

SIX ELEMENTS OF A COMPLIANCE CULTURE



EXECUTIVE SUMMARY

More than just a boardroom buzzword, "compliance culture" represents the next generation of corporate compliance and ethics programs. Regulators, legal scholars, and businesses are urging organizations to develop a culture of compliance that aligns with external laws, internal policies, and increasingly, ethical values. Despite its importance, there is no singular definition. This paper explores what it means to have a compliance culture, and how you can build one.

THE PROBLEM - WHY COMPLIANCE CULTURE

Since 1991, when the Federal Sentencing Guidelines for Organizations (FSGO) gave organizations leniency for corporate crimes in exchange for implementing effective ethics and compliance programs, compliance has largely adapted to meet regulator expectations. Yet, this "extrinsic, incentive-based approach to compliance is ineffective."¹

For example, employees have engaged in illegal or unethical behavior regardless of their company's rigorous code of conduct. These same companies may have anti-retaliation policies to compel employees to present problems sooner, yet many employees are nonetheless scared to report unethical behavior before it becomes front page news. As a result, a gap forms between what an organization communicates and expects, and what employees actually do.

Developing a compliance culture bridges that gap.

DEFINING COMPLIANCE CULTURE

While there is little consensus about what constitutes a compliance culture, research and thought leadership boil down to this concept:

Workplace behavior that naturally meets ethical and legal norms

Compliance is adhering to established norms, which take the form of external laws, internal policies, and ethical values. Values depend on the organization, but can take the form of things like reputation and employees' personal ethics and goals. In essence, norms are rules.

Regulators are most concerned with a corporation meeting external laws and related policies whereas board members, employees, and the public expect compliance according to internal policies and values. Not all three types of norms are present in modern ethics and compliance programs, but they ultimately should be.

¹ Stucke, M. (2014). In Search of Effective Ethics & Compliance Programs. *Iowa Journal of Corporation Law*, 39: 769, 775.

Culture provides the foundation that shapes employee decisions in the moment. "[C]ulture informs compliance decision-making through explicit and implicit reference to organizational values, norms and assumptions."² In other words, employee decisions are made implicitly, or naturally, through the influence of corporate culture.

Nortek, Inc. is an American company based out of Rhode Island with a wholly-owned subsidiary in China.³ From 2009 to 2014, the subsidiary made improper payments and gifts to local Chinese officials to receive preferential treatment from the government. Also known as bribes, these payments totaled approximately \$290,000 and went undetected by Nortek for years. Not only did this violate Nortek policies for anti-bribery and corruption and recordkeeping, it was propagated by senior leaders of Nortek, including the managing director, accounting manager, and customs liaison officer in China.

The improper payments were uncovered from an audit Nortek performed on the subsidiary in 2014, leading to an internal investigation and ultimately self-disclosure to the U.S. Securities and Exchange Commission, one of two federal agencies responsible for enforcing the Foreign Corrupt Practices Act (FCPA). The parties entered into a non-prosecution agreement partly as a result of Nortek's prompt disclosure.

*This scenario highlights many aspects of a compliance culture. It's arguable that Nortek leadership established a positive **tone at the top** through internal policies and the resulting self-disclosure. Yet, this tone was not matched by the Chinese subsidiary. The visible disregard for law and policy reduced the **legitimacy** of Nortek's compliance program. Additionally, **management** set a bad example for peers and employees through their improper conduct, especially when they obscured it with fake recordkeeping, a **daily practice**. After discovering the briborous acts, Nortek provided extensive **training** to its employees around the globe, among other remedial measures to end corruption in its ranks. This could represent Nortek's commitment to **ethics** as well as being incentivized by the SEC for self-disclosure of bribery.*

² Interligi, L. (2010). Compliance Culture: A Conceptual Framework. *Journal of Management & Organization*, 16: 235, 239.

³ Securities and Exchange Commission. (2016, Jun. 7). SEC Announces Two Non-Prosecution Agreements in FCPA Cases [Press Release]. Retrieved from <https://www.sec.gov/news/press/2016/2016-109-npa-nortek.pdf>.

HOW TO BUILD A COMPLIANCE CULTURE

Not all effective compliance programs are built alike. The market, industry, risk profile, and corporate governance vary across organizations. As a result, businesses need to leverage and incorporate different elements to achieve a culture of compliance. It may sound like a tall order. However, we've narrowed the biggest elements into six (6) topics to help you create a culture of compliance.

1 Tone at the Top

To create a culture of compliance, an organization's leadership needs to emphasize the importance of compliance. Also known as a "tone at the top," this simple message to stakeholders is critical and is often found in internal policies and code of conduct.⁴

However, a simple sound bite is not sufficient. In a survey conducted by PwC, 98% of interviewed compliance professionals stated that senior leadership supported compliance and ethics, yet only 45% stated that the same leadership did anything more than oversee or delegate.⁵ Mere oversight is not enough.

