Will Sarbanes-Oxley Improve Ethics?

A LOT OF ATTENTION HAS BEEN PAID TO SECTION 404 of the Sarbanes-Oxley Act of 2002 (SOX) and its requirements for management certification and external auditor attestation of internal controls. But it's the ethics aspects of SOX that may be more important to achieving the law's objectives. And almost forgotten is the axiom that controls are only as effective as the control environment allows them to be. The "tone at the top" is critically important.

Section 406 of SOX requires all public companies to have a code of conduct for senior management and financial officers that contains appropriate compliance and enforcement procedures. Pursuant to SOX, the stock exchanges have expanded this requirement to require the code to cover all directors, officers, and employees and have made it a condition of continued listing.

There are several determinants of success for a code of conduct. First is an awareness of the code and sensitivity to its application. Codes that are put into an employee manual and never referred to become meaningless. The New York Stock Exchange believes so much in publicity for a company's code that it is required to be published on a company's website.

SEC Chairman William Donaldson has also addressed the importance of ethics in corporate governance as well as the importance of the board of directors. He has advised that companies, management, directors, and the gatekeepers who serve them must go beyond simply conforming with the letter of the new laws and regulations that have been adopted in response to corporate scandals. In a speech at the 2003 Washington Economic Policy Conference, Donaldson encouraged boards to "define the culture of ethics that they expect all aspects of the company to embrace. The philosophy that they articulate must pertain not only to the board's selection of a chief executive officer, but also to the spirit and very DNA of the corporate body itself—from top to bottom and from bottom to top" (speech available at www.sec.gov/news/speech/spch032403whd.htm). In spite of the need for more director involvement in matters of ethics, research at the 2003 Conference Board Business Ethics Conference showed that 73% of companies hadn't provided ethics training to members of the board of directors.

"Tone at the top" is critically important.

Another and perhaps even more important factor in achieving an ethical control environment and successful compliance program is the willingness for people to step forward with information that may indicate wrongdoing. Information that never reaches decision makers can't be useful in achieving a culture of greater trust. Realizing the importance of upward and confidential communication, SOX encourages this type of "whistle blowing" by motivating publicly held companies to have a more open culture—one sympathetic to employees speaking up if they have a "reasonable belief" that a law has been violated. Section 301 of SOX requires audit committees to have a system for tracking and acting on anonymous information from employees. This element of a successful compliance program should already be in place in well-run organizations.

As an indication of how far some organizations have to go, the same Conference Board ethics research showed that 69% of respondents said fear of retaliation for those coming forward with information is a big issue in their organization, and half disagreed with the statement "My organization has a culture of dissent, where people can speak their minds." Another finding was that 27% say great performers in their organization who don't live up to the organization's values continue to be promoted or tolerated. The weakest link in corporate America as far as ethics and compliance efforts are concerned is middle management, according to the Conference Board ethics research.

For example, the recent CPA firm scandals involving overbilling of travel costs to clients came up on the radar screen of the ethics officer of PricewaterhouseCoopers, but she was unable to convince senior firm partners of the wisdom of full disclosure of the problem and full restitution.

As a further motivating factor to encourage information to come forward for action, Section 806 of SOX directs companies to adopt procedures to protect employees who provide information about corporate financial wrongdoing. Companies are not allowed to "discharge, demote, suspend, threaten, harass, or in any way discriminate" against such employees. The law authorizes criminal penalties for violators.

Finance professionals must themselves engage in ethical conduct, but they must also be advocates for and promote ethical behavior elsewhere in their organizations. ■

Curtis C. Verschoor is the Ledger & Quill Research Professor, School of Accountancy and MIS, DePaul University, Chicago and Research Scholar in the Center for Business Ethics at Bentley College, Waltham, Mass. His e-mail address is cverscho@condor.depaul.edu.