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## TOP STORIES INSIDE

- 8 The seven biggest mistakes companies make that erode ethical culture and destroy reputation
- 20 Culture and values: Driving innovation in ethics and compliance
- 24 Understanding the compliance risks of deemed exports
- 34 The “why” of misbehavior: Recent advances in behavioral business ethics
- 42 In the Spotlight: Alex Brigham, executive Director of the Ethisphere Institute



**Meet Paul Fiorelli**  
Co-Director of the Cintas Institute for  
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# The seven biggest mistakes companies make that erode ethical culture and destroy reputation

By Eric Feldman

You can't pick up a newspaper or turn on the television news today without hearing yet another disturbing story about corporate fraud in all its forms: bribery, gratuities, kickbacks, false claims, violations of the Foreign Corrupt Practices Act (FCPA), and even illegal corporate wiretapping of private citizens. Most of these stories begin with a rogue company employee, manager, or executive who violates the rules of the road, followed by a whistleblower reporting the "crime" to the Securities and Exchange Commission (SEC), the Department of Justice (DOJ) or a federal/state Office of Inspector General. A subsequent federal or state investigation leads to government prosecutions of both the employee and the company, followed by lengthy and costly litigation. The DOJ, SEC, or other agencies then demand settlements or fines in the millions or hundreds of millions of dollars, forcing the company to sign a consent decree admitting responsibility and accepting years of monitoring and reporting requirements.

The end result is usually disastrous for companies and the people that run them: financial losses that can cripple a company's future; the tanking of corporate and product reputation that took years, even decades to build; erosion of stock prices; and the loss of jobs in an already weak economy. It is at this point in the process that most companies just begin to take action, usually in the form of damage control and crisis management.

The truth is that, in most cases, the most severe consequences of corporate ethical lapses can be mitigated, even avoided, by proactive care and feeding of a company's ethical culture. Even small companies can afford to invest in several very simple steps to demonstrate to stakeholders and government regulators that their commitment to ethics and integrity is real, pervasive, and unwavering. Unfortunately, with all of the pressure surrounding business performance these days, the elements of an ethics program often take a back seat until a crisis

blows up—when it's too late to "put the genie back in the bottle."

The following is a list of the most frequent mistakes companies make by failing to build in the elements of a credible ethics and compliance program into their business process. Avoiding these mistakes, employing time-tested risk reduction strategies, and demonstrating due diligence and a strong ethical culture in advance of the inevitable crisis can make the difference between a bump in the road or quicksand when the government comes knocking at the door.

## 1. Put the Code on the shelf

A corporate code of business ethics and conduct, or the "code of conduct," is not a reference handbook, like a dictionary, which contains the list of "thou shalt nots" that can be stored on the shelf in the unlikely event that someone might need to look at it sometime down the road. Nevertheless, bookshelves of many Fortune 100 companies all over America are cluttered with nice, glossy Code booklets with

bindings intact and inches of dust. An effective code of conduct is the living manifestation of a company's core values. It identifies the company's ethical expectations of its employees in a variety of areas, communicates the CEO's personal priorities and commitments to ethics and integrity, outlines the most common rules and regulations that are applicable to their unique business areas, and lays out the consequences of employee failure to adhere to these rules. Most importantly, it should provide the framework for good ethical decision making by both new employees and veterans, it can be applied to virtually every situation, and it provides numbers for employees to contact when there are doubts about which path to take.

The code of conduct should also form the basis for company ethics training, and be used and referenced in staff meetings, from the boardroom to the mailroom. It needs to be regularly updated to reflect constantly changing laws, regulations, business practices, and new markets, and be included in annual tests of employees' ethics knowledge. I know of one company that attempted to use its code of conduct as a defense of its ethical culture when an employee took bribes from a subcontractor and passed the cost of the bribes along to the government as "overhead." The company said that the employee was a "rogue actor" in

an otherwise stellar ethical culture, as supposedly demonstrated by their glossy code of conduct. When asked by prosecutors about the last revision of the Code, the company sheepishly admitted that it hadn't been updated in six years. The company was subsequently prosecuted for submitting a false claim.

## 2. Ignore the culture

There is a lot of confusion these days between the terms "ethics" and "compliance" and many businesses think they are one and the same. They are not. "Compliance" refers to adherence to laws, rules, and regulations. It is the "floor" of behavior, the very minimum the government expects a company to honor as it goes about its business. "Ethics" is the set of guiding principles and core values that guide a company's (and its employees') behavior and decision making, and is often a higher standard than what is laid out in the law.

