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Compliance v. Culture Employees Judge Ethical Conduct in the Workplace

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President, Ethics Resource Center



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Bridging Business and Government

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PREFACE

Corporate compliance programs and standards of conduct in the workplace have received new emphasis in recent years motivated, in part, by the Sarbanes-Oxley Act, the *Federal Sentencing Guidelines for Organizations*, and investor outrage in reaction to corporate scandal. Enormous resources have been dedicated to the implementation of compliance and ethics programs, but the question lingers. Do they work?

In this issue, Patricia J. Harned, Ph.D, President of the Ethics Resource Center (“ERC”), discusses whether and how elements of a formal ethics and compliance program make a difference and, equally important, the extent to which organizational culture motivates ethical conduct. Using key findings from ERC’s National Business Ethics Survey, a unique report that captures the views of more than 3,000 American workers across industry lines, she discusses the impact of various formal and cultural elements of ethics programs on the outcomes one expects from such programs. The bottom line: ethics and compliance programs can and do make a difference; however, their impact is related to the culture in which they are situated.

This *Briefly* provides corporate leaders with new ideas for assessing—and improving—the effectiveness of their ethics and compliance programs.

Richard A. Hauser

President, National Legal Center

INTRODUCTION

Accounts of ethical wrongdoing continue to make regular appearances in the daily news. No sector has been left out—business, government, education, sports; recent reports indicated that even in church, people are stealing from the offering plate.¹ Ethics today is newsworthy more by its absence than its presence. Misconduct no longer surprises. In fact, research indicates that 52 percent of American workers observe at least one type of misconduct each year, and over a third witness more than one inappropriate act.²

For organizational leaders, this phenomenon is particularly troubling. Success in the marketplace (or in the public square) depends on public trust. Fortunately, evidence shows that the vast majority of organizational leaders across the United States are responding to this public need for improved standards of conduct. Just over 85 percent of organizations across the United States have implemented codes of conduct, and 81 percent of organizations have created a mechanism to hold people accountable to those standards. Equal numbers have established systems as a result of a regulatory suggestion that internal controls will address the problem. But do these efforts actually work?

In the court of employee opinion, what motivates employees to behave ethically?

This *Briefly* examines research gauging employee perceptions of ethics in the workplace and the factors that encourage right conduct. Findings are based on the Ethics Resource Center's ("ERC") National Business Ethics Survey³—a longitudinal study of workplace ethics from the employee's perspective.⁴ Results released in October 2005 measured the extent to

¹ Associated Press (June 7, 2007), *Woman accused of stealing from church donations*, Northwest Herald, <http://www.nwherald.com/articles/2007/06/07/news/state/doc46678fb547e9e020259144.txt>.

² Unless otherwise noted, the statistics referenced in this article come from analyses of data collected by and reported in the Ethics Resource Center's National Business Ethics Survey: How Employees View Ethics in Their Organizations (ERC 2005).

³ National Business Ethics Survey, *supra* note 2. Executive Summary and ordering information, available at www.ethics.org.

⁴ The National Business Ethics Survey ("NBES") is a household survey of employees across the United States, nationally representative of organizational sectors, sizes, and

which different elements of a formal ethics and compliance program make a difference. Additionally, given changes in the law and a new emphasis on measuring what makes programs effective, the 2005 study analyzed the impact of organizational culture and the extent to which it motivates ethical conduct.

management levels. Over the entire period of NBES studies, more than ten thousand American workers have been surveyed. In 2005, more than three thousand employees across the United States were randomly selected to participate in the effort.

The Case for Compliance

The passage of recent ethics laws and regulations has influenced organizations to develop compliance systems. Compliance in these programs takes several forms. First, organizations create formal programs of internal controls that specifically answer to regulatory frameworks. Second, compliance systems take steps to communicate organizational and regulatory guidelines to employees and establish systems to encourage whistle-blowing if employees observe any violations of these standards. In essence, compliance systems endeavor to prevent and detect criminal misconduct.

Currently, a few key policies, in conjunction with the threat of legal and regulatory consequences for noncompliance with these policies, shape and make a strong case for the importance of formal ethics and compliance programs in organizations.

Sarbanes-Oxley Act

While technically applicable only to financial controls within publicly held corporations, the 2002 Sarbanes-Oxley Act (“SOX”)⁵ started a wave of intense government and public scrutiny of corporate ethics. Coming on the heels of the Enron scandal, SOX required the implementation of internal controls over financial reporting. In 2005, the SEC provided additional guidance, shunning a formulaic checklist approach and encouraging companies to follow a top-down, risk-based approach to the evaluation of internal controls, applying reasoned judgment to identifying and devoting resources to those areas that presented the greatest risk.⁶

Federal Sentencing Guidelines

Since November 1991, the U.S. Sentencing Commission’s *Federal Sentencing Guidelines for Organizations* (“FSGO”)⁷ has become generally accepted as the prevailing framework for defining the elements that are essential to an effective ethics and compliance program. Though purely

⁵ Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745; 15 U.S.C. § 7262.

