Instilling A Corporate Culture Of Integrity, Ethics And Compliance—Setting The Tone At The Top

By Harvey L. Pitt, Compliance Week Columnist—September 28, 2004

The corporate scandals of 2001-2003 are presumably behind us, but their aftermath lives on. Shareholders’ perception of American business is at an all-time low, as businesses scurry to decipher and satisfy a myriad of complex new regulatory requirements, many engendered by Sarbanes-Oxley. In that context, one hears a lot these days about the ‘tone at the top’—that is, the message a company’s leaders communicate about how their company and its employees should comport themselves. As with any difficult concept, there are many euphemisms employed to describe the same thing. Aristotle called it ‘ethos,’ the sense of credibility or trustworthiness in one’s rhetoric. More recently, the Federal Sentencing Guidelines described the concept as “an organizational culture that encourages ethical conduct and a commitment to compliance with the law.”

Whatever it’s called, people tend to talk more about the concept, than how to achieve it. That’s because too few companies actually succeed in establishing a credible corporate tone, as Jim Collins, in his book Good to Great, observed: “All companies have a culture, some companies have discipline, but few companies have a culture of discipline.” In practice, a company’s tone is set by its leadership's deeds, not merely its words. There are some practical suggestions corporate leaders can consider to establish a “culture of discipline” and integrity.

1. **The starting point for creating an effective ‘tone at the top’ resides with the character of senior corporate managers themselves.** Particularly in this day and age of complex regulatory requirements, companies err if they assume that their tone can be set by having effective procedures and policies in place. Having effective procedures and policies is certainly necessary, but it’s not sufficient. A company must also have the right people in leadership positions, leaders who are truthful, transparent, and fair, just as they expect their companies and employees to be. That means leaders must not only talk the talk, they must also walk the walk. As financier and Wall Street legend Bernard Baruch aptly put it, a whole succession of technological revolutions can’t do away with the need for character or the ability to think and act ethically.

2. **A climate of transparency must be set at every level.** Creating a real culture of discipline and integrity requires that the entire management team, at every level, reflect those essential qualities, as Pfizer Chairman and CEO Hank McKinnell has observed. Employees pay close attention to what managers do, not just what they say. An appropriate culture doesn’t simply happen, and managers aren’t born knowing or exuding it; it must continuously and repeatedly be taught, inculcated and emphasized.

Reprinted with permission. © 2005 Financial Media Holdings Group, Inc. All Rights Reserved.
Compliance Week can be found at http://www.complianceweek.com. Call (888) 519-9200 for more information.
3. **Communicate directly and honestly with employees.** Corporate leaders must connect with employees face-to-face, not simply through memos and emails, or a “Wizard of Oz” approach. NFL coach Bill Parcells has turned around four hapless football teams, as he noted in an article for the *Harvard Business Review*, by being brutally honest and direct about what he expects and how people are performing—a message that must be communicated face-to-face, and over and over again. This means that all managers need training in ethics and communication skills.

4. **Managers must be engaged in their company’s compliance and ethics program.** Establishing a culture of compliance and ethics isn’t something that can be delegated. Those who govern and lead a corporation must be knowledgeable about their company’s compliance and ethics programs, and exercise reasonable oversight of them. This means that the board must play an active and continuing role in developing the programs, monitoring them, assessing their effectiveness and revising them, all on a regular, periodic, basis. It also means that members of the board and senior managers must, themselves, receive ethics and compliance training to educate and sensitize them to the importance of these requirements. It is hard to set a tone at the top unless those at the top demonstrate their familiarity and facility with these programs, and unless those at the top demonstrate their personal commitment to these programs by active involvement.

5. **Employees must be empowered.** Employees must feel they are part of a team that values them and encourages them to be ethical. This means that companies, and their leaders, must demonstrate just how important it is for employees to “buy in” to the culture of compliance and ethics. This is done, in part, by assuring employees that they have a role to play in developing or refining existing programs, and that they will be rewarded for ethical behavior, even if it uncovers some problems everyone would prefer not to know about. It also means that employees must have the tools to assure their conformity to, and compliance with, ethical standards.

6. **Establish a corporate ombudsman.** Notwithstanding the impact of the recent corporate scandals and their aftermath, many corporate managers are fearful of “encouraging” employees to “find problems.” This is a shortsighted view that engenders difficult problems that can actually tank a company. In years gone by, the standard wisdom was not to go looking for problems. But today, companies must have in place sufficient mechanisms to allow them to detect and investigate problems. When employees are persuaded that their company really does care about ethical and lawful behavior, they will buy into the process and will take their concerns—in the all-important first instance—to internal mechanisms rather than taking their concerns to external forces. Companies that encourage their employees to raise problems internally give themselves that all important critical step—finding out about a problem before it has become a crisis or a catastrophe. Put starkly, there simply are no external forces to which corporate managers should want their employees to divulge concerns about their company’s ethos.

7. **Separate the message from the messenger.** In far too many situations, companies start by assessing the motivations of the messenger, rather than considering the accuracy of the message. This is a critical fallacy that leads companies down the wrong path, and discourages employees from believing—and acting—as if their company’s ethical standards have real meaning. Even disgruntled employees may have accurate information about wrongdoing that is ongoing within a company. The biggest obstacles to an effective
culture of ethics and integrity are, first, the lack of anonymity in the reporting process, and second, the fears of possible retribution if the concerns identified and expressed turn out to be mistaken (or worse, turn out to be accurate).

