CREATING AN ETHICAL CULTURE

Values-based ethics programs can help employees judge right from wrong.

BY DAVID GEBLER

WHILE THE FATE of former Enron leaders Kenneth Lay and Jeffrey Skilling is being determined in what has been labeled the "Trial of the Century," former WorldCom managers are in jail for pulling off one of the largest frauds in history.

Yes, criminal activity definitely took place in these companies and in dozens more that have been in the news in recent years, but what's really important is to take stock of the nature of many of the perpetrators.

Some quotes from former WorldCom executives paint a different picture of corporate criminals than we came to know in other eras:

"I'm sorry for the hurt that has been caused by my cowardly behavior." *—Scott Sullivan, CFO*

"Faced with a decision that required strong moral courage, I took the easy way out....There are no words to describe my shame."
—Buford Yates, director of general accounting

"At the time I consider the single most critical character-defining moment of my life, I failed. It's something I'll take with me the rest of my life."
—David Myers, controller

These are the statements of good people gone bad. But probably most disturbing was the conviction of Betty Vinson, the senior manager in the accounting department who booked billions of dollars in false expenses. At her sentencing, U.S. District Judge Barbara Jones noted that Vinson was among the lowest-ranking members of the conspiracy that led to the $11 billion fraud that sank the telecommunications company in 2002. Still, she said, "Had Ms. Vinson refused to do what she was asked, it's possible this conspiracy might have been nipped in the bud."

Judge Jones added that although Ms. Vinson "was among the least culpable members of the conspiracy" and acted under extreme pressure, "that does not excuse what she did."

Vinson said she improperly covered up expenses by drawing down reserve accounts—some completely unrelated to the expenses—and by moving expenses off income statements and listing them as assets on the balance sheet.

Also the company's former director of corporate reporting, Vinson testified at Bernie Ebbers's trial that, in choosing which accounts to alter, "I just really pulled some out of the air. I used some spreadsheets." She said she repeatedly brought her concerns to colleagues and supervisors, once describing the entries to a coworker as "just crazy." In spring 2002, she noted, she told one boss she would no longer make the entries. "I said that I thought the entries were just being made to make the income statement look like Scott wanted it to look."

Standing before the judge at her sentencing, Vinson said: "I never expected to be here, and I certainly won't do anything like this again." She was sentenced to five months in prison and five months of house arrest.

PRESSURE REIGNS

While the judge correctly said that her lack of culpability didn't excuse her actions, we must carefully note that Betty Vinson, as well as many of her codefendants, didn't start out as criminals seeking to defraud the organization. Under typical antifraud screening tools, she and others like her wouldn't have raised any red flags as being potential committers of corporate fraud.

Scott Sullivan was a powerful leader with a well-known reputation for integrity. If any of us were in Betty Vinson's shoes, could we say with 100% confidence that we would say "no" to the CFO if he asked us to do something and promised that he would take full responsibility for any fallout from the actions we were going to take?

Today's white-collar criminals are more likely to be those among us who are unable to withstand the blistering pressures placed on managers to meet higher and tougher goals. In this environment, companies looking to protect themselves from corporate fraud must take a hard look at their own culture. Does it promote ethical behavior, or does it emphasize something else?

In most companies, "ethics" programs are really no more than compliance programs with a veneer of "do the right thing" messaging to create an apparent link to the company's values. To be effective, they have to go deeper than outlining steps to take to report misconduct. Organizations must understand what causes misconduct in the first place.

We can't forget that Enron had a Code of Ethics. And it wasn't as if WorldCom lacked extensive internal controls. But both had cultures where engaging in unethical conduct was tacitly condoned, if not encouraged.

BUILDING THE RIGHT CULTURE

Now the focus has shifted toward looking at what is going on inside organizations that's either keeping people from doing the right thing or, just as importantly, keeping people from doing something about misconduct they observe. If an organization wants to reduce the risk of unethical conduct, it must focus more effort on building the right culture than on building a compliance infrastructure.

The Ethics Resource Center's 2005 National Business Ethics Survey (NBES) clearly confirms this trend toward recognizing the role of corporate culture. Based on interviews with more than 3,000 employees and managers in

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the U.S., the survey disclosed that, despite the increase in the number of ethics and compliance program elements being implemented, desired outcomes, such as reduced levels of observed misconduct, haven't changed since 1994. Even more striking is the revelation that, although formal ethics and compliance programs have some impact, organizational culture has the greatest influence in determining program outcomes.

