Curtis C. Verschoor, CMA, Editor

Siemens AG Is the Latest Fallen Ethics Idol

Siemens AG is a huge German-based conglomerate that provides electronics and engineering products and services worldwide for use in markets such as telecommunications, industrial automation, power generation, and transportation. With the sale of Chrysler by Daimler, it is now perhaps the largest publicly held German corporation and one of Europe's largest, ranking 28th in sales on the *Fortune* Global 500 list. Siemens frequently has been acclaimed for its publicly stated emphasis on good governance, strong corporate responsibility, and ethical behavior. But as with what went on at Enron, the highly visible veneer of effective governance and a strong ethical corporate culture appears to have masked the reality of bribery, conflicts of interest, tax evasion, and corruption.

The corporate governance section of the Siemens website states the corporate policy:

"Corporate Governance forms the basis of all our decision-making and monitoring processes. Our actions are aligned with clearly defined ethical principles.

"Responsible Corporate Governance supports our long-term value creation and strengthens the trust in our company of shareholders, customers, employees, business partners, politics, and the public."

In the 2005 Annual Report, Klaus Kleinfeld, who became CEO at the beginning of that year, stated in his Letter to Shareholders that Siemens is "committed to being an active and responsible member of every community where we do business worldwide, and we've set the goal of becoming best-in-class in corporate governance, business practices, sustainability, and corporate citizenship."

Pursuant to the stipulations of the Sarbanes-Oxley Act, the New York Stock Exchange, the German Corporate Governance Code, and other requirements, Siemens developed a code of conduct that also expresses corporate policy. A corporate compliance officer reports regularly to the audit committee of the Supervisory Board. German companies have a Managing Board of employee directors that has oversight from a more independent Supervisory Board. Managerial employees sign a pledge renewing their commitment to uphold these rules. Ethics counselors are widely available for employees who need advice when confronted with a potential ethical conflict. The code, which is also emphasized in training programs, states:

"We base our strategic planning and our day-to-day business practices on high ethical and legal standards. Our Business Conduct Guidelines (BCG)—globally binding rules that apply to every Siemens employee and require us to abide by laws, to show mutual respect, and to act honestly and with integrity—set the basis for our conduct.

"In addition to our own guidelines, there are a number of conventions and recommendations from international organizations that are important for the conduct of multinational companies and their employees. For Transparency International, a respected global nongovernmental organization, we have signed a pledge to actively combat corruption."

The text of the BCG itself is clear and unequivocal concerning bribery and corruption, stating, "No employee may directly or indirectly offer or grant unjustified advantages to others in connection with business dealings, neither in monetary form nor as some other advantage. In order to ensure a fair and corruption-free competitive conduct, Compliance Officers are specially designated at the level of Siemens AG and subsidiaries as well as at the level of the Groups."

The reputation of Siemens as a well-governed and responsible corporation has been reported by external evaluators, including the selection of Siemens for membership in the Dow Jones Sustainability Index, which chooses companies that "…set the highest standards of corporate governance and stakeholder engagement, including corporate codes of conduct and public reporting." The long-established provider of data on corporate governance, Institutional Shareholder Services (ISS), rates Siemens as a leader in Corporate Governance.

Although German companies have long had a clean reputation, until recently there has been little regulation against bribery, kickbacks, and payoffs in the corporate sector. For example, insider stock trading became illegal only in 1995, as the German government and investment community tried to respond to pressure from international investors. Until 1996, German companies were permitted to pay bribes to win contracts and could get a tax deduction as a cost of doing business unless a criminal complaint was sustained. Siemens adopted U.S./U.K. governance standards when it applied for listing on the New York Stock Exchange in 2001.

The news of scandal at Siemens began to become public in mid-2004, when the German federal prosecutor's office reported an investigation into suspected bribes by former Siemens employees valued at €6 million ($7.3 million) paid to former employees of Italian utility Enel SpA to secure gas-turbine contracts. The former managers are suspected of transferring money through accounts in Liechtenstein and the United Arab Emirates.

In early 2006, an Illinois grand jury indicted Siemens and two of its employees in a fraud scheme to win a $49 million contract. The officials allegedly schemed with a minority contractor in setting up a shell company to win the contract for radiology equipment. According to the prosecutor, the shell company received a flat fee of $500,000 without providing any real service and without sharing in the risks or profits of the deal.

