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Beyond Compliance: Creating a Culture of Integrity

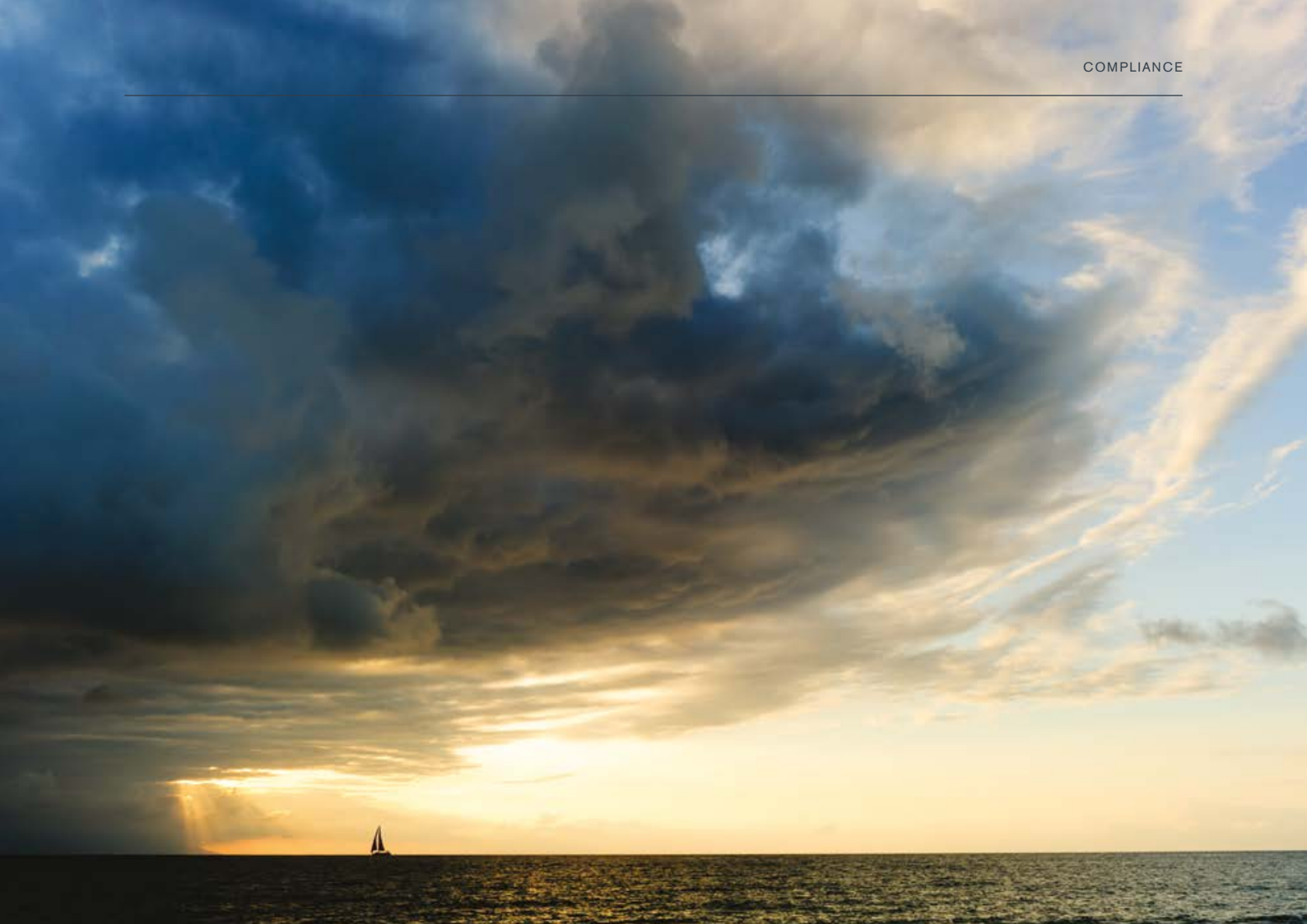
Integrating transparency, accountability and ethical behavior into company culture can help organizations mitigate risk and keep ahead of regulatory change.

Compliance forms an integral part of virtually every organization's operations. Depending on the organization's ownership structure, industry and location, everything from its accounting to its human resources may be subject to a regulatory regime, industry association guidelines or internal codes of conduct. Organizations that operate in more than one jurisdiction will, of course, have to contend with different regimes in each place.

The significant legal, financial, and reputational damage that a violation can bring is reason enough for enterprises to stress compliance. Yet compliance is also critical, because poor compliance often signals the larger problem of poor business practices, which expose the organization to further risk. Ultimately, compliance is about more than fulfilling regulatory or other obligations: It involves establishing a culture of integrity that is centered on transparency, accountability and ethical behavior.

A culture of integrity yields benefits beyond those that come with scrupulous behavior. Government regulations, which can seem ubiquitous, are also often in flux. Any jurisdiction's regulatory priorities can vary significantly over time, depending on the administration in power and other variables. An effort at regulatory reform at the national level may filter down unevenly to the local level or may cross industries. In addition, emerging industries often find that they are operating in regulatory gray areas. At those times, companies with strong cultures of integrity can stay ahead of regulatory change. Moreover, enterprises from more stringent jurisdictions will prefer to do business with companies where compliance is just considered the right thing to do.