A sufficient tone at the top requires executives and senior leadership to:

- Be informed about compliance risks and solutions
- Make sure the compliance team has enough resources
- Get other team members on board
- Monitor progress personally

2 Management

Management plays a critical role in implementing a culture of compliance. "Employees will pick up on the lead of their bosses. If the bosses take compliance seriously, the employees are far more likely to take it seriously. If they don't, the employees won't. It's as simple as that."⁶

⁴ Hess, S. (2016). ETHICAL INFRASTRUCTURES AND EVIDENCE-BASED CORPORATE COMPLIANCE AND ETHICS PROGRAMS: POLICY IMPLICATIONS FROM THE EMPIRICAL EVIDENCE. *N.Y.U. Journal of Law and Business*, 12: 317, 350.

⁵ PwC. (n.d.). PwC State of Compliance Study 2016. Retrieved from .

<https://www.pwc.com/us/en/risk-assurance/state-of-compliance-study/assets/state-of-compliance-study-2016.pdf>.

⁶ US Department of Justice. (2014, Sept. 9). [Compliance Is a Culture, Not a Policy](#).

Local and senior management are visible role models that employees look up to for guidance for ethical behavior. *"The variable that had the biggest positive impact in deterring unethical behavior was the positive example set by senior and local management."*⁷ So, managers' own actions must model ethical behavior and the employer's code of conduct. This sends a message to everyone that managers, and thus the company, take compliance with norms seriously.

Red Flags:

- Management not following company code or policy
- Company not holding managers accountable for actions
- Management cutting procedural corners

Businesses must look out for these red flags and resolve them promptly.

3 Ethics

Companies have ethical and social responsibilities just as much as legal ones. Ethics comprises a lot of things, but for compliance programs it means two major things: (1) employees thinking and acting according to the organization's values and (2) speaking up when those values aren't met.

Firm Values

Each company should operate under a unique set of values. "[C]ompliance programs perceived to be values-oriented were more effective than those perceived to exist only to protect the firm from legal hazards."⁸ The value of integrity is particularly important to effective compliance and ethics programs as it commands employees to "do the right thing, always" by a business set of values and codes.⁹ Integrity can "create an environment that supports ethically sound behavior, and to instill a sense of shared accountability among employees."¹⁰ Companies should identify their core values and ensure all stakeholders- executives, managers, and individual employees- uphold them. Values are key in linking employee behavior with external laws and internal policies.

⁷ Blount, J. and Markel, S. (2012). The End of the Internal Compliance World As We Know It, Or An Enhancement of the Effectiveness of Securities Law Enforcement? Bounty Hunting Under the Dodd-Frank Act's Whistleblower Provisions. *Fordham Journal of Corporate & Financial Law*, 17: 1023, 1045.

⁸ Perezts, M. & Picard, S. (2015). Compliance or Comfort Zone? The Work of Embedded Ethics in Performing Regulation. *Journal of Business Ethics*, 131: 833, 849.

⁹ Verhezen, Peter. (2010). Giving Voice in a Culture of Silence. From a Culture of Compliance to a Culture of Integrity. *Journal of Business Ethics*, 96: 187, 200.

¹⁰ Hess, Scott. (2016). ETHICAL INFRASTRUCTURES AND EVIDENCE-BASED CORPORATE COMPLIANCE AND ETHICS PROGRAMS: POLICY IMPLICATIONS FROM THE EMPIRICAL EVIDENCE. *N.Y.U. Journal of Law and Business*, 12: 317, 345-46.

Speaking Up

Employees should feel comfortable speaking up when a firm's values aren't being upheld, or when the law is being violated. There's a structural element here- employees need a reliable mechanism to communicate their concerns, maybe a confidential website or through a compliance officer. Experts recommend providing multiple ways for employees to report concerns.¹¹

Additionally, employees need motivation from policies, management, and fellow employees that reporting an issue will be free from potential retaliation. One study showed that the worse the conduct was, the less likely it would be reported, especially if committed by management.¹² Companies must show employees that their complaints will be taken seriously.

4 Daily Practices

Senior management can create policies, and management can set good examples, but the day-to-day operations matter to a compliance culture because they involve decisions employees make, every day.¹³ For example, an employee may coach another to cut corners when documenting a payment transaction, or a salesperson may misrepresent a product to score a big deal.

Understanding and managing how employees interact with each other and with customers will help make a better culture. This is an opportunity for local management to monitor employee behavior according to a company's code of conduct, as the code "can be easily trumped by a conflicting message from the employee's informal environment (e.g., group pressures)."¹⁴

Companies, particularly local managers, should look at four major factors affecting culture:

- **Communication** - Do employee communications track firm values? Ex. transparency.
- **Motivation** - What incentives do employees have? How are they rewarded? Ex. money vs. feedback.
- **Pressures** - What barriers prevent employees from doing ethical things? Ex. Aggressive sales goals.
- **Needs** - Are employees' basic needs being met? Ex. Fair wages and benefits.

¹¹ Day, C. (2016, Oct. 24). Whistleblower Hotlines May Not Be Enough. Retrieved from <http://blog.lawroom.com/ethical-conduct/whistleblower-hotlines-might-not-be-enough/>.