⁶ Staff Statement on Management’s Report on Internal Control Over Financial Reporting (SEC May 2005), <http://www.sec.gov/info/accountants/stafficreporting.htm>.

⁷ UNITED STATES SENTENCING COMMISSION, GUIDELINES MANUAL ch. 8, <http://www.ussc.gov/2005guid/tabconchapt8.htm>.

voluntary, the FSGO provides the incentive of a lighter sentence and reduced risk of being placed on probation for organizations that can show they have implemented “an effective program to prevent and detect criminal conduct.” The FSGO also serve as a model for other policy-setting bodies.

In November 2004, the Commission revised the guidelines to include several substantive changes.⁸ Among these changes, FSGO expanded the elements that are required by the U.S. Sentencing Commission if an organizational ethics program is to be considered “effective.” Section 8B2.1(a) expands the definition of an “effective compliance and ethics program” beyond the existing requirement that an organization “exercise due diligence to prevent and detect criminal conduct” to include the requirement that an organization “otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.” In addition, section 8B2.1(b) provides that the due diligence and organizational culture requirements are fulfilled by meeting seven minimum requirements that define an effective program.

These include:

1. Having compliance standards and procedures that are reasonably capable of reducing the prospect of criminal activity;
2. Providing oversight by high-level personnel;
3. Exercising due care in delegating substantial discretionary authority;
4. Using effective communication to all levels of employees;
5. Taking reasonable steps to achieve compliance, including implementing systems for monitoring, auditing, and reporting suspected wrongdoing;
6. Consistently enforcing compliance standards, using established disciplinary mechanisms; and
7. Taking reasonable steps upon detection of a violation to respond to and prevent similar offenses.

The Commission also explained that these requirements are not the “elements” of an effective program so much as they are “indicators” of the

⁸ FSGO Revisions, <http://www.uscc.gov/orgguide.htm>.

required due diligence and promotion of an ethical organizational culture. They signal that actions taken by management are consistent with the purpose of a company’s compliance and ethics program. Like the latest guidance on SOX, these changes also allow, even require, companies to design programs that are best suited for their particular operations.

The purpose and intent of FSGO’s “organizational culture” becomes clear when one considers a statement by Paula Desio, former Deputy General Counsel, United States Sentencing Commission, in *An Overview of the Organizational Guidelines*:⁹

“Criminal liability can attach to an organization whenever an employee of the organization commits an act within the apparent scope of his or her employment, even if the employee acted directly contrary to company policy and instructions. An entire organization, despite its best efforts to prevent wrongdoing in its ranks, can still be held criminally liable for any of its employees’ illegal actions. Consequently, when the Commission promulgated the organizational guidelines, it attempted to alleviate the harshest aspects of this institutional vulnerability by incorporating into the sentencing structure the preventive and deterrent aspects of systematic compliance programs. The Commission did this by mitigating the potential fine range—in some cases up to 95 percent—if an organization can demonstrate that it had put in place an effective compliance program. This mitigating credit under the guidelines is contingent upon prompt reporting to the authorities and the non-involvement of high level personnel in the actual offense conduct.”

Indeed, at least in part because of these regulatory frameworks, the establishment of compliance systems has been pervasive. An increasing number of employees recognize that their organization has a formal compliance program. Implementation of five of the six elements of a formal program measured by NBES rose during the years in which questions were asked about these elements:

⁹ Paula Desio, *An Overview of the Organizational Guidelines*, <http://www.uscc.gov/corp/ORGOVERVIEW.pdf>.

- Written standards of conduct increased 19 percentage points¹⁰ since 1994;
- Training on ethics increased 32 percentage points since 1994;
- Mechanisms to seek ethics advice or information increased 15 percentage points since 2000;
- Means to report misconduct anonymously increased 7 percentage points since 2003;
- Discipline of employees who violate ethical standards increased 4 percentage points to 88 percent since 2003.

Only one element of a formal compliance program has not substantially increased in recent years: the evaluation of employee performance based on ethical conduct decreased by 7 percentage points since 2003.

¹⁰ Percentage points refer to the difference between two percentages. For example, in 1994, 67 percent of employees said their organizations had written standards. In 2005, 86 percent indicated as such, resulting in a difference of 19 percentage points.

The Case for Culture

Other factors beyond a formal compliance program can influence how ethics plays out in an organizational context. One powerful element is ethical culture. An ethical culture is the informal and social system that sets norms for the employee's behavior and that tells employees how things really work in an organization. It is composed of shared beliefs, assumptions, traditions, and values that guide decision-making behavior in an organization, especially in instances where no clear guidelines exist. It may include organizational role models, heroes, stories, and language. Ethical culture pervades and influences employee attitudes and behaviors across all organizational levels.