The real test of the commitment to a culture of integrity is how it responds to questionable or prohibited behavior—particularly when the transgression involves a key employee or a member of management.



However, building a culture of integrity is a broader, more complex undertaking than simply ensuring that checklists and reporting mechanisms are in place. In our experience working with governments and corporations to help build, sustain and monitor such cultures, we have found that they rest on a foundation of six distinct elements:

- 1 Tone from the top:** An organization takes its direction from its leaders. A board that emphasizes compliance will likely be able to communicate that message much more powerfully than the head of compliance or internal audit.
- 2 Resourcing:** A stated commitment to transparency and accountability must be backed up with the resources needed to build and maintain such a culture.
- 3 Processes and controls:** The right procedures provide a framework that ensures that decision making and actions are transparent and do not involve conflicts of interest. Controls allow the organization to identify and respond to exceptions and weaknesses that are more systemic.
- 4 Education:** Everyone in the organization must understand what is expected. Executives and employees also need ongoing reinforcement and training so that they can apply their judgment in unexpected or ambiguous situations.
- 5 Performance goals and incentives:** Ultimately, executives and employees act according to how they are incentivized. Board members and senior management must understand that unrealistic deadlines or budget constraints can constitute risks in their own right. Managers should set performance goals that can be achieved without compromising integrity, transparency, or compliance.
- 6 Response and remediation:** The real test of an organization's commitment to a culture of integrity is how it responds to questionable or prohibited behavior. Particularly in cases where the transgression involves a key employee or a member of management, the temptation to rationalize or overlook the misdeed can be high.

In our survey, we asked respondents about the extent to which they followed various best practices for instilling a culture of integrity (see Figure 16). Globally, each of the eight best practices is followed by roughly three-quarters of the organizations surveyed. However, while 35 percent say they have adopted all eight practices, one in four organizations say they have adopted half at most.

It is notable how few respondents *strongly* agree that their organization's performance goals and incentives do not conflict with its risk management practices. While all of the practices listed are important, ensuring that performance goals and incentives can be met without compromising integrity is arguably the single most important step that organizations can take in building a culture of integrity.

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For most organizations, building a culture of integrity is an ongoing task, with each element at a different level of strength at any given time. Organizations can use a matrix to assess the state of their culture of integrity and prioritize areas requiring further work (see Figure 17).

FIGURE 16
HOW DO ORGANIZATIONS PROMOTE A CULTURE OF INTEGRITY?



FIGURE 17

THE INTEGRITY MATRIX

WEAK	EMERGING	MODERATE	STRONG
TONE FROM THE TOP			
Leadership does not acknowledge the importance of integrity. Management exhibits an “ends justify the means” mentality.	Leadership gives a pro forma acknowledgement of the importance of following procedures. Compliance is separated from other company functions. The board is not involved.	Fully staffed compliance office delivers intermittent updates to the board. Integrity as good business is reinforced in ongoing internal communications from the CEO and in day-to-day decision making throughout the organization. Company executives consciously set an example through their actions.	The chief compliance officer has direct access to and support of the CEO and board and is included in strategic decision making. The organization consciously guards its reputation for integrity in its partnerships and business decisions. The audit committee incorporates oversight of company integrity into its work.
RESOURCING			
The compliance function is minimally staffed and resourced.	Compliance receives the resources it needs to fulfill requirements, but rarely more.	Compliance is viewed as an investment rather than an expense. Programs are adequately resourced without cutting corners.	Management makes strategic investments to continuously improve the compliance program.
PROCESSES AND CONTROLS			
A minimally sufficient compliance mechanism exists, in order to conform to regulations. Controls are weak or absent.	The compliance mechanism is robust. Some controls are in place.	Processes extend beyond compliance to reinforce transparency and accountability at key points within the organization.	Extensive processes are paired with effective controls that are actively monitored. Controls are holistically analyzed to “connect the dots.”
EDUCATION			
Education is minimal and strictly focused on compliance procedures.	Compliance procedures are instilled and reinforced through training and regular retraining.	Education extends beyond compliance to include the importance of transparency and accountability.	Education includes opportunities to sharpen judgment and to practice dealing with unknown or ambiguous situations.
PERFORMANCE GOALS AND INCENTIVES			
Performance goals are aggressively set with no consideration of ethics or integrity. Incentives and disincentives are based entirely on “making one’s numbers.”	Employees do not feel pressured to act unethically, but neither is there reinforcement of ethical behavior.	It is implicitly and explicitly understood that high performance does not excuse unethical behavior.	Integrity is incorporated into evaluations and promotions. Executives and managers are evaluated in part on their teams’ integrity.
RESPONSE AND REMEDIATION			
Responses to ethical breaches are completely situational.	A written code of conduct and other guidelines sets forth expected behavior and consequences for ethical breaches. No escalation policy exists to ensure that ethical breaches are addressed at the proper level in a timely fashion.	Executives and managers are expected to respond in a consistent manner to ethical breaches. Ethical breaches that result in compliance failures are self-reported to the appropriate agency. An escalation policy, including an effective whistleblower mechanism, is in place.	Employees have confidence that standards are applied consistently. The board ensures that the CEO and senior management are held to high ethical standards. Serious ethical breaches are met with thorough internal investigations; findings are used to improve processes.