Companies that focus solely on compliance ignore the ethical culture of their organization, often at their own peril. Ethical culture, loosely defined, refers to "how things are *really* done around here" versus what is in the manual. It is the employees' perception of what their bosses expect and what they will really do under different circumstances. For example, although the company may talk a good line about

ethics and integrity and officially denounce the giving of gifts or gratuities to "facilitate" contracts, the culture may value production and reaching quarterly financial goals over the prohibition of gifts and payments. According to the Ethics Resource Center, the state of a company's ethical culture is a key determining factor that drives the amount of employee misconduct within a company.<sup>1</sup>

Ethical culture can be readily assessed through the administration of simple employee cultural surveys at regular intervals (every other year is recommended). Survey areas can include employee perceptions of ethics and integrity at the executive, middle management, and supervisory levels; employee comfort level with reporting observations of code of conduct violations; employee fear of whistleblower retaliation; overall knowledge of the content of the code of conduct and other aspects of the ethics program; and perception of the strength of internal controls. These surveys can be benchmarked against other companies to help determine where your company stands, and the results (and trends from year to year) can help form the agenda for constant improvements to the ethics and compliance program.

A sound ethical culture is viewed as a key to avoiding corporate scandal, safeguarding a company's reputation, and

*CONTINUED ON PAGE 10*

sustaining brand value. This requires the investment of time and attention, not necessarily a heavy investment of resources. A study on ethical culture by the Woodstock Center at Georgetown University said it best: “An ethical corporate climate is either developing or deteriorating, enriching itself or impoverishing itself. It needs constant care and attention.”<sup>2</sup>

### 3. Worship the GPA

Companies often pride themselves on extensive recruitment programs that focus on hiring only the best and the brightest from the nation’s finest academic institutions. Their recruitment focuses on student grade point averages (GPAs), extracurricular activities, past work experience, and how much they impress the recruiter during the on-campus interview.

Unfortunately, recent studies of student cheating in high school, college, and graduate school show a disturbing and fundamental shift in the values of the nation’s emerging workforce. One recent study revealed that 78% of high school students admitted to cheating; another found that the highest percentage of college cheaters was in the field of business, where 75% admitted they had cheated to get into MBA programs. This data represents a 360-degree shift from similar studies done 20 years ago. Students acknowledged a belief that the “ends justify the means”

in both school and the business world—a perspective which they have unfortunately gleaned from Wall Street foibles over the last several years.

Companies that fail to recognize this fundamental difference in the worldview of newly hired employees do so at great risk of getting burned. For example, the Gen X and Gen Y view of “information” is that it is a commodity that ought to be freely shared via the Internet and social media; this often flies in the face of corporate policies that restrict the flow of information deemed to be proprietary. The Gen X and Gen Y view of the workplace is also fundamentally different; the growth of technology has created workplace mobility where employees feel they don’t need to be tied to a desk from 9 to 5 to do their jobs effectively. Nevertheless, companies with government contracts are subjected to strict, timeclock-type cost charging, which I have seen create serious conflicts within their younger workforce. Problems with résumé credibility, although by no means limited to the new generation of workers, have also taken on a new dimension in a highly competitive job market.

All of these generational problems can be effectively addressed through proactive steps designed to ensure that new hires understand their company’s ethical and behavioral expectations when they walk through the lobby doors.

These steps include comprehensive new-hire ethics and compliance orientation; annual values-based ethics training; an effective system of rewards and sanctions; and leadership commitment/tone at the top that inspires employees to do the right thing. In the words of Warren Buffet: “In looking for people to hire, you look for three qualities: integrity, intelligence, and energy. And if you don’t have the first, the other two will kill you.”<sup>3</sup>

### 4. Let money talk

Even the most ethically committed of companies can make the mistake of developing their systems of rewards, including executive and staff compensation and bonuses, completely independent of their ethics and integrity objectives. The result: a system of perverted incentives that focuses solely on financial performance to the exclusion of any other corporate value or objective. As a result, employees hear the usually unintended message that they will meet their quarterly financial goals, no matter what they have to do to achieve them. If employees perceive that their jobs may be on the line, or that elusive promotion hangs in the balance, the company’s ethics and integrity objectives seem a bit more academic and “advisory” in nature.

Companies with world-class ethics and compliance programs have “broken the code” in this

area. Some have developed specific ethics and integrity goals that are given equal weight in employee and manager performance appraisals and bonus decisions. The CEO of one company I visited meets with each business unit vice president (VP) on a monthly basis, reviewing not just financial performance, but requiring each VP to discuss how he/she has executed the ethics program in their organization. At another company, all VP candidates must be vetted through the Ethics and Business Conduct Office; their active support and performance in maintaining corporate ethics and integrity is a factor considered in the promotion decision.

