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CONFRONTING THE ROOT CAUSES OF MISCONDUCT

2020 ETHICS & COMPLIANCE PROGRAM EFFECTIVENESS REPORT



LRN® *Inspiring Principled Performance*®

Dear Colleague,

As we publish our *2020 Ethics & Compliance Program Effectiveness Report*, the COVID-19 virus is devastating communities across the world. In the midst of the tragedy, there are shining examples of individuals and organizations doing their best to help those afflicted, going above and beyond what is required by law or duty.

These efforts demonstrate once again the power of values to inspire ethical behavior, particularly in the face of adversity. Our report sheds empirical insight onto how shared values can help organizations scale ethics throughout their operations, a topic all the more timely in light of the challenges we face.

From everyone at LRN, we extend fervent wishes that you and your families, communities, and colleagues stay safe during this profound crisis.

DAVID GREENBERG
LRN CORPORATION

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About the Ethics & Compliance Program Effectiveness Report

LRN's mission—"Inspiring Principled Performance"—embodies a commitment to understanding what makes ethics and compliance (E&C) programs truly effective. Our annual *Ethics & Compliance Program Effectiveness Report* reflects the input of ethics and compliance professionals from around the world, filtered through insights we have gained over our 25 years of operation.

LRN's ongoing research and experience with thousands of organizations over the decades demonstrates that a values-based approach to governance builds and sustains ethical culture that correlates strongly with more effective E&C programs. Values transform culture and impact behavior; rules merely set minimum standards. Both are necessary, but our research and analysis of ongoing misconduct scandals, plus regulators' evolving expectations, establish that more attention and focus on the factors and best practices that underlie and foster ethical culture represents the key to success.

Our research has consistently shown that an organization dedicated to sustainable human values will exhibit superior performance across operations and be significantly more successful at integrating ethics and compliance into its day-to-day operations.

Moreover, ethical culture underpins successful performance across the organization, not just in the ethics and compliance area. Our research has consistently shown that an organization dedicated to sustainable human values will exhibit superior performance across operations and be significantly more successful at integrating ethics and compliance into its day-to-day operations. As LRN's 2018 and 2019 editions of *The State of Moral Leadership in Business* demonstrate, effective moral leadership by leaders and managers translates to greater success in meeting business goals. Resiliency, innovation, and growth flourish when leaders inspire trust and respect, as opposed to demanding obedience.

And, LRN's 2016 *HOW Report*[®] showed that values-based organizations produce better financial results than do competitors without governance cultures grounded in values. They also foster more innovation, stronger customer satisfaction, higher levels of employee engagement, significantly reduced levels of misconduct, and a greater willingness to report wrongdoing when observed.

insights
thought leadership
best practices



500

The *2020 Ethics & Compliance Program Effectiveness Report* is based in part on a survey of 500 ethics, compliance, and legal executives and experts around the world conducted during the second half of 2019.

SECTION 1

MISCONDUCT CAN HAVE MORTAL CONSEQUENCES—AND SIMPLY RELYING ON RULES AND PROCESSES WON'T PREVENT IT

The context of LRN's 2020 Ethics & Compliance Program Effectiveness Report has a particular import and urgency. The past year reminded us and illustrated that, tragically, ethics and compliance failures at organizations can be deadly, not just costly. The collapse of Vale SA's dam in Minas Gerais, Brazil, Pacific Gas and Electric's (PG&E's) culpability in the California wildfires and the Boeing 737 MAX crashes, are recent illustrations of how compliance failures can have mortal consequences, on a grand scale.

In each case, the problems leading to catastrophes were known, regulators were deceived and/or not fully informed, and the organizations ignored concerns raised by their employees that pointed to weaknesses that led to disasters. And these disasters occurred despite elaborate sets of rules, processes, and procedures designed to prevent them.

Time and again, organizations rely on processes but neglect to address how they work in practice. Failure to identify and address the critical issues that determine the health of an organization's ethical culture leaves the door open for misconduct, no matter how well organized or funded its E&C program may be. These scandals and others, including many that have come to light as a result of the #MeToo movement, occurred in organizations that had staff, training, policies, and the other standard elements of E&C programs. But they did not deter significant misconduct.