Some examples of ethical culture include:

- The values that drive “how things are really done around here”;
- The amount of pressure to perform and to cut corners to do so;
- Whether employees are surprised when misconduct occurs;
- The level of employee confidence that their management is committed to ethics as fundamental to doing business;
- How often people talk about the importance of ethics;
- Whether employees and management are supportive of ethical behavior; and
- Whether managers are trusted to keep promises and commitments.

Ethical culture is the unwritten code of conduct by which employees learn what they should think and do. Consider something as simple as the employee coffee break. In one organization, coffee breaks take place at appointed times, for a predetermined duration, and in a single, designated location. In another company, employees never take formal breaks and, instead, grab coffee and engage in chatty conversations in the halls throughout the day. Both organizations may have written policies regarding coffee breaks or maybe neither does, but, either way, it is clear that there is a “way things are done around here.” Do things the “right” way and you will be deemed responsible and respectful or friendly and collegial. On the other

hand, employees who, even unintentionally, violate the culture may be deemed lazy slackers or aloof snobs. Such judgments—based initially only on coffee break missteps—eventually can lead to the ostracization or even discipline of the culturally ignorant employees. *When it comes to culture, perception creates reality.*

The ethical culture of the organization communicates acceptable limits, how employees ought to treat other people, whether it is acceptable to question authority figures and safe to report observed misconduct, and the importance of compliance with controls and safeguards.¹¹ Linda Trevino, a leading scholar in the study of ethical culture, notes that ethical culture determines “how employees understand what is expected of them, and how things really get done.”¹²

¹¹ Trevino, Weaver, Gibson, & Toffler, 1999, the Ethics Resource Center’s National Business Ethics Survey 2005, and the findings of the Business-Higher Education Forum, Ethics Initiative Working Group (Soule).

¹² *Id.*

How Employees View Ethics in Their Organizations

In reality, all organizations have an ethical culture—whether positive or negative—and a growing majority of organizations also have a compliance program in place. Which makes the biggest difference?

At first glance, neither. Overall, employees across the country painted a less-than-positive picture about ethics in the workplace, despite the fact that increasing numbers are provided resources by their employers. For example, employees indicated:

- ***Little Change in Levels of Observed Misconduct***

Little change has taken place since 1994 in the extent to which employees observed misconduct in the workplace. In 2005, 52 percent of employees observed at least one type of misconduct taking place; 36 percent of those employees observed two or more violations.¹³

- ***Less Willingness to Report Misconduct***

Of the employees who observed misconduct at work in 2005, just over one half (55%) reported it to management, a 10 percentage point decrease since 2003 and a backsliding to levels similar to those in 2000.

- ***Little Change in Pressure to Compromise Standards***

Pressure to compromise standards has also remained unchanged. In 2005, 10 percent of employees felt such pressure always or fairly often, a level similar to 2003 and down 3 percentage points since 2000.

¹³ Two measures of misconduct are collected in NBES. Increases over time reported here are drawn from a comparison of questions asking employees outright if they have observed misconduct. Levels of observed misconduct are drawn from an analysis of employee observations of specific forms of violations.

• *Strong Risk for Misconduct*

When employees are exposed to risk-related situations, they are highly likely to observe actual misconduct. One third of all employees encounter a situation at work that they think invites ethical misconduct. Of those people, 74 percent also observed at least one act of misconduct. Among employees who feel pressured to compromise the standards of their organizations, 94 percent observed at least one type of misconduct.

But further analysis paints a different picture. Despite these poor findings overall, NBES also revealed that employees *do* improve their conduct, and there are other factors within the workplace that make a difference. NBES respondents had a great deal to say about the factors that influence that positive change.

The Impact of a Compliance Program

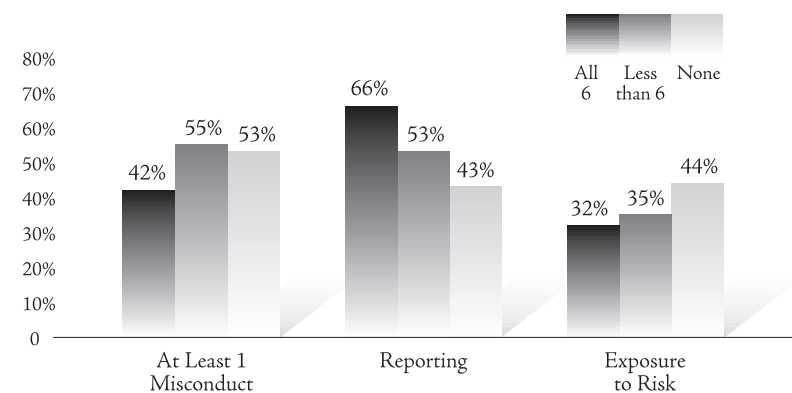
There is a positive result from the presence of a compliance program. In other words, employee behavior does change—and for the better—when a program is present. And, the more program elements that are in place, the greater the impact.