The most effective companies have also created a buzz surrounding their ethics programs, rewarding or recognizing employees for extraordinary commitments to ethics. Some will privately reward whistleblowers (they often prefer to avoid public recognition) by a private lunch with the CEO. Others give out an annual integrity award at a special event that recognizes good ethical decisions, even those that may compromise financial goals. Recognition of employee contributions for “doing the right thing” can be an even more powerful motivator than money. The company will ultimately profit as well. According to Ethisphere Institute, companies with highly rated ethics and compliance programs,

which include leaders and compensation systems that regularly reward ethical behavior, have financially outperformed virtually every market index over the last ten years.<sup>4</sup> Companies that nurture a robust ethics program that is viewed as credible by their workforce are also more successful at channeling the tremendous internal and external pressures to perform that employees feel during today’s economic turmoil.

### **5. Do as I say, not as I do**

Some companies believe that the CEO message on the inside cover of the corporate code of conduct is enough to demonstrate leadership commitment to running the business in an ethical manner. Add a videotaped message at the annual ethics training, and perhaps an article or two in the company newsletter, and the company has received the ethical equivalent of the polio vaccine, right?

Not so fast. Studies have shown that leadership commitment and a demonstrable “tone at the top” are essential pieces of creating a strong ethical culture that prevent employees from making bad decisions that can put a company at risk. What leaders say or don’t say, and what they actually do, can either create confidence and trust, or foster mistrust, cynicism, or indifference—factors that erode the ethical culture. A few years back, a major Fortune 100

defense contractor settled charges of Procurement Integrity Act violations by paying a large fine and agreeing to a revised code of conduct and a strengthened ethics and compliance program. Just as they were “selling” this new program to the large employee base and hoping to shift the ethical culture of the company, it was revealed that their married CEO was having a personal relationship with his secretary—a clear violation of the Code. The CEO was removed by the board, but the impact on the workforce’s perception of corporate integrity, and the devastating impact on the company’s ethical culture, is felt to this day.

Leadership commitment to the principles laid out in the code of conduct is watched by employees, day in and day out. In fact, “mood in the middle” may be even more important than “tone at the top”, because most employees view “leadership” as their immediate supervisor. Studies have shown that an employee’s immediate work group of 25 or less impacts their workplace behavior and ethical decision making in a much more fundamental way than what happens in the “C suite.” In fact, 40% of employees who voluntarily leave their companies do so because of their immediate supervisor.

The most effective CEOs take every opportunity to address business matters in the context of

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the company's core values, which often include a commitment to ethics and integrity. This includes staff meetings, speeches, employee gatherings, holiday celebrations, etc. CEOs must constantly remind senior managers and employees alike that they are expected not only to follow all laws, rules, and regulations, but to make decisions that they would be proud to share with their families, friends, and local newspapers, regardless of whether or not those decisions maximized revenue. CEOs and other senior leaders must also follow through on sanctions for those employees who violate the code of conduct—regardless of rank or position, financial contributions to the company, etc. A CEO who allows the mail clerk to be fired for stealing petty cash, while giving the Assistant VP for Marketing a “slap on the wrist” for improper client billings because he's in the middle of putting together “a really big deal,” has essentially abdicated his credibility and invalidated the company's commitment to integrity.

## 6. Ethics in the corner

Nothing says “This isn't really important” more than creating a company ethics officer position and placing it down in the bowels of the organization chart. Recent amendments to the Federal Sentencing Guidelines for Organizations allow credit only for those corporate ethics and compliance

programs where the chief ethics and compliance officer (CECO) has a direct reporting responsibility to the board and the CEO. Establishing a CECO position with responsibility and authority commensurate with the other company business units makes Ethics and Compliance a force equivalent to that of Sales, Marketing, Finance, or Legal.

I visited one company a few years back to conduct an assessment of their ethics and compliance program. The CEO asked me to brief the senior leadership team about my review at their weekly Monday morning meeting. I agreed, and said I was looking forward to meeting the company CECO at the meeting. He looked puzzled, and asked if I wanted him to invite the CECO to that meeting. It turns out that the CECO was not a member of the senior leadership team...not even close. The CECO was not present when key business matters were proposed, debated, and decided upon. How, then, was ethics considered as an integral part of the company's business process? In fact, it was not. The Ethics Office was created as a result of a previous consent decree, and although the company was “in compliance” with the letter of the agreement, it certainly was not changing the ethical culture of the organization.

The most effective companies follow several key principles

when establishing their CECO positions:

- Accountability to appropriate authority for fiduciary responsibility;
- Independence to raise matters of concern without fear of reprisal or conflict of interest;
- Authority to have decisions and recommendations taken seriously; and
- Connection to company operations, to build an ethical culture and enforce standards.

## 7. Shoot (or ignore) the messenger

The 2009 National Business Ethics Survey found that almost 40% of employees who witnessed misconduct in their companies failed to report it to the appropriate company authorities. A similar percentage of employees indicated that they feared retaliation, such as being demoted or fired, if they came forward with allegations of misconduct. Others didn't report because they had little faith that their company would do anything about it.<sup>1</sup>

So, despite the widespread use of anonymous reporting hotlines, anti-retaliation policies, and robust corporate investigatory capabilities, company employees are still remaining silent about fraud and misconduct thriving in their organizations. In essence, corporate ethics and compliance programs often don't have credibility in the eyes of these employees.