When Kleinfeld became CEO of Siemens AG in early 2005, he made it a top priority to clean up the company's telecommunications unit. Corruption in this business group made news in November 2006 when a Munich prosecutor reported that police were investigating alleged embezzlement and possible bribery designed to help Siemens secure business contracts. Siemens said the allegations involved "a still-undetermined number of individual acts of fraud" in its fixed-line telecommunications-equipment business. The amount of suspicious transactions amounted to €20 million ($25.7 million). A week later, Italian authorities estimated the suspicious money laundering and/or

continued on page 61

[ETHICS] *cont'd from p. 12*

bribery to be about €60 million ($77 million). Italian authorities say the transactions under investigation passed through a Siemens bank account in Austria before disappearing through a network of shell companies in the Channel Islands, Puerto Rico, and the British Virgin Islands.

The amount of suspicious transactions escalated to €200 million ($257 million) later in November, and Transparency International announced it had suspended the membership of Siemens in the group. In December, Siemens's appointment of the same individual to function both as ombudsman and legal advisor to the company was widely viewed as a conflict of interest and thus ineffective. At the same time, Finland-based Nokia announced in a joint statement with Siemens that the ongoing black money scandal, stemming from evidence that Siemens used a $265 million network of "black accounts" for bribery around the world, has weakened Nokia's trust in the company and hampered original merger plans. The start of operations of Nokia-Siemens Networks was delayed nine months.

Later in December 2006, a New York law firm was appointed to conduct an independent review of the Siemens compliance system and engage an independent audit firm other than KPMG, Siemens's external auditor, to provide assistance. Siemens provided its first estimate of the extent of the scandal in mid-December, saying it could reach €420 million ($556 million)—or more than double other estimates. Analysts pointed out, however, that even more could have been siphoned off since the €420 million relates only to money that flowed through Siemens's books.

The scandal widened to include price fixing in February 2007 when Siemens was fined a record €397 million ($480 million) for its "leadership role" in a long-running pricing cartel that carved up the market for gas-insulated switchgear. The U.S. Department of Justice and the Securities & Exchange Commission opened investigations in February as well, and the FBI began to study a possible link between Siemens and another corruption scandal involving the sale of telecommunications equipment to the Russian telephone industry. A second New York law firm was engaged by the audit committee to deal with the U.S. inquiries.

The parade of resignations caused by the scandal began in mid-April with the chairman of the Supervisory Board. Only six days later, CEO Klaus Kleinfeld was forced to resign. All of the senior executives of Siemens have chosen the failed Ken Lay defense: "I didn't know anything about these matters." The successor CEO, Peter Loscher, took over on July 1. He has extensive senior experience in pharmaceuticals as the "Number Two" at Merck, but he's also the first outsider to be named to the post in Siemens's 160-year history. At the same time, the head of corporate compliance left Siemens after only six months on the job amid comments his activities were getting in the way of doing business.

The latest disclosure in this ongoing scandal was made in late September by the New York law firm hired last December. It reported that the amount of suspicious payments now being investigated is €1.6 billion ($2.3 billion), almost four times the earlier amount. Most involves the telecom business, but about €300 million is connected to the power generation group. The French government has threatened to strip Siemens out of a joint venture, and authorities in Liechtenstein and China (as well as Germany and the U.S.) are still pursuing criminal cases.

Lessons to be learned from the Siemens scandal:

1. A strong ethical culture is critical for effective corporate governance.
2. Merely publicizing the need for integrity won't bring it about.
3. Senior executives need to know what is going on throughout the organization.
4. Strong internal control is more important in a widely dispersed and decentralized company.
5. A focus on "making the numbers" will never be successful in the long run.

Questions still needing to be answered:

1. How acceptable are bribes and kickbacks in industrialized countries?
2. Who will go to jail, and how much will the financial settlement cost Siemens?
3. What will be the effect of the scandal on Siemens's strategic plans to acquire/dispose of business units?
4. Where were the internal and external auditors?
5. Can an outsider like new CEO Loscher really change an entrenched corporate culture?

Curtis C. Verschoor is the Ledger & Quill Research Professor, School of Accountancy and MIS, and Wicklander Research Fellow in the Institute for Business and Professional Ethics, both at DePaul University, Chicago. He is also a Research Scholar in the Center for Business Ethics at Bentley College, Waltham, Mass. His e-mail address is curtisverschoor@sbcglobal.net.