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# Top-Management Example and Peer Pressures Bring Benefits

**Research studies from the Ethics Resource Center examine how a strong ethical culture and effective tone at the top permeate through all levels of an organization, while a study by the Association of Certified Fraud Examiners emphasizes the importance of an anonymous hotline for the reporting of misdeeds.**

Two research studies show how the power of pressures triggered by the actions of top and middle management bring significant benefits to organizations. *The Importance of Ethical Culture: Increasing Trust and Driving Down Risks* and *Ethics and Employee Engagement* are reports published in mid-2010 by the Ethics Resource Center (ERC), a private, nonprofit organization devoted to independent research and the advancement of high ethical standards and practices in public and private institutions.

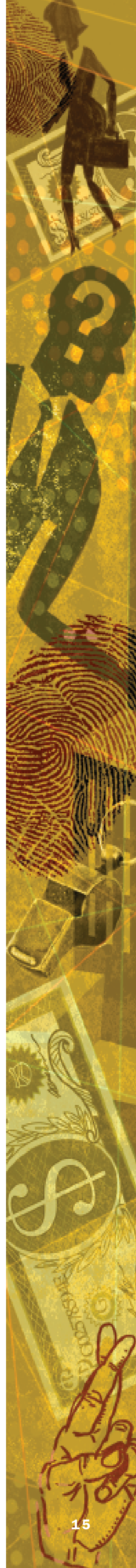
The latest reports analyze in a new way the data gathered in the Center's 2009 National Business Ethics Survey® (NBES). The NBES is a biennial random telephone survey of adults currently employed at least 20 hours per week for a company with at least two employees. Those working in the governmental sector are eliminated from the survey results.

Consistent with the results of NBES studies in previous years, both of the latest ERC reports link a strong ethical culture to a number of favorable workplace outcomes. A strong ethical culture is associated with both a reduction in observed wrongdoing and an increase in employee engagement. Basically, the ethical culture uses both formal and informal methods to teach employees how things really get done around the organization. To measure ethical culture, ERC has developed indexes that measure employee perceptions of management and supervisory commitment to open and honest communication, positive ethical role modeling, and accountability.

The *Increasing Trust* report notes that fewer instances of observed wrongdoing by employees result in lower organizational risks. These include damage to reputation, deterioration in relationships with customers, loss of valued employees, and even criminal prosecution and fines. The *Employee Engagement* study indicates that increased employee engagement results in highly motivated employees who work more productively, require less supervision, and adapt their efforts more easily to changing roles and responsibilities.

Specific findings concerning wrongdoing in the workplace show that in a strong ethical culture only 4% of employees feel pressure to compromise standards and commit misconduct, compared to 15% in a weaker culture—almost four times greater. Rates of observed misconduct in strong cultures are roughly half (39%) as high as those in weaker cultures (76%). Failure to report observed misconduct in a strong culture (28%) is less than two-thirds of that in weaker cultures (43%). The retaliation against reporters of misconduct is six times greater in weaker cultures (24%) compared to strong ones (4%).

Ethical leadership by top management is the principal driver of a strong and responsible management style. But a strong coworker culture is associated with the greatest favorable difference in the level of observed financial misconduct. Worrisome financial activities include misappropriating assets, misrepresenting the financial health of the company, violating contracts, and so forth. Only 8% of employees in stronger coworker cultures reported financial misconduct compared to 31%



reported in weaker cultures. In other words, stronger cultures cut observations of financial misconduct by three-quarters.

The recent reports revealed some interesting characteristics and trends in workplace culture. The percentage of employees who characterized the ethical culture of their organization as either strong or strong-leaning was higher in 2009 (62%) than in any of the five previous biennial studies. A high percentage of employees (68%) also felt positive about the ethics of their coworkers, but perceptions of the strength of the ethics of supervisors (70%) and top management (66%) are declining from levels in earlier years.