The Securities & Exchange Commission (SEC) and the Department of Justice have also been watching these trends. Stephen Cutler, the recently retired SEC director of the Division of Enforcement, was matter of fact about the importance of looking at culture when it came to decisions of whether or not to bring an action. "We're trying to induce companies to address matters of tone and culture…. What we're asking of that CEO, CFO, or General Counsel goes beyond what a perp walk or an enforcement action against another company executive might impel her to do. We're hoping that if she sees that a failure of corporate culture can result in a fine that significantly exceeds the proverbial 'cost of doing business,' and reflects a failure on her watch—and a failure on terms that everyone can understand: the company's bottom line—she may have a little more incentive to pay attention to the environment in which her company's employees do their jobs."

MEASURING SUCCESS

Only lagging companies still measure the success of their ethics and compliance programs just by tallying the percentage of employees who have certified that they read the Code of Conduct and attended ethics and compliance training. The true indicator of success is whether the company has made significant progress in achieving key program outcomes. The National Business Ethics Survey listed four key outcomes that help determine the success of a program:

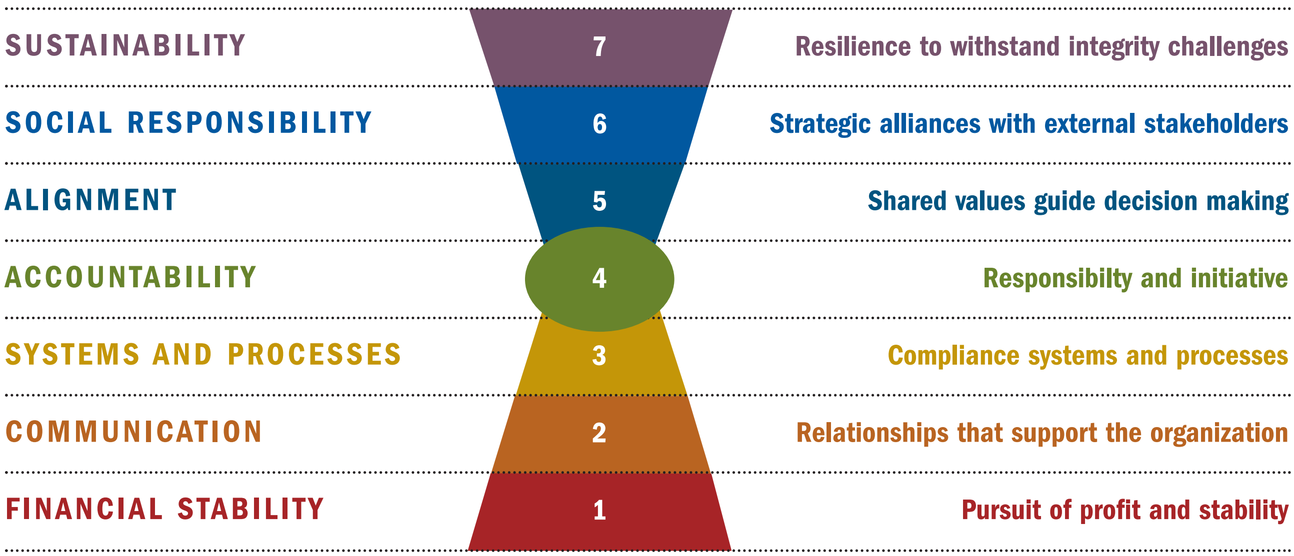
- Reduced misconduct observed by employees,
- Reduced pressure to engage in unethical conduct,
- Increased willingness of employees to report misconduct, and
- Greater satisfaction with organizational response to reports of misconduct.

What's going to move these outcomes in the right direction? Establishing the right culture.

Most compliance programs are generated from "corporate" and disseminated down through the organization. As such, measurement of the success of the program is often based on criteria important to the corporate office: how many employees certified the Code of Conduct, how many employees went through the training, or how many calls the hotline received.

Culture is different—and is measured differently. An organization's culture isn't something that's created by senior leadership and then rolled out. A culture is an objective picture of the organization, for better or worse. It's the sum total of all the collective values and behaviors of all employees, managers, and leaders. By definition, it can only be measured by criteria that reflect the individual values of all employees, so understanding cultural vulnerabilities that can lead to ethics issues requires knowledge of what motivates employees in the organization. Leadership must know how the myriad human behaviors and interactions fit together like puzzle pieces to create a whole picture. An organization moves toward an ethical culture only if it understands the full range of values and behaviors needed to meet its ethical goals. The "full-spectrum" organization is one that creates a positive sense of engagement and purpose that drives ethical behavior.