Why does this matter? Most allegations of fraud, in both public and private organizations, result from employee tips. In essence, employee whistleblowers constitute the eyes and ears of the corporation. Without these tips, the company is operating blind, and is likely to be blindsided later as the fraud becomes larger and more widespread. According to the Association of Certified Fraud Examiners (ACFE) 2010 Report to the Nations on Occupational Fraud and Abuse, companies with an effective, credible anonymous hotline suffered 60%t lower median losses due to fraud, and the duration of the fraud schemes were 35% shorter than at companies without an effective hotline program.<sup>5</sup>

If a hotline is going to be credible, it needs to (1) ensure anonymity (if requested), (2) provide confidentiality, and (3) result in demonstrable company actions in response to the allegations. At one company I recently visited, I asked about whether the company had an anonymous reporting process. I was told that they did indeed have a hotline. I then asked about the activity (how many allegations, how many requests for assistance, etc.). Company officials “proudly” reported that the hotline had received no calls—zero during the previous year. They (erroneously) thought that this metric demonstrated the strength of their ethical culture. I then asked who

answered the phone. Turns out, the hotline was answered by the security director, who was well known by the employees. If this wasn’t bad enough, the phone had caller ID capability that was not disabled. Thus, the mystery of the unused hotline was solved.

A new sense of urgency to the hotline credibility problem has surfaced this year, with implementation of the whistleblower provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. This legislation created awards of 10%–30% of monetary sanctions for whistleblowers who report their concerns directly to the SEC with information leading to securities law enforcement actions that recover more than \$1 million. In essence, Dodd-Frank places corporate ethics programs in direct competition with the SEC for employee loyalty and trust, further increasing the risk of severe company losses to both their reputation and their bottom line.

Credibility is the name of the game for corporate ethics and compliance activities. The hotline is, in many ways, the centerpiece of the ethics program, serving as a bridge between the employee and the company in bringing forth allegations of wrongdoing, ethical concerns, or even questions regarding an ethical dilemma and the various options available. Companies that retaliate against employees for taking the time to bring information to the company,

or that ignore employee concerns, do so at their own peril.

## Conclusion

Although any of these mistakes can create enormous risks for a company, the good news is that those risks can be mitigated, even avoided, by creating a business ethics and compliance program that includes seven basic principles:

1. Demonstrated leadership commitment and tone at the top;
2. A corporate focus on regularly assessing, and improving, the ethical culture;
3. A CEO who is properly placed in the organization and has the authority and resources to do the job;
4. A comprehensive, dynamic code of conduct that provides the framework for good ethical decision-making by employees on a day-to-day basis;
5. A values-based ethics training program that goes beyond compliance with the law and focuses on both entry-level hires and senior executives;
6. A system of rewards and sanctions that equalizes financial and ethics/integrity objectives; and
7. An anonymous hotline that earns the credibility of employees through corporate action. \*

*CONTINUED ON PAGE 27*

## The seven biggest mistakes that companies make...

CONTINUED FROM PAGE 13

### Notes:

- 1 Ethics Resource Center: 2009 National Business Ethics Survey. Available at [www.ethics.org](http://www.ethics.org).
- 2 *Woodstock Theological Center's Seminar on Business Ethics: Creating and Maintaining an Ethical Corporate Climate*. Georgetown University Press, 1990. Available at <http://woodstock.georgetown.edu/resources/books/Creating-an-Ethical-Corporate-Climate.html>.
- 3 Mary Buffet and David Clark: *The Tao of Warren Buffet: Buffett's Words of Wisdom: Quotations and Interpretations to Help Guide You to Billionaire Wealth and Enlightened Business Management*. Simon and Schuster, 2007.
- 4 Ethisphere Institute: "2010 World's Most Ethical Companies" Available at [www.ethisphere.com](http://www.ethisphere.com).
- 5 Association of Certified Fraud Examiners: ACFE 2010 Report to the Nations on Occupational Fraud and Abuse. Available at [www.ACFE.com](http://www.ACFE.com).

**Editor's note:** Eric Feldman is the President of Core Integrity Group, LLC in Redondo Beach, California, a consulting practice specializing in the development and assessment of corporate business ethics and compliance activities. He retired from the Central Intelligence Agency (CIA) in 2011 with over 32 years' experience in Inspector General oversight and federal auditing, in both the Executive and Legislative branches of government. He has served in executive positions with Offices of Inspector General at the Department of Defense, Defense Intelligence Agency, and CIA, and the National Reconnaissance Office (NRO). He can be contacted at [eric@coreintegritygroup.com](mailto:eric@coreintegritygroup.com).