Programs Do Make a Difference

NBES measured six elements of a typical compliance program:

- Presence of a Code of Conduct (or the equivalent);
- Training of employees on organizational standards;
- Presence of a whistle-blower hotline;
- Provision of resources (or a place to call with questions);
- Discipline of violators; and
- Evaluation of employees based on organizational standards.

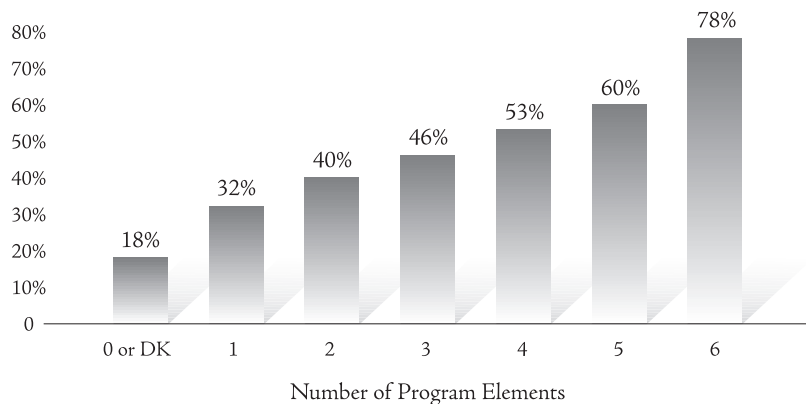
Results revealed that the percentage of employees who observed at least one type of misconduct decreased by 13 percentage points when all the elements of a formal program were in place, compared to a program where fewer than six elements are in place. Similar patterns are revealed for the other outcome measures. Having a code, plus training, plus a helpline has a greater impact than just having a code (see chart below comparing employees in organizations with all six elements of a compliance program to those with some elements).



The More You Do, the Stronger the Culture

A compliance program also benefits an organization by helping to grow an ethical culture. In fact, the more elements of an ethics and compliance program that are in place, the more likely it is that the culture of the organization is perceived by employees to prioritize ethical conduct (see the following graph).

Percentage of U.S. Workers Whose Organization Has a Strong Culture by Number of Ethics/Compliance Program Elements Present



Still, only half of employees indicated that they worked in organizations that they perceived to prioritize ethical conduct. And in light of the impact of an organization's culture on employees, this is discouraging news.

Impact of Ethical Culture

Employees are far more influenced by the culture of the organization than the compliance programs their employers put into place. Outcomes are significantly better in cultures that are strong.

Ethical Culture Has a Greater Impact than Formal Program Elements

Generally, the data showed that culture had a stronger impact on the outcomes reported by employees than did formal ethics and compliance programs. When all the elements of a strong culture are in place, the percentage of employees who observe misconduct decreased by 40 percentage points, reporting increased by 35 percentage points, and pressure decreased by 12 percentage points, compared to employees whose organizations do not have strong ethical cultures (see chart below).

How Does Culture Influence Employees?

Culture is perpetuated through the actions of people. When it comes to learning the ethics of their workplace, employees reported that the actions of leaders and peers are particularly influential. For example:

- ✦ Where top management displays certain ethics-related actions, employees are 50 percent less likely to observe misconduct.
- ✦ Ethics-related actions of coworkers can increase employee willingness to report misconduct, by as much as 10 percent.
- ✦ When employees perceive that others are held accountable for their actions, their overall satisfaction increases by 32 percent.

Actions Speak Louder than Words

ERC measured ethical culture by asking whether employees perceived management and coworkers performing certain 18 Ethics-Related Actions ("ERAs"), including the following:

- ✦ Communicating ethics as a priority (as observed in top management, middle management, supervisors);
- ✦ Setting a good example of ethical conduct (as observed in top management, middle management, supervisors, coworkers);
- ✦ Keeping promises and commitments (as observed in top management, middle management, supervisors);
- ✦ Providing information about what is going on (as observed in top management);
- ✦ Holding others accountable for ethics violations (as observed in top management, middle management);
- ✦ Supporting employees in following organizational standards (as observed in supervisors, coworkers);
- ✦ Considering ethics while making decisions (as observed in coworkers);
- ✦ Talking about importance of ethics (as observed in coworkers); and
- ✦ Holding nonmanagers accountable for ethics violations (as observed in coworkers).

The study also included measures of employee perceptions of accountability—the extent to which employees believed that all levels of employees and management were held accountable to the standards of the organization.

