including the existence of strong compliance programs, evidence of voluntary disclosure of misconduct, and evidence of full cooperation in the investigation of misconduct. Failing to find such evidence, the commission recommends that judges enforce regulations and sentencing without any mitigation. The requirements imposed by the Sarbanes-Oxley Act (SOX) are also significant for ethical planning. This legislation has created new requirements for accountability and ethical conduct as a result of the corporate financial scandals in recent years. The major provisions of the SOX include criminal and civil penalties for noncompliance violations, certification of internal auditing by external auditors, and increased disclosure regarding all financial statements. In addition, the law mandates codes of ethics for senior financial officers and disclosure of audit committee financial experts. Compliance with SOX has been estimated at an additional expense of \$7 billion a year for public companies.

In addition, the Department of Justice, through the Thompson Memo (Larry Thompson, Deputy Attorney General , 2003 memo to the United States Attorneys) advanced general principles to consider in cases involving corporate wrongdoing. This memo makes it clear that ethics and compliance programs are important to detect types of misconduct most likely to occur in a particular corporation's line of business. Without an effective ethics and compliance program to detect ethical and legal lapses, the firm should not be treated leniently. Also, the prosecutor generally has a wide latitude in determining when, whom and whether to prosecute violations of Federal law. United States Attorneys are directed that charging for even minor misconduct may be

appropriate when the wrongdoing was pervasive by a large number of employees in a particular role, e.g., sales staff, procurement officers, or was condoned by upper management. Without an effective program, to identify an isolated rogue employee involved in misconduct there can be serious consequences associated with regulatory issues, enforcement, and sentencing.

Third, the 2004 amendment to the Federal Sentencing Guidelines for Organizations require that a business's governing authority is well informed about its ethics program with respect to content, implementation, and effectiveness. This places the responsibility squarely on the shoulders of the firm's leadership, usually the board of directors. The board must ensure that there is a high-ranking manager accountable for the day-to-day operational oversight of the ethics program. The board must provide for adequate authority, resources, and access to the board or an appropriate subcommittee of the board. The board must ensure that there are confidential mechanisms available so that the organization's employees and agents may report or seek guidance about potential or actual misconduct without fear of retaliation. Finally, the board is required to oversee the discovery of risks and to design, implement, and modify approaches to deal with those risks. If board members do not understand the nature, purpose, and methods available to implement an ethics program, the firm is at risk of inadequate oversight in the event of ethical misconduct that escalates into a scandal.

The Role of an Ethical Corporate Culture

However, it is important not to merely emphasize legal compliance at the expense of developing an ethical corporate conscience. Training, educating, and

motivating employees to act in ways consistent with both legal requirements and ethical expectations is at the core of planning to prevent and manage misconduct. Companies themselves do much to establish the values, the culture, and the expectations for conduct that employees hold about daily life within the firm. This is achieved explicitly through codes of conduct and statements of values/ethics documented in organizational communication. This is also accomplished implicitly through dress codes, anecdotes about company heroes and villains, treatment of customer complaints, treatment of employee complaints, how meetings are conducted, and in which behaviors and accomplishments get rewarded and recognized compared with which behaviors are criticized, ignored, or punished. In fact, ethical leadership and ethical culture of the organization are considerations in the 2004 amendments to the Federal Sentencing Guidelines for organizations and the Department of Justice Thompson memo.

Managers cannot motivate employees or coordinate their efforts without effective communication about values, standards, and expectations. Communication is important in providing guidance for ethical standards and activities that provide integration between the functional areas of the business. No program can be implemented without complete understanding of its objectives and employee cooperation to make it work. While most managers and employees don't have "ethics" in their job title, everyone is ultimately accountable.

Ethical Leadership

To move from just being an ethical person in everyday life experiences to being an ethical leader in a corporation requires synchronizing the development of both character and competence. Leaders must be competent in understanding organizational ethics and the requirements to implement programs. Leadership requires an understanding of the firm's vision and values, as well as the challenges of responsibility and risk in achieving organizational objectives. The West Point model would suggest that character and competence must be developed simultaneously. Character alone will result in failure and competence without character will result in misconduct and eventually failure. Lapses in ethical leadership do occur even in people who possess strong ethical character, especially if they view the organization's ethical culture as being outside of the realm of decision making that exists in the home, family, and community. This phenomenon has been observed in countless cases of so-called good community citizens engaging in ethical misconduct that sometimes lead to corporate ethical disasters. An ethical individual can be a cautious and conforming participant in a corporate culture that tolerates unethical conduct.

In the long run, if a company's leader fails to satisfy stakeholders, he or she will not retain a leadership position. In today's earnings driven world, many top managers think only of the bottom line and quarterly expectations. Leadership requires knowledge of complex regulation related to SOX, FSGO, and other regulatory agencies. The NBES 2005 Study found that 81% of employees trust the promises of top management. This means that almost 1/5 of all employees are skeptical. In addition, the study found that 42% of companies have a weak ethical culture.

Ethical leaders are competent managers who take a holistic view of the firm's ethical culture. Ethical leaders can see a holistic view of their organization and therefore view ethics as a strategic component of decision making, much like marketing, information systems, production, and so on. You don't want key employee or issue information trapped in a "silo" structure not coordinating information between human resource management, legal, auditing, and ethics. Without the ability to coordinate these domains key oversight and understanding will be lost.

In addition, employees need guidance on where to go for assistance from managers or other designated personnel in resolving ethical problems. To communicate ethical values and implement an effective ethics program, there must be interaction including monitoring, reporting and answering concerns and questions about issues and events.