The scandals graphically illustrate that checking all the boxes when it comes to an ethics program only matters if the organization's underlying culture matches its commitments on paper.



integrity
accountability
transparency


Overview of Key Insights

The research and survey results behind the **2020 Ethics & Compliance Program Effectiveness Report** affirm that the most important factor in preventing misconduct is a culture based on integrity, accountability, and transparency. Only then can an organization safely assume that its policies, rules, and procedures are being followed effectively.

The critical differences our research identifies between highly effective E&C programs and those that are less impactful are the following:

- **Leaders at all levels** model values-based behaviors and bring to life the organization's Code of Conduct and policies. Ethics and compliance isn't just left to the lawyers—it's everyone's responsibility.
- **The organization's values** permeate its Code, policies, training, and evaluation/compensation processes. In these organizations, values are "in the drinking water," as one chief ethics and compliance officer (CECO) remarked, not just on the website.
- **Ethics and compliance considerations** are integrated into business decisions, planning, and operations. In particular, these considerations are taken into account when setting revenue targets and schedule priorities to avoid incentivizing misconduct or sending mixed messages when it comes to following the letter and the spirit of internal controls.
- **Audit, evaluation, and risk mitigation** are used to effectively identify problems and learn from mistakes. High-impact programs use audit, regular evaluation of their effectiveness, and root cause analysis when misconduct occurs to ensure they aren't on "cruise control." They also integrate the results of self-scrutiny into their risk mitigation processes going forward.

Overall, high-performing programs go beyond the minimum required by law, regulation, or procedures and ask their employees to live their values, not merely follow rules. They use the same standard of justice for everyone, regardless of status or rank, and ensure that employees can raise concerns without retaliation. That, in turn, creates and sustains an ethical culture, which is the only meaningful defense against misconduct.



Incorporating values into business decisions, embracing organizational justice, ensuring employees can speak out without retaliation, and taking a values-driven, transparency-based approach to governance within an organization are the pillars of ethical culture.

SECTION 2

WHERE MISCONDUCT SCANDALS ARE MOST LIKELY TO OCCUR—AND WHY

LRN's research shows that when it comes to misconduct, culture eats rules for lunch, to paraphrase the late Peter Drucker. Incorporating values into business decisions, embracing organizational justice, ensuring employees can speak out without retaliation, and taking a values-driven, transparency-based approach to governance within an organization are the pillars of ethical culture. An organization's ethical culture determines whether its rules and procedures will be followed, ignored, or circumvented, no matter how thick the rule book may be.

The common threads in the misconduct scandals mentioned above and in other high-profile ones, such as at Wells Fargo, Deutsche Bank, Volkswagen, and the sexual harassment scandals exposed by the #metoo movement, illustrate what happens when those pillars are not solid.

The problems at the heart of the scandals were known within the organizations.

- Boeing internal emails disclosed by government investigators illustrate serious, unresolved concerns about the safety of the 737 MAX as it was undergoing pre-launch review.
- Vale had warnings of weakness in the Minas Gerais dam.
- Deutsche Bank relationship managers and middle managers repeatedly ignored their compliance officers' warnings about substantial money laundering risks and circumvention of internal controls.



In 2014, PG&E replaced middle managers who reported that an ambitious program director was pressuring employees to report false progress on safety issues.

Leaders and managers failed to take ownership of the problems.

- Vale had a similar dam collapse four years before the 2019 disaster that killed 270 people, but leaders chose aggressive growth over prioritizing safety, according to reports.
- Senior Boeing test pilots and developers had major misgivings about the design and safety of the 737 MAX.
- Months before sparking the deadly fires, PG&E knew that 49 steel towers carrying the electrical line that failed needed to be replaced entirely.

Threats of retaliation and/or actual reprisals against employees who raised concerns were common.

- Disgraced Hollywood producer