

CONFERENCE PROCEEDINGS

Perspectives of Chief Ethics and Compliance Officers on the Detection and Prevention of Corporate Misdeeds

What the Policy Community Should Know

Michael D. Greenberg

APPENDIX C: INVITED PAPERS FROM PANEL PARTICIPANTS

From Enron to Madoff: Why Many Corporate Compliance and Ethics Programs Are Positioned for Failure

Donna Boehme, Compliance Strategists, LLC

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Introduction: "Where Was the Ethics Officer"?¹

With the wreckage of the first generation of Enron-type corporate scandals in the rear view mirror, and the chaos of Madoff and the subprime meltdown now all around us, commentators are asking "Where were the ethics officers?" and "Are corporate compliance and ethics programs just window dressing?" These are fair questions, given that in the 18 years since the 1991 promulgation of the U.S. Organizational Sentencing Guidelines (which set out the roadmap for companies to detect and prevent wrongdoing),² several studies have indicated that little progress has been made,³ and recent events in the corporate world suggest that effective mechanisms to prevent corporate misconduct are lacking. This paper sets out a response to these two questions from some leading practitioners in the field of corporate compliance and ethics. This paper also suggests a path forward, moving beyond the sometimes unrealistic assumption of policymakers, boards and management that integrity and compliance can be achieved simply by establishing basic elements such as a formal code of conduct, an "ethics officer," a training program, monitoring, and/or an employee helpline, and then expecting that good results will necessarily follow. In short, we believe that it is time for companies to get serious about corporate culture, accountability, compliance and ethics, and that the key initial step in achieving this involves the creation of a C-level, empowered compliance and ethics officer: someone with the experience, positioning, mandate and clout to actually make things happen in the organization.

¹ For convenience, the term "ethics officer" is intended to encompass the role of the chief compliance and ethics officer, in its many variations.

² The guidelines, including the 2004 amendment, are available at <http://www.ussc.gov/guidelin.htm>. The amendment became effective on November 1, 2004.

³ The Ethics Resource Center's 2007 National Business Ethics Survey, based upon interviews with 2,000 employees at a broad range of public and private U.S. companies, found "little if any meaningful reduction in the enterprise-wide risk of unethical behavior at U.S. companies." ERC Press Release, November 28, 2007, available at <http://www.ethics.org/about-erc/press-releases.asp?aid=1146>.

The "Kumbaya" Approach to Ethics and Compliance

On paper, many companies have established a wide range of compliance and ethics programs since 1991.⁴ Moreover, companies were subsequently required to add to their compliance infrastructure by Sarbanes-Oxley in 2004, and by other government efforts to impose elements of compliance programs. Today, most major corporations have at least some compliance and ethics infrastructure, including formal codes of conduct and confidential employee hotlines, and the new management role of "chief ethics and compliance officer" (CECO) is rising in demand. Most companies in highly regulated industries, such as financial services, health care, and defense, also have developed detailed compliance procedures. But there is a critical distinction between compliance and ethics programs that have all the designated features on paper, and those that have real "teeth" and the potential for success. The former might be described as adopting a "Kumbaya"⁵ approach – an optimistic but rather naive expectation that once a code is published, a hotline activated, a rousing speech and memorandum from the CEO is delivered, and an "ethics officer" appointed, then all the employees and managers will join hands in a "Kumbaya" moment, and the program will somehow magically work as envisioned. This kind of program may look good at first, but without continuing, empowered leadership on compliance and ethics issues, together with tangible management commitment to making hard choices, such a program is unlikely to succeed in preventing, detecting, and addressing real world problems. We would note that Enron had a 64-page code of ethics and an employee hotline in place prior to the exposure of the scandals that ultimately brought that company down. Similarly, today's newspaper headlines are full of allegations of corporate fraud and crime, at companies with relatively hollow, check-the-box compliance and ethics programs.

Leading Integrity: The Critical Role of the Chief Ethics and Compliance Officer

We believe an effective approach to integrity and corporate ethics starts with a senior-level chief ethics and compliance officer (CECO) who understands the compliance and ethics field, is empowered and experienced, and who has the independence, clout, a "seat at the table" where key senior management decisions are made, and resources to lead and oversee a company's ethics and compliance program – even when that program appears at odds with other key business goals of the company. A well-implemented compliance and ethics program doesn't spring from the void ex nihilo – it requires a strong leader to engage others in the

⁴ The U.S. Sentencing Guidelines, requiring organizations to establish an "effective program" to prevent and detect violations of law, were initially promulgated in 1991 and further amended in 2004. See footnote 2.