ERC found that employees who perceive their managers, supervisors, and coworkers displaying ERAs are more likely to observe positive outcomes expected of an effective ethics and compliance program than those whose colleagues and managers exhibit fewer ERAs. Further analysis showed that certain of these actions have a greater impact on program outcomes.¹⁴

In particular, three actions have an especially large impact:

- ✦ Setting a good example;
- ✦ Keeping promises and commitments; and

- ✦ Supporting others in adhering to ethics standards.

These results demonstrate the importance of employees observing their superiors and peers demonstrate ethical behavior in the work they do and decisions they make every day, over and above talking about ethics.

In addition, employees who see ethical actions report that they are more satisfied at work. Employees who perceive that top management sets a good example, adequately disseminates information, and keeps promises and commitments, are 10 to 12 percentage points more likely to be satisfied with the organization where they work. Perceptions that top management is held accountable and communicates the importance of ethics, on the other hand, have a smaller impact on satisfaction, both outcomes and employee satisfaction.

More Benefits from a Positive Ethical Culture

NBES provides proof that there are more reasons to encourage an ethical culture than hoping for lighter sentencing under the FSGO standards. A positive ethical culture is essential to maintaining a successful and effective ethics and compliance program and a workforce that is fully committed to company values, standards, procedures, and expectations.

An organization with a strong ethical culture can withstand legal and public challenges to its integrity. When employees are encouraged to live a company's values, hold themselves and their colleagues accountable, and feel comfortable raising issues and concerns, they can make better, more ethical, decisions independently. In fact, NBES findings demonstrate that corporate culture may provide the best indication as to whether employees will comply with an organization's code of conduct.

Furthermore, these findings suggest that organizations can make more effective and efficient use of their training resources by encouraging employees to behave in a way that is conducive to a strong ethical culture instead of simply dispensing information about standards and policies.

¹⁴ Amber Levanon Seligson & Laurie Choi, *Critical Elements of an Organizational Ethical Culture* (ERC, in collaboration with Working Values, 2006).

Compliance and Culture

In the matter of Compliance v. Culture, employees indicated that culture makes the biggest difference. Still, it is important to note that only 1 percent of the employees who indicated they worked in a strong culture worked in organizations that did not have all the elements of a compliance program in place. It seems clear that, while culture ultimately may have the greater impact on outcomes, formal programs are essential in growing and maintaining that ethical culture. In fact, according to employees, where cultures are strong, it is in part *because* a formal program is in place.

The lesson learned from NBES is that both compliance and a strong ethical culture are necessary if employee conduct is to be positively changed. The two must work together. A compliance program provides a foundation by which employees can understand the regulations and standards that are relevant to their work and the point to which employees are overstepping the boundaries of their employer or the law. But once a program is established, the job isn't done. NBES data reveals that over time, the impact of a program is diminished unless the culture gains strength in its prioritization of ethics. A focus on compliance should turn to a focus on ethics as "the way things are really done around here." Organizations that have been successful in this regard tailor training to management levels and other strong subcultures within the organization. They emphasize the integration of ethics into everyday decision-making, and consistently communicate that the *values* of the organization really do guide organizational activity. As compliance tells employees what they should not do, the ethical culture of the organization shows them how they should act.

CONCLUSIONS

The NBES findings may not come as a great surprise to organizations that have had ethics and compliance programs for a long time. That ethical culture matters is not news. After all, many experts have written about the importance of "tone from the top," and, even without NBES data, there are enough real-life examples of how negative actions by top management can unravel the effectiveness of even the best ethics and compliance programs.

Nevertheless, the NBES findings reveal some encouraging things: programs do make a difference, and they likely grow and support strong ethical cultures. A program is not complete, however, if it does not include ethical culture as an element of focus. Here, there is much work to be done, since only 22 percent of employees in the NBES survey indicated that their organizations had all the elements of a formal ethics and compliance program in place, in addition to all the elements of a strong ethical culture. Tellingly, in the 2005 survey, none of the elements of ethical culture measured increased substantially over past years—and this may be one reason that outcomes have remained unchanged.

If organizations are to achieve more positive outcomes, creating a strong ethical environment should become a top priority. Formal programs are critical and work well initially, but organizations need to take the next step and focus greater attention on building the right culture in which these programs can operate. To this end, NBES provides guidance by demonstrating that certain ethics-related actions have a greater impact on ethical culture and positive outcomes. Management will be better served by communicating ethics as a priority, setting a good example, and keeping promises and commitments than by writing even more regulations. Supervisors can be more effective if they are trained to support employees when they make decisions based on ethical standards. If employees hold themselves and their coworkers accountable to the standards and feel free to report misconduct without fear of retaliation, the quality of ethical decision-making will improve. In general, if organizations are to achieve increased positive results from their ethics and compliance efforts, ethics must infuse every decision.