Consistent with other research, top managers were reported to be more optimistic about the strength of the culture in their organization than lower-level employees. Eighty-two percent of top managers consider their culture to be strong or strong-leaning compared to 56% of first-line supervisors. Demographic factors are also important in determining the strength of ethical culture. Highly unionized workforces tend to have weaker cultures. Companies with 500 or more employees and are publicly owned were also reported to be at a disadvantage.

Specific findings in *Employee Engagement* document the strong correlation between ethical culture—particularly at the top-management and supervisor levels—and employee engagement. In addition to providing greater productivity and lowering costs, engaged employees are more stable and aware that prospects for continuing employment, career development, and advancement depend on their companies' health and stability.

Employees who witnessed misconduct were less engaged than those who didn't. Only 61% of employees who witnessed misconduct displayed high levels of engagement compared to 85% of those who didn't witness wrongdoing. Concerning the most serious violations, higher proportions were seen by disengaged employees. Seventy-three percent of employees who witnessed bribery of a public official, 67% who witnessed environmental violations, 67% who saw misrepresentation of financial information, 60% who saw anticompetitive practices, and 60% who observed insider trading were all disengaged.

Engaged employees (67%) are more likely to report misconduct when they witness it than other employees (57%). Observed but not reported misconduct by disengaged employees means that management is less able to quickly assess and resolve issues. Unreported misconduct can be a huge liability for the organization. Surmise how different the future of BP PLC would have been if it had had a culture of reporting maintenance shortfalls and meaningful testing of safety procedures.

The *Employee Engagement* report summarizes the implications of the research on ethical culture for managers. These findings have several implications for leaders who want to increase productivity, decrease turnover, reduce misconduct, and lessen ethics risk:

- Adopt leadership training that highlights management behaviors that will inspire and motivate employees to be highly effective and efficient—while upholding the company's ethical standards.
- Ensure that ethics resources—such as hotlines/helplines, procedural justice systems, and standards of conduct—are available to management and employees and that those resources are effectively designed, implemented, and promoted.
- Encourage the human resources and ethics and compliance functions to coordinate efforts and initiatives to maximize the effectiveness of both roles.
- In order to identify areas of weakness and promote accountability, regularly assess both the level of employee engagement and the ethical culture of the company.
- Actively and overtly strive to make decisions and act in ways that promote employee engagement and demonstrate the importance of ethics and ethical standards.

In summary, maintaining a strong ethical culture is an important contributor to successful achievement of organizational objectives. It not only improves employee performance, but it helps avoid risks that could result in jeopardy.

### Occupational Fraud Research

The sixth biennial edition *2010 Report to the Nations on Occupational Fraud and Abuse* by the Association of Certified Fraud Examiners (ACFE) has also been published recently. The ACFE is

continued on page 63

## Ethics

*continued from page 16*

the world's largest antifraud organization. For the first time, the 2010 survey includes global ACFE members.

The extent of occupational fraud continues to amount to about 5% of an organization's annual revenue. Asset misappropriation schemes were the most common, representing 90% of cases, but these had the lowest median loss. Financial-statement frauds, on the other hand, made up only 5% of the cases but caused a median loss of more than $4 million.

Small organizations are disproportionately victimized by occupational fraud. This is understandable because they typically lack the antifraud controls of their larger counterparts. Consistent with every prior biennial report, occupational frauds are much more likely (40%) to be detected by a tip. This is nearly three times the number for any other form of detection. At least a third of fraud tips came from sources outside a company. This means that fraud reporting policies and programs should be publicized to customers, vendors, and other external stakeholders as well as to employees.

Presence of an anonymous helpline/hotline is an effective way to encourage tips from employees. Two-thirds of anonymous tips came through an organization's fraud hotline. Organizations that had anonymous reporting methods suffered much smaller fraud losses than those without hotlines. This may be because they detected the fraud on average seven months earlier than their counterparts. Frauds committed by owners/executives were the most costly, more than three times the loss experienced by manager frauds and nine times the loss of employee schemes. Executive-level frauds also took much longer to detect.

To summarize, preventing occupational fraud requires continual vigilance. **SF**

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