¹² Blount, J. and Markel, S. (2012). The End of the Internal Compliance World As We Know It, Or An Enhancement of the Effectiveness of Securities Law Enforcement? Bounty Hunting Under the Dodd-Frank Act's Whistleblower Provisions. *Fordham Journal of Corporate & Financial Law*, 17: 1023, 1049-50.

¹³ DeStefano, Michele. (2014). Creating a Culture of Compliance: Why Departmentalization May Not Be the Answer. *Hastings Business Law Journal*, 10: 71.

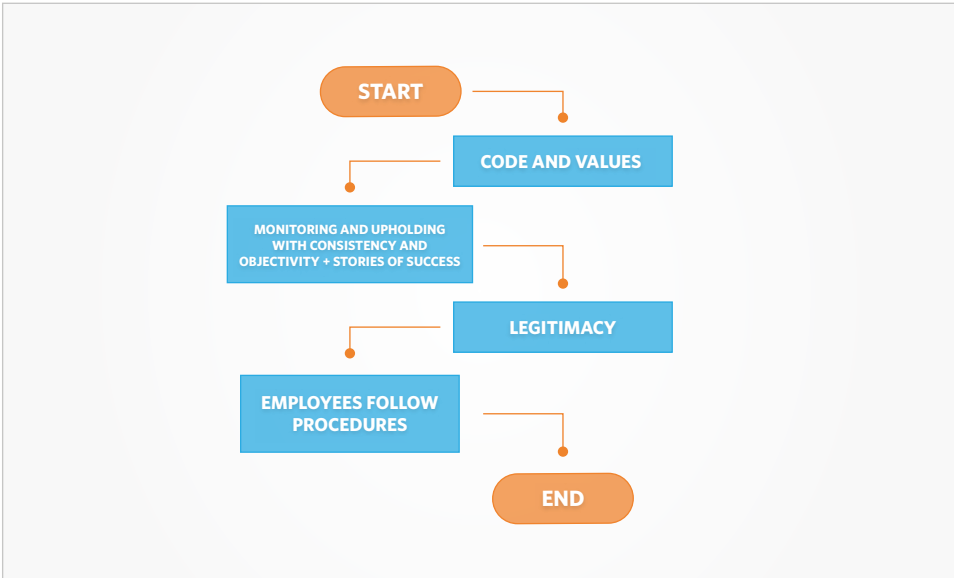
¹⁴ Hess, S. (2016). ETHICAL INFRASTRUCTURES AND EVIDENCE-BASED CORPORATE COMPLIANCE AND ETHICS PROGRAMS: POLICY IMPLICATIONS FROM THE EMPIRICAL EVIDENCE. *N.Y.U. Journal of Law and Business*, 12: 317, 350.

5 Legitimacy

Simply put, legitimacy exists when a company's does what it says it will do. Company policies, values, even promises by management are all things that, once said, should be enforced in the workplace fairly- with objectivity, consistency, and purpose. Research has shown that fairness, in turn, encourages employees to comply with norms and act ethically.¹⁵

When policy violations are accepted, violators go unpunished, and exceptions to the rules feel arbitrary or invalid, "an organization has created a culture where corrupt behavior is acceptable, individual employees can become desensitized to the conduct such that it becomes commonplace and no longer shocking."¹⁶ At a minimum, companies must enforce their own policies if they want employees to do the same.

STEPS TO LEGITIMACY



¹⁵ Verhezen, Peter. (2010). Giving Voice in a Culture of Silence. From a Culture of Compliance to a Culture of Integrity. *Journal of Business Ethics*, 96: 187, 190.

¹⁶ Blount, J. and Markel, S. (2012). The End of the Internal Compliance World As We Know It, Or An Enhancement of the Effectiveness of Securities Law Enforcement? *Bounty Hunting Under the Dodd-Frank Act's Whistleblower Provisions. Fordham Journal of Corporate & Financial Law*, 17: 1023, 1045.

6 Training

Creating and maintaining an ethical culture requires a sustainable effort. At a minimum, training should be periodic for all directors, officers, relevant employees, agents, and business partners and cover policies, procedures, and relevant laws that come into contact with ethical decision-making. To be effective, however, ethics training should incorporate human conduct such as language, behavior, and decision-making.

The 'how' is just as important as the 'what' for training. Dr. Carmen Poole identifies two critical ways to effectively teach compliance and ethics. First, training has to meet the trainee where they are ready to learn. Second, case-based studies are good vehicles to teach complex concepts especially when behavioral change is counted among the desired outcomes. "Case-based studies connect directly to the learning expectations of the adult learner: there's realism, clear utility, and an opportunity to 'act' through an experience rather than passively consume the training content."¹⁷

If delivered effectively, conduct training is a powerful way to model behavior and reach employees on a

CONCLUSION

There are many elements to a culture of compliance. Compliance programs that incorporate culture can promote ethical behavior that help businesses achieve organizational and regulatory goals.

¹⁷ Poole, Carmen. (2016). Value of Conduct Training. Retrieved from <http://ow.ly/4xkK306d5MW>.

ABOUT THE AUTHOR



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