ABOUT THE AUTHOR

Dr. Patricia J. Harned was appointed President of the Ethics Resource Center (“ERC”) in May 2004. From December to May, Dr. Harned was Vice President for the organization. In January 1999, Dr. Harned joined the ERC as the Director of Character Development. She assumed the role of Director of Research in 2001, and later became Managing Director for Programs in 2002.

Dr. Harned brings to the ERC broad experience in the areas of ethics, education, research, and advocacy. During her tenure at the ERC, Dr. Harned has directed or supported a wide range of projects, ranging from the development of ethics initiatives in such organizations as Arvin Meritor, the World Bank, Ohio Health, ITT, and the Society for Human Resource Management. She has conducted both quantitative and qualitative studies, ranging from program evaluations to descriptive research. Her research efforts include evaluations of specific ethics initiatives undertaken by individual organizations, including Lockheed Martin Corporation, the Regulatory Affairs Professional Society, Martin Marietta Materials, and the Office of Government Ethics in the Commonwealth of Puerto Rico. Dr. Harned has also supported meta-analyses of organizational efforts through the National Business Ethics Survey, and evaluation of the D.C. Public Schools’ character education program. Dr. Harned has been a primary consultant to the Securities Industry/Regulatory Council on Continuing Education, authoring the ethics module for the Regulatory Element for broker/dealers in the United States.

Dr. Harned has also taken a leading role in the efforts of the ERC to advocate for the prioritization of research in character education—successfully assisting with the development and passage of legislation in the No Child Left Behind Act of 2002. Dr. Harned spearheaded the efforts of the ERC to comment on SEC regulations regarding codes of conduct in publicly traded companies, and response to the Federal Sentencing Commission’s Advisory Group as they formulated recommendations to the Commission regarding the *Federal Sentencing Guidelines for Organizations*. Dr. Harned has testified on Capitol Hill before the Education & Workforce Committee, as well as the Federal Sentencing Commission.

Dr. Harned has authored several works, including *Creating a Workable Company Code*, *Common Sense & Everyday Ethics*, in addition to middle-school textbooks for Harcourt, Brace & Co., *Leading the Effort to Teach Character in Schools* (NASSP Bulletin, 83(609)), *Partnering Character Education and Conflict Resolution* (Kappa Delta Pi Record, 35(3)), and *Creating a Culture of Development for the New Professional* (New Directions for Student Services, Jossey-Bass Pub.). Dr. Harned was an editor for *Morale, Culture, and Character: Assessing Schools of Hope*, written by Dr. Douglas Heath, the prominent character education scholar. She is also an accomplished speaker, having given talks such as “Self-interest Is Manifest by Cheating,” “Spirituality and the Research University,” and “Supervising New Professionals.” Dr. Harned serves on the editorial board of *Public Integrity*.

Dr. Harned received her Doctor of Philosophy degree in the area of the Social and Comparative Analysis of Education, with a specialization in the Philosophy of Education, from the University of Pittsburgh.

APPENDIX

Ten Things Your Company Can Do to Avoid Being the Next Enron

1. Examine your ethical climate and put safeguards in place.

Corporations are composed of cultures. Take a good close look at your culture. What are the norms of behavior? What is valued? Are employees rewarded for succeeding at any cost or are they urged to be shepherds of the corporation's reputation as well as its assets? What pressures do they face to commit misconduct? What systemic problems exist that could encourage good people to make bad decisions?

Consider conducting a formal assessment of your corporate culture from the perspective of attitudes, perceptions, values, standards of conduct, pressures to commit misconduct, communications, risks, and vulnerabilities. Pay particular attention to your corporate values and how well they have been internalized by your board, senior leadership, employees at all levels, and key stakeholders.

2. Don't just print, post, and pray.

If you have a Code of Conduct or an Ethics Code, printing copies, posting them on the wall and on bulletin boards is not enough. Codes of conduct are an outgrowth of company missions, visions, strategies, and values. Thoughtful and effective corporate codes provide guidance for making ethical business decisions that balance conflicting interests.

Codes of conduct need to be actual living documents encouraged and valued at the highest levels. Board members and senior executives have to set an example for the type of conduct they expect from others. Ethical lapses at the upper echelons of management tend to be perceived as tacit permission to choose the "path of least resistance" at lower levels. Senior

management needs to hold itself to the highest standards of conduct before it can demand similar integrity from those at lower levels.

Executives who refuse to tolerate misconduct among their peers and who actively seek to model high standards of honesty, transparency, and trustworthiness can best demonstrate the commitment to ethical conduct.

Publicly restate your corporate Code of Ethics as soon as possible and agree to publish the code every year in your corporation's annual report.

3. Build a robust ethics infrastructure that is self-sustaining.

Writing a code of conduct, supporting it at top levels, and communicating it to employees are just a start.

Corporations should have a committee of independent nonexecutive directors on its Board of Directors who are responsible for ensuring that systems are in place in the corporation to assure employee compliance with the Code of Ethics.