⁵ Kumbaya, a 1930s Southern spiritual that some trace to the former slaves living in the sea islands of South Carolina and Georgia, is sometimes used to describe a "naively optimistic view of the world and human nature" – see <http://en.wikipedia.org/wiki/Kumbaya>.

organization, including powerful senior managers, to surface and resolve issues and challenges, and to make a culture of transparency, accountability and responsibility a reality.

But accomplishing this is easier said than done. To a great extent, the evolving role of the CECO was initially viewed by companies as a lower-level management or even administrative role, often positioned within the legal department or another function such as finance, audit or even HR, and with little empowerment, mandate or independence to fulfill the important accountabilities of the role. When compliance programs have been mandated by government rules and regulations, programs have tended to devolve into hyper-technical efforts devoid of senior-level participation and commitment.

In a serious compliance and ethics role, the CECO is often required to challenge the established way of doing things, or to introduce new concepts such as stricter controls on senior managers, increased transparency, and consistent standards of discipline. Imagine a CECO being called into the office of a powerful Andy Fastow-type CFO and being ordered to drop a confidential investigation, change a report to the Board, or otherwise compromise the responsibilities of the role. This is corporate ethics' "dirty little secret": In many companies today, the CECO is still poorly positioned, and lacking in the empowerment and independence needed for successful discharge of the critical role he or she is expected to play.⁶ It is important to note that the "expectations" of having an effective CECO and ethics and compliance program come, not only from the organization itself, but also from regulators, from policymakers and other stakeholders, and from the general public.

This view is expressly endorsed by a startlingly candid white paper published last year on the topic, entitled "Leading Corporate Integrity: Defining the Role of the Chief Ethics and Compliance Officer" – a collaboration of five leading nonprofit organizations supporting the profession.⁷ Echoing the sentiment that "most CECOs do not believe they have been given sufficient authority and resources to achieve their mission," the white paper comments that "many executives and boards have not yet realized the potential of their CECOs" and that "a CECO that serves as window dressing likely does more harm than good, especially in times of difficulty." The CECO's line of reporting is the "single biggest influence on his or her credibility within the organization" and should be a direct reporting relationship to either the CEO or the board, with "direct, unfiltered access to the Board." The CECO must be "independent to raise matters of concern without fear of reprisal or a conflict of interest." Further, a reporting line to the general counsel, one of the most common structures in

⁶ As reported by the *Financial Times* on June 29, 2007, "Siemens Anti-Graft Chief Quits," Daniel Noa, a former German prosecutor with "impeccable credentials" appointed to the post as part of Siemens' response to the corruption scandal in 2007, quit the role involuntarily after only six months on the job. The paper quoted one source: "He was alone and lacked support. He came up against a lot of people who didn't want him to succeed in his job." Media reports cite a changed reporting relationship that "undermined" Noa, "infighting" and "lack of support."

⁷ See Ethics Resource Center (2007), *Leading Corporate Integrity: Defining the Role of the Chief Ethics and Compliance Officer (CECO)*. This report is available for download at <http://www.ethics.org/CECO/>.

companies today, is not viewed as effective positioning – since the aim of reducing external litigation risk is not always well-aligned with the aim of promoting ethics and compliance within the organization. Thus for companies serious about integrity, merely establishing a new ethics management position is not sufficient as a foundation for a strong compliance and ethics program. Rather, close attention must also be paid to empowerment, mandate, a seat at the table, independence, and reporting relationships of the CECO. Without proper positioning, a CECO (and ultimately, the compliance and ethics program that he or she administers) is likely to be ineffective and in serious danger of failure.

That brings us back to the two questions we posed in the introduction, with regard to the most recent wave of corporate scandals: Question: “Where was the ethics officer?” Answer: “Present, but most likely lacking empowerment, positioning and independence (and probably not even a true ‘officer’ of the corporation).” Question: “Are corporate compliance and ethics programs just window-dressing?” Answer: “In many companies, probably yes.”

