CEOs Set Ethics Priorities; Ordinary Citizens Define Ethics Broadly

THE FIRST RESEARCH STUDY CONDUCTED BY the prestigious Business Roundtable Institute for Corporate Ethics surveyed CEOs of large corporations to determine the most important corporate ethics issues facing the business community. According to the CEOs, the five most important ethics issues, in order of priority, are: (1) regaining the public trust, (2) effective company management in the context of today's investor expectations, (3) ensuring the integrity of financial reporting, (4) fairness of executive compensation, and (5) ethical role-modeling of senior management.

The study also revealed that 81% of CEOs believe that standards for corporate ethics have risen in the wake of recent controversies, and 74% indicated their companies have made changes in how ethics issues are handled or reported within the last two years. Changes cited most often include enhanced internal reporting and communications (33%), establishment of ethics hotlines (17%), improved compliance procedures (12%), and greater oversight by the board (10%). Concerning their specific top-priority plans, the majority of CEOs (57%) cited establishing a framework for business decision making that integrates ethics. Second, they plan to encourage pushback and establish a culture for addressing potential bad news early and proactively (35%).

A second study involved focus groups of ordinary citizens and interviews of business leaders. Conducted by researchers Public Agenda in collaboration with the Kettering Foundation, it provided an interesting comparison of how ordinary citizens and business executives view issues of business ethics. Written by Steve Farkes, Ann Duffett, and Jean Johnson, *A Few Bad Apples? An Exploratory Look at What Typical Americans Think About Business Ethics Today* notes that the two groups agree on some issues but disagree on others—understandable considering that the ordinary citizens are consumers and employees whereas the business leaders function as managers and decision makers.

Both groups agreed that a general decline in ethics and morals in society contributed to recent scandals. Ordinary citizens often said that greed for money and power and a weakening of personal values were at the root of many transgressions. They believed the most egregious violators of ethical principles were corrupt business executives who protected their own wealth while driving their companies into bankruptcy and taking the livelihood of many employees. Business leaders agreed that executives who had committed the most atrocious misdeeds should be punished to the full extent of the law. Business executives also said that the tremendous pressure to show profits could lead the "ethically vulnerable" to take questionable shortcuts.

There was also general agreement that the current scandals haven't produced a systemic cynicism about ethics in business. Many ordinary citizens thought that it was certainly possible for executives to be ethical as well as successful. The business leaders were aware that CEOs had lost a great deal of public credibility and recognized the importance of the need to regain the trust of the general public. Both groups also agreed that companies that support their communities engender the public's goodwill and should be rewarded.

The greatest divergence of opinion involved the creating and saving of jobs. Job security and whether a company treated employees and customers fairly was the primary worry of ordinary citizens. Their main concern was for the interests of individuals, not what was best for a particular company and its shareowners. Business leaders, on the other hand, didn't speak about jobs in moral and ethical tones the way the general public did. Layoffs and offshoring of work to lower-cost countries were viewed simply as an inevitable part of doing business. Virtually all executives believed that the vast majority of business leaders are ethical, and many protested that just a few bad apples were ruining their collective reputation.

In view of these findings, business leaders should include the public's broad perception of how ethics affects business decisions as they plan their strategies. Business entities have been assigned many critically important roles by today's society, and they need to recognize these roles and consider their responsibilities to the interests of a broad range of stakeholders, including the general public, when they act. Attention to strategies that promote the interests of employees, customers, suppliers, the environment, and the community also results in superior financial returns to shareowners.

Good ethics is certainly good business. Including ethics in decision-making processes throughout an organization is essential to long-term success.

2004 Fraud Statistics Reinforce Need for Action

The Association of Certified Fraud Examiners (ACFE) has conducted another survey of occupational fraud cases that its members have investigated. The 2004 survey reports that 508 fraud cases caused losses of more than $761 million. As a consequence, ACFE estimates total fraud losses in a typical U.S. organization to be 6% of total revenues. By applying this percentage to the 2003 U.S. Gross Domestic Product, these findings can be extrapolated to the total U.S. economy, which results in an estimate of total fraud costs of $660 billion.

As in the past, the ACFE found that the most effective fraud detection mechanism is a tip from a knowledgeable person. Forty percent of frauds were identified this way, with internal auditing a distant second at 23.8%. These are followed by accidental discovery, 21.3%; internal controls, 18.4%; and external audit, 10.9%. Further supporting the benefits of an effective help/hotline system, the size of the median fraud loss in organizations where a confidential employee reporting system was in place was less than half that of organizations where no system was available. Also, the median fraud loss in organizations with an internal audit function was only 60% of the size of that in organizations that had no internal auditing.

Although almost 60% of the informative tips came from employees, more than 35% came from customers and suppliers. The ACFE report notes that the confidential reporting mechanisms that are mandated by Sarbanes-Oxley only cover employees. The ACFE recommends that a fully effective reporting structure be designed to reach out to customers, suppliers, and other third-party sources as well.

Analyzing recoveries from the reported losses indicates that, even considering recoveries from fidelity insurance, only 22% of fraud victims managed to recover their total loss. The median recovery amount was only 20% of the amount lost. Given that recovery efforts are expensive, time-consuming, and frequently futile, the ACFE suggests that the most cost-effective way to deal with fraud is to prevent it.

Internal controls weren't shown to be very effective in detecting fraud, and the size of fraud detected through the operation of controls was the lowest of any detection method. Nevertheless, the ACFE report recommends maintenance of more effective types of internal controls to detect the larger frauds where senior personnel may have overridden or circumvented traditional methods. This illustrates the importance of an ethical culture that will allow more traditional controls to function most effectively. ■

The survey by the Business Roundtable Institute for Corporate Ethics, Mapping the Terrain, *is available at www.corporate-ethics.org. The Public Agenda research is available at www.publicagenda.org/research/research_reports_details.cfm?list=5. The ACFE's 2004 Report to the Nation on Occupational Fraud and Abuse is available at www.cfenet.com/resources/RttN.asp.*

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