Measures they recommend should include staff training, evaluations of compliance systems, appropriate funding and staffing of the corporate ethics office, and effective protections to employees who "blow the whistle" on perceived actions contrary to the spirit and/or letter of the code.

Many corporations establish independent "hot lines" or "help lines" where employees can seek guidance when they are faced with an ethical dilemma or when they encounter unethical conduct in the workplace. Annual training on the code is becoming commonplace. Every publicly listed corporation should consider establishing a regular review system to ensure the code is dynamic and updated in the light of new developments.

4. Publicly commit to being an ethical organization.

Go public. No, not an IPO ("Initial Public Offering")—an EPO, an Ethical Public Offering. Corporations that are open about their ethical standards and conduct seem to be more trustworthy than those who stay silent. Some issue an annual report of their ethics accomplishments and the challenges they faced. Other corporations openly post their vision, values, and codes of conduct on their web sites for public viewing.

Every member of the Board of Directors of a publicly-listed corporation should be required to sign the Code of Ethics and pledge that she or he will never support a Board motion to suspend the code.

All outside law firms and auditing firms that consult to publicly-listed corporations should be required to sign statements noting that they understand and accept the corporation's Code of Ethics.

5. *Separate auditing from consulting functions.*

Allowing Arthur Andersen to both audit and consult with Enron created at least an appearance of a conflict of interest. Subsequently, hiring Arthur Andersen employees as Enron employees who then managed the affairs of their former colleagues made this a real ethical conflict of interest. The independence and integrity of financial auditing organizations are fundamental to the stability and growth of American business and free markets throughout the world. Auditing and consulting functions must be kept separate.

6. *Talk with employees at all levels—often!*

Failure to communicate causes far more pain than smashing your thumb with a hammer. The sore thumb will heal, poor communication can be fatal.

In the 1980s, Tom Peters talked extensively about Managing by Walking Around ("MBWA"). In the purest sense, MBWA is a way for supervisors and managers to best communicate their (task and ethical) expectations and requirements in daily, informal meetings with employees. These informal conversations give employees two sets of data. There is the spoken information that is exchanged and the inferred data that employees glean from the more subtle communications that accompany a manager's words.

Employees basically want to know two things. They want to know what is expected or required for them to survive and to be successful (tasks and ethics). They also want to know "how they are doing" at this point in time (tasks and ethics).

Communicate the following: Goals, Roles, Expectations, and Priorities.

♦ Goals

When "wandering around" make certain that you remind people of the short term and long term goals of the job. They should see how their goals support the organization's mission and vision. This is also an excellent opportunity to tie goals to the code of conduct or code of ethics. Let employees know that how you accomplish a goal is just as important as accomplishing the goal itself. Cutting corners can hurt the corporation, its reputation and, eventually, the individual employee.

♦ Roles

Let employees know how their piece of the job fits into the bigger picture. Remind them of their importance and value. Ensure that they understand their role as it relates to yours. Ensure that they understand what kind of conduct you expect.

♦ Expectations

Be certain that employees understand exactly what you expect. What has to be done? When? To what standards? How will it be evaluated? What should they do if they encounter any roadblocks or unanticipated changes? How do you want them to handle questions and/or "gray areas" where expectations may be unclear or conflicting?

♦ Priorities

Remind your employees of the organization's operational priorities. If safety, quality, and customer service come first for example, then make that clear to your employees. Be clear about what you expect them to do when they experience conflicts between any of these core values. Clarify what constitutes ethical conduct.

Don't just assume your employees know where you stand. Ethics Research Center Fellows Program research indicates that unless leaders clearly and consistently communicate their values, employees will assume they are neutral on the subject.

7. *Build ethical conduct into corporate systems.*

Define your position as an ethical business. Provide employees and customers with a written pledge. “These are our values. This is how we define what is right, fair, and good. We promise that all employees (at every level) of this organization will treat each other and customers accordingly.”

Train your employees on their ethical responsibilities. Teach people how to translate the pledge into specific actions that support the pledge and build trust.

Provide support and guidance to employees. Take time to share what you have learned about how the pledge applies in particular cases within the organization.

Measure your success. Implement simple systems to measure the effectiveness of this ethics initiative. Determine if employees are living the pledge and measure the differences it makes to your employees, your customers, and your bottom line.

Reward those employees who choose to live the promises and remove those who don't.

8. *Establish an ethics committee to constantly keep the organization focused on the seven main provisions of the Federal Sentencing Guidelines of 1991.*

The Federal Sentencing Guidelines that became effective on November 1, 1991, require that “Specific individuals within high level personnel of the organization have been assigned overall responsibility to oversee compliance with (the organization's) standards and procedures.” We believe that oversight process involves seven main functions to be addressed by an organization's ethics committee:

• **Function One**

Review the definitions of standards and procedures. Starting with your organization's areas of operation, what are the activities that require a formal set of ethical standards and procedures? Begin

by reviewing those that apply to each department. Are existing internal guidelines complete? Are they clear and useful to those who must carry them out?