Dealing with the Risk of Misconduct

An ethics and compliance program needs to develop and support an ethical corporate culture. Employees should know that they will be supported if they do the "right thing" in all situations where this is an opportunity to engage in misconduct or to be complacent when others engage in misconduct. The Ethics Resource Center, reported in its 2005 National Business Ethics Survey (NBES), that 52% of employees observed at least one type of misconduct in the past year. Just over one-half (55%) reported the misconduct to management, a 10 percentage point decrease since the 2003 NBES survey. In addition, organizations with strong ethical cultures and full formal programs are less likely to observe misconduct. Formal programs were found to be an essential element of a strong culture.

The reality is that employees are at high risk for observing or engaging in misconduct. According to the NBES survey, one-third of all employees encounter a situation at work that they think invites ethical misconduct. Of those employees, 74% also observed at least one act of misconduct. Formal programs and strong ethical cultures significantly reduce the pressure to engage in misconduct, observe misconduct, and report misconduct. The Open Compliance Ethics Group reports that firms that have effective programs and culture do not have scandals and events that cause significant legal or reputation damage. Therefore, we should assume that the only way to effectively detect and prevent serious organizational misconduct is through effective ethics and compliance programs.

The Role of Monitoring and Reporting in Ethics Programs

Corporate America seems to be moving quickly to install important components of formal programs. In 2005, the NBES survey reported that 73% of employees say they firms have a means which they could use to report misconduct anonymously, an increase of 7 percentage points over 2003. Also, the NBES survey indicated that 65% of U.S. employees have a place where they can seek ethics advice, 21 percentage points more than in 2003. The ability of an organization to discover misconduct depends on integrated systems and reporting mechanisms.

Monitoring and reporting events is an ongoing activity that requires measuring organizational performance against the firm's stated ethical standards. Compliance can be appraised through the observation of employees and adopting a proactive approach to dealing with ethical and legal issues. An effective ethics program uses investigatory

reporting and case management systems, not just any reporting. While anonymous reporting through electronic systems can identify issues, more advanced case management systems assist with analysis, investigations; follow up, tracking and reporting. Sometimes external auditing of other organizations' programs can be helpful in developing benchmarks of compliance. In 2005, the Open Compliance Ethics Group developed a Benchmarking Study to identify gaps in programs and evaluate programs against an objective standard.

Questionnaires that survey employees' perceptions of the ethics of their superiors, colleague, and themselves, as well as their ratings of ethical or unethical practices within the firm and industry can serve as benchmarks in an ongoing assessment of ethical performance. Then, if unethical behavior is perceived to increase, managers will have a better grasp of what types of misconduct are occurring and why. A change in the ethics training within the company may be a necessary response.

A system for employees to report their observations of wrongdoing or ask questions is particularly valuable in monitoring and evaluating ethical performance. A growing number of corporations have established case management systems to offer support and give employees an opportunity to register ethical concerns. Initially, these were operated internally, but the trend today is for companies to outsource their anonymous reporting to firms with expertise in managing electronic reporting methods and providing other compliance services. While there is always some worry that people may misreport a situation or misuse the system to retaliate against another employee, anonymous reporting has become widespread and employees do utilize them.

Effective monitoring systems also require prompt investigation of any recognized or suspected misconduct. Once an investigation is complete, the ethics officer or other appropriate manager needs to make a recommendation to senior management on how to respond. In some cases, a company may be required to report substantial misconduct to a designated government or regulatory agent. As with simple telephone or email reporting (hotlines), there is a growing number of experts and consulting firms providing services that can businesses can rely on to manage incidents of misconduct, sometimes called case management. One such firm is Greenfire International/Intercede (Charlotte, NC), which provides professional case-management services and software. The Intercede software system enables companies to receive reports of employee concerns, complaints, or observations of misconduct, anonymously where applicable, and to track and manage these reports. The Intercede system helps in investigations, analysis, resolutions, and documentation of misconduct reports. Among the benefits of such systems is that the management of conflicts can help prevent the possibility of lawsuits and that shared management and prevention can help a company analyze and learn about ethical lapses.

Assessing the Benefits of Ethics and Compliance Programs

Finally, an ethics programs should be regularly assessed or audited to determine its effectiveness. In particular, it is useful to focus on the key factors that influence how ethical decisions are made, including organizational culture, peers, superiors, and formal systems of reward and punishment. Understanding the ethical issues in an assessment can help in refining the codes of ethics and developing other programs to encourage ethical behavior in your organization.

Finally, what are the rewards of ethics and compliance? An Open Compliance Ethics Group study indicates that among companies with an ethics program in place for 10 years or more, none has experienced damage to their reputation in the last 5 years. The U.S. Sentencing Commission reports no firm with an effective ethics and compliance program was sentenced between 2000 and 2004. Communication by the firm's leadership helps keep the firm on its ethical course, and these executives must ensure that the ethical climate is consistent with the company's overall mission and objectives. Developing a values-based orientation fosters a system that provides a core of ideals such as respect, honesty, trust, and responsibility. In a values-centered program, employees become more open, are willing to deliver necessary information to supervisors, and generally begin to feel comfortable about how to make decisions in situations where there are no defined rules.

*Some of the content has been adapted from Lynn Brewer, Robert Chandler, and O.C. Ferrell *The Value of a Corporate Ethical Disaster*, Texture, forthcoming March 2006.