8. **Put in place an anonymous complaint system.** Employees must be free to raise issues. Anonymous reporting channels permit employees and others to complain about things they’ve observed without fear of retribution. This is not only important to achieve, it is important for employees to know and believe that the reporting process is truly anonymous. The use of 800 numbers and anonymous email communication systems are two effective ways to provide anonymity.

9. **Follow-up is critical.** By the same token, and seemingly somewhat inconsistent, is the need to make certain that those who report concerns receive appropriate follow-up, so they know whether action has been taken and, if action is not taken, the reasons that no action was taken. The best way to provide both anonymity and follow-up is to “outsource” the reporting function. When employees report to persons who appear to be concerned solely with their company’s integrity and compliance, rather than their own advancement, they develop faith in the process and will likely make use of it should they become aware of something requiring reporting. Moreover, if a senior member of management is assigned the task of pursuing complaints, then management as a whole—along with the company—is left to absorb the blame should something fall through the cracks. If a decision is made not to pursue a report, the person reporting the matter should be given an explanation of why the matter wasn’t pursued, and offered an opportunity to provide further information in the event there are additional facts or “leads” that can, or should, be pursued.

10. **Keep careful records.** It is critical to maintain a thorough and accurate log of all information reported to the company regarding possible ethical lapses or compliance breaches. The record should indicate the nature of the concern, the generic identity of the person reporting the concern, and the action taken—or not taken—along with a description of the reasons that prompted that conclusion. Every time a new concern is raised, the log should be reviewed to ascertain whether the new concern replicates prior issues explored. Where there is a repetition of the type of concern being raised, extra procedures should be pursued to ensure that a systemic pattern hasn’t evolved.

11. **Utilize a special compliance committee.** Contrary to some current wisdom, independent directors are a CEO’s best friends. If outside directors are properly trained in how to function effectively—and if they are appropriately employed—they can help ensure the right culture and corporate tone, providing a true demonstration that the company’s actions fully comport with its words. Thus, the process of overseeing a company’s compliance and corporate “tone” should be vested in a special compliance or legal quality control committee. Far too often, companies resort to the time-tested practice of heaping additional responsibilities on their already fully-taxed audit committees. This is, as a general proposition, unwise, as it will diminish the audit committee’s effectiveness in responding to the chores and obligations it already has. To avoid the falling-through-the-cracks syndrome, at least one member of the audit committee should be a member of the special compliance committee.
12. **Employ quarterly reviews.** Boards of directors are well advised to review compliance and ethics programs on a quarterly basis. This includes consideration of how effectively the existing program is working, and whether there are demonstrable needs that should be addressed by system “tweaks.” It also includes ascertaining whether any patterns of complaints have surfaced, and assuring general familiarity with how the program functions. The absence of complaints is not necessarily a sign for rejoicing, since it may mean that employees are not yet comfortable that the system provides anonymous and non-retributive channels of communication.

13. **Require periodic forensic audits.** It is sensible for companies to bring in special external experts to evaluate the effectiveness of compliance and ethics programs—as well as internal controls—and to do so on a periodic basis. To the extent that a company fails to do so, its analyses and conclusions are bound to be viewed as insular, and a company’s otherwise exemplary efforts may be for naught. The old rubric of not fixing things that aren’t broken doesn’t really apply in the new millennium. Instead, companies that are vigilant in ensuring that they aren’t overlooking problems will be rewarded with better performance and results.

14. **There is no such thing as de minimis ethical or compliance breaches; publicize sanctions.** While every breach of corporate standards is not a capital offense, breaches of corporate standards must be treated as serious and significant. The surest way to impair the “tone at the top” is to ignore misconduct. The “punishments” should fit the misconduct, but all violations of company policies should result in some type of sanction. Part and parcel of this is the need to keep adequate records that demonstrate how the officials who administer the program have dealt with instances of misconduct. When breaches are found, some companies attempt to fix the problem, but keep the problem and its solution a secret. Unfortunately, this is not the way to produce the best results company-wide. When violations are found, employees should be made aware of the mistakes uncovered, any responses by the company, and an indication of the types of sanctions employed.

15. **Employ a system of rewards for good ethics.** Bonuses and rewards should be available to managers and employees who evidence exemplary adherence to a company’s ethical and compliance policies and procedures. If we want corporate managers to set the right tone, they should be rewarded when they achieve that result.

16. **Sometimes, bad things happen to good companies.** As the Federal Sentencing Guidelines evidence, even with the establishment of a proper tone at the top and an effective compliance and ethics program in place, someone within the company could break the law or act unethically. This doesn’t automatically mean there isn’t a proper “tone at the top.” How the company deals with evidences of breach, however, will determine exactly how the company will be perceived. When the unthinkable occurs, companies have a small window of opportunity to seize control of the situation and cabin its consequences. Being prepared to do so is of the utmost essence.

The column solely reflects the views of its author, and should not be regarded as legal advice. It is for general information and discussion only, and is not a full analysis of the matters presented.