Have potential conflicts between individual regulations been resolved and their resolutions stated clearly? Make use of the information gleaned from employee reporting and clarification processes (i.e., your ethics “Hot Line” as well as employee surveys) to assist in this review process.

Once the review is complete and any shortcomings have come to light, your ethics committee should assign the creation of revised guidelines to the appropriate personnel. Included in that task is the design of a formal method for communicating standards and procedures to employees. This method should ensure that employees both understand and accept the ethics program.

Meanwhile, the ethics committee can suggest behaviors to upper management that reinforce the organization's guidelines. Do not underestimate how management's conduct can affect the successful implementation of an ethics program.

• **Function Two**

Assume responsibility for overall compliance. The ethics committee should assert that it is the responsible authority for ethics compliance within its area of jurisdiction (corporate-wide or division-wide, for example). It should serve as the court of last resort concerning interpretations of the organization's standards and procedures. When and if inconsistencies come to light in this manner, the committee should make recommendations on improving the existing compliance mechanisms. And, as always, there should be follow-up to ensure that compliance recommendations have been understood and accepted.

• **Function Three**

Assure due care in assigning discretionary responsibility. The ethics committee should define how the organization will balance the rights of individual applicants and employees against the

organization's need to avoid risks that come from placing known violators in positions of discretionary responsibility. This includes the oversight of background investigations on employees/applicants who are being considered for such positions.

• **Function Four**

Communicate the organization's standards and procedures. As in our first point above, the ethics committee should define methods and mechanisms for communicating ethical standards and procedures. This includes the distribution of documents (codes of conduct, for example) to ensure that every employee understands and accepts the organization's ethical guidelines. To make certain that published standards are understood, the ethics committee should provide regular training sessions as well.

Since communication is two-way, the ethics committee should solicit stakeholder input regarding how standards and procedures are defined and enforced. In this connection, it is useful to create ways of providing proof that each employee has received the appropriate documents and understands the standards and procedures described.

We also suggest an ethics "hot line" to protect employees' privacy and ensure their access to a "safe" mechanism for seeking guidance and reporting suspected wrongdoing.

• **Function Five**

Monitor and audit compliance. Because compliance is an ongoing necessity, the ethics committee should design controls that monitor, audit, and demonstrate employees' adherence to published standards and procedures. There should also be mechanisms that check the effectiveness and reliability of such internal controls.

To warrant that the organization's goals, objectives, and plans do not conflict with its ethical standards and procedures, the ethics committee should develop methods for regular review and assessment. Check also to ensure that formalized measurements and rewards do not motivate noncompliance.

• **Function Six**

Serve as primary agent for enforcement and discipline. Disciplinary provisions should be in place to ensure consistent responses to similar violations of standards and procedures (versus applying different standards to different employees based on their position, performance, function, and the like). There should be provisions for those who ignore as well as those who violate standards and procedures.

• **Function Seven**

Take the steps necessary to ensure that offenses are not repeated. When violations do occur, the ethics committee should have ways to identify why they occurred. It is also important that lessons learned from prior violations are systematically applied to reduce the chance that similar violations can take place in future.

Stay abreast of changes. The Federal Sentencing Guidelines are currently under review and may soon change.

9. Choose to live your corporate values.

No compliance manual, regardless of its thoroughness, can cover every contingency. And, if one could be written that **did** cover all possibilities, it would occupy so much space and be so cumbersome to use that its covers would never be opened.

By equipping employees with corporate-supported values and empowering them to make decisions based on those values, you will free them to take action even when specific guidance isn't readily available. You will also enjoy the peace of mind that comes from knowing your employees have common ground from which all decisions can be made. There are also creative ways to get ethical issues communicated up the corporate ladder.

10. Keep the lines of communications open.

If you ask about what is going right, what is going wrong, and what makes employees uncomfortable in their jobs, you can usually identify pitfalls before you step into them. Communicate openly and honestly.

Summary

To help avoid the fate of Enron and other companies whose ethics are called into question:

1. Examine your ethical climate and put safeguards in place.
2. Don't just print, post, and pray.
3. Build a robust ethics infrastructure that is self-sustaining.
4. Publicly commit to being an ethical organization.
5. Separate auditing from consulting functions.
6. Talk with employees at all levels ...often!
7. Build ethical conduct into corporate systems.
8. Establish an ethics committee to constantly keep the seven main provisions of the Federal Sentencing Guidelines of 1991 in mind.
9. Choose to live your corporate values.
10. Keep the lines of communications open.

Dr. Stuart Gilman, Dr. Patricia Harned, Frank Navran, and Jerry Brown contributed to this article.

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