Policymakers Need to Support Effective Programs

Congress and regulators can also do more to support effective CECOs, and (by extension) effective corporate compliance and ethics programs. For instance, the New York Stock Exchange (NYSE) listing rules have been hailed for requiring all listed companies to have a code of ethical conduct. This is certainly an important starting point in establishing a good compliance and ethics program, but by itself, a formal code of conduct can become an empty gesture unless that code is implemented effectively. Similarly, the Sarbanes-Oxley reforms of 2002 responded to a stream of corporate accounting and fraud scandals by mandating new ethics hotlines, codes of conduct, and stronger internal controls and reporting efforts, but here again, these steps are only part of the overall compliance and ethics approach needed to support a culture of integrity at a corporation. Two key ideas have been missing from related government regulations. First, any single element of a corporate compliance and ethics program, taken in isolation, is unlikely to be effective by itself. Thus, formal codes of conduct, employee hotlines, and internal controls ideally should all be implemented as parts of an overall, holistic compliance and ethics program. Second, such programs should ideally be led and overseen by a senior-level, empowered chief compliance officer, with the clout and independence to make things happen in the organization. Without both of these elements, an NYSE-style paper requirement for a formal code of conduct (for example) is unlikely to succeed in achieving its aims. In sum, more is needed from government and policymakers to make more plainly stated the expectations for an effective CECO and a strong corporate compliance and ethics program – ultimately, prerequisites for protecting the interests of the organization itself, and for maintaining accountability to other stakeholders and to the public interest. In a companion paper in this document (titled “What Government Can Do to Prevent Corporate Crime”), our colleague provides some specific suggestions on how policymakers can help to support more effective ethics and compliance programs and stronger CECOs.

How Can Companies Put Integrity Back In Business?

Perhaps the underlying question here is, how do we move beyond corporate compliance and ethics programs that look good on paper, but that are ineffective at achieving real world results? More generally, CEOs of successful companies know that little is accomplished in business without first having a plan, resources, and an accountable, effective leader in place to implement the plan. A company's program for compliance and ethics is no different from any other aspect of business enterprise. Where the stated goal is to change the culture of an entire organization, to identify and address key compliance and ethics risks, and to encourage good business judgments among all managers and employees, a serious approach and commitment of resources is needed. We've already described the first step of creating an empowered, independent CECO position, filling it with someone who is knowledgeable about compliance and ethics, and giving that person a seat at the senior management table. The rest of the formula, which the CECO will drive, has to do with implementing and integrating a range of compliance and ethics initiatives, supported by management at all levels of the organization. Without diminishing the key role of formal codes of conduct and help lines, establishing those features is a relatively easy part of a company's compliance and ethics effort. The more difficult aspects of the effort involve incorporating the company's code of conduct and policies into the DNA of its business operations, and all of the resulting tough choices management needs to make along the way in doing so. This is where many compliance and ethics efforts fall short, whether by lack of management resolve, loss of focus, or lack of leadership by a strong CECO in driving the program on a daily basis. Here are some examples of features we view as essential indicia of a serious compliance and ethics program (i.e., one with "teeth"):

- Executive and management compensation linked to compliance and ethics leadership
- Consistent enforcement of the company's code of conduct and policies, especially at senior levels
- Confidential, professional management of the help line, including investigations
- Vigorous enforcement of non-retaliation policies
- Effective and ongoing compliance and ethics risk-assessment
- Integration of clear, measurable compliance and ethics goals into the annual plan
- Direct access and periodic unfiltered reporting by the CECO to a compliance-savvy board
- Strong compliance and ethics infrastructure throughout all parts of the business
- Real compliance audits designed to uncover lawbreaking
- Practical and powerful action (not merely words) by the CEO and management team to promote compliance and ethics
- Shared learning within the company based on actual disciplinary cases.

Conclusion and Way Forward

With committed management support, together with empowerment, independence, a seat at the table, resources and appropriate reporting structure for its CECO, a company can forge beyond window-dressing in its compliance and ethics effort. This is an essential first step toward establishing a corporate culture of transparency, openness and integrity, in which ethical and compliance problems are more likely to be detected earlier rather than later – so that the company can seek to prevent fires, rather than put them out after the fact. Unless we want to keep asking “Where was the ethics officer?”, it’s time for companies – and policymakers – to reject a check-the-box approach to compliance and ethics programs, and get much more serious about putting integrity back into the heart of business.