Figure 1: SEVEN LEVELS OF AN ETHICAL ORGANIZATION



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Why is understanding the culture so important in determining the success of a compliance program? Here's an example: Most organizations have a policy that prohibits retaliation against those who bring forward concerns or claims. But creating a culture where employees feel safe enough to admit mistakes and to raise uncomfortable issues requires more than a policy and "Code training." To truly develop an ethical culture, the organization must be aware of how its managers deal with these issues up and down the line and how the values they demonstrate impact desired behaviors. The organization must understand the pressures its people are under and how they react to those pressures. And it must know how its managers communicate and whether employees have a sense of accountability and purpose.

CATEGORIZING VALUES

Determining whether an organization has the capabilities to put such a culture in place requires careful examination. Do employees and managers demonstrate values such as respect? Do employees feel accountable for their actions and feel that they have a stake in the success of the organization?

How does an organization make such a determination? One approach is to categorize different types of values in a way that lends itself to determining specific strengths and weaknesses that can be assessed and then corrected or enhanced.

The Culture Risk Assessment model presented in Figure 1 has been adapted from the Cultural Transformation Tools® developed by Richard Barrett & Associates. Such tools provide a comprehensive framework for measuring cultures by mapping values. More than 1,000 organizations in 24 countries have used this technique in the past six years. In fact, the international management consulting firm McKinsey & Co. has adopted it as its method of choice for mapping corporate cultures and measuring progress toward achieving culture change.

The model is based on the principle, substantiated through practice, that all values can be assigned to one of seven categories:

Levels 1, 2, and 3—The Organization's Basic Needs

Does the organization support values that enable it to run smoothly and effectively? From an ethics perspective, is the environment one in which employees feel physically and emotionally safe to report unethical behavior and to do the right thing?

Level 1—Financial Stability. Every organization needs to make financial stability a primary concern. Companies that are consumed with just surviving struggle to focus enough attention on how they conduct themselves. This may, in fact, create a negative cycle that makes survival much more difficult. Managers may exercise excessive control, so employees may be working in an environment of fear.

In these circumstances, unethical or even illegal conduct can be rationalized. When asked to conform to regulations, organizations do the minimum with an attitude of begrudging compliance.

Organizations with challenges at this level need to be confident that managers know and stand within clear ethical boundaries.

Level 2—Communication. Without good relationships with employees, customers, and suppliers, integrity is compromised. The critical issue at this level is to create a sense of loyalty and belonging among employees and a sense of caring and connection between the organization and its customers.

The most critical link in the chain is between employees and their direct supervisors. If direct supervisors can't effectively reinforce messages coming from senior leadership, those messages might be diluted and confused by the time they reach line employees. When faced with conflicting messages, employees will usually choose to follow the lead of their direct supervisor over the words of the CEO that have been conveyed through an impersonal communication channel. Disconnects in how local managers "manage" these messages often mean that employees can face tremendous pressure in following the lead established by leadership.

Fears about belonging and lack of respect lead to fragmentation, dissension, and disloyalty. When leaders meet behind closed doors or fail to communicate openly, employees suspect the worst. Cliques form, and gossip becomes rife. When leaders are more focused on their own success, rather than the success of the organization, they begin to compete with each other.

Level 3—Systems and Processes. At this level, the organization is focused on becoming the best it can be through the adoption of best practices and a focus on quality, productivity, and efficiency.

Level 3 organizations have succeeded in implementing strong internal controls and have enacted clear standards of conduct. Those that succeed at this level are the ones that see internal controls as an opportunity to create better, more efficient processes. But even those that have successfully deployed business processes and practices need to be alert to potentially limiting aspects of being too focused on processes. All organizations need to be alert to resorting to a "check-the-box" attitude that assumes compliance comes naturally from just implementing standards and procedures. Being efficient all too often leads to bureaucracy and inconsistent application of the rules. When this goes badly, employees lose respect for the system and resort to self-help to get things done. This can lead to shortcuts and, in the worst case, engaging in unethical conduct under the guise of doing what it takes to succeed.

Level 4—Accountability

The focus of the fourth level is on creating an environment in which employees and managers begin to take responsibility for their own actions. They want to be held accountable, not micromanaged and supervised every moment of every day. For an ethics and compliance program to be successful, all employees must feel that they have a personal responsibility for the integrity of the organization. Everyone must feel that his or her voice is being heard. This requires managers and leaders to admit that they don't have all the answers and invite employee participation.

Levels 5, 6, and 7—Common Good

Does the organization support values that create a collective sense of belonging where employees feel that they have a stake in the success of the ethics program?

Level 5—Alignment. The critical issue at this level is developing a shared vision of the future and a shared set of values. The shared vision clarifies the intentions of the organization and gives employees a unifying purpose and direction. The shared values provide guidance for making decisions.

The organization develops the ability to align decision making around a set of shared values. The values and behaviors must be reflected in all of the organization's processes and systems, with appropriate consequences for those who aren't willing to walk the talk. A precondition for success at this level is building a climate of trust.

Level 6—Social Responsibility. At this level, the organization is able to use its relationships with stakeholders to sustain itself through crises and change. Employees and customers see that the organization is making a difference in the world through its products and services, its involvement in the local community, or its willingness to fight for causes that improve humanity. They must feel that the company cares about them and their future. Companies operating at this level go the extra mile to make sure they are being responsible citizens. They support and encourage employees' activities in the community by providing time off for volunteer work and/or making a financial contribution to the charities that employees are involved in.

Level 7—Sustainability. To be successful at Level 7, organizations must embrace the highest ethical standards in all their interactions with employees, suppliers, customers, shareholders, and the community. They must always consider the long-term impact of their decisions and actions.

Employee values are distributed across all seven levels. Through surveys, organizations learn which values employees bring to the workplace and which values are missing. Organizations don't operate from any one level of values: They tend to be clustered around three or four levels. Most are focused on the first three: profit and growth (Level 1), customer satisfaction (Level 2), and productivity, efficiency, and quality (Level 3). The most successful organizations operate across the full spectrum with particular focus in the upper levels of consciousness—the common good—accountability, leading to learning and innovation (Level 4), alignment (Level 5), sustainability (Level 6), and social responsibility (Level 7).

Some organizations have fully developed values around Levels 1, 2, and 3 but are lacking in Levels 5, 6, and 7. They may have a complete infrastructure of controls and procedures but may lack the accountability and commitment of employees and leaders to go further than what is required.

Similarly, some organizations have fully developed values around Levels 5, 6, and 7 but are deficient in Levels 1, 2, and 3. These organizations may have visionary leaders and externally focused social responsibility programs, but they may be lacking in core systems that will ensure that the higher-level commitments are embedded into day-to-day processes.

Once an organization understands its values' strengths and weaknesses, it can take specific steps to correct deficient behavior.

STARTING THE PROCESS

Could a deeper understanding of values have saved WorldCom? We will never know, but if the culture had encouraged open communication and fostered trust, people like Betty Vinson might have been more willing to confront orders that they knew were wrong. Moreover, if the culture had embodied values that encouraged transparency, mid-level managers wouldn't have been asked to engage in such activity in the first place.

The significance of culture issues such as these is also being reflected in major employee surveys that highlight what causes unethical behavior. According to the NBES, "Where top management displays certain ethics-related actions, employees are 50 percentage points less likely to observe misconduct." No other factor in any ethics survey can demonstrate such a drastic influence.

So how do compliance leaders move their organizations to these new directions?

1. The criteria for success of an ethics program must be outcomes based. Merely checking off program elements isn't enough to change behavior.

2. Each organization must identify the key indicators of its culture. Only by assessing its own ethical culture can a company know what behaviors are the most influential in effecting change.

3. The organization must gauge how all levels of employees perceive adherence to values by others within the company. One of the surprising findings of the NBES was that managers, especially senior managers, were out of touch with how nonmanagement employees perceived their adherence to ethical behaviors. Nonmanagers are 27 percentage points less likely than senior managers to indicate that executives engage in all of the ethics-related actions outlined in the survey.

4. Formal programs are guides to shape the culture, not vice versa. People who are inclined to follow the rules appreciate the rules as a guide to behavior. Formal program elements need to reflect the culture in which they are deployed if they are going to be most effective in driving the company to the desired outcomes.

Culture may be new on the radar screen, but it isn't outside the scope or skills of forward-thinking finance managers and compliance professionals. Culture can be measured, and finance managers can play a leadership role in developing systematic approaches to move companies in the right direction. ■

David Gebler, J.D., is president of Working Values, Ltd., a business ethics training and consulting firm specializing in developing behavior-based change to support compliance objectives. You can reach him at dgebler@workingvalues.com.

Ethics is a topic at IMA's Annual Conference June 17-21. For details, visit www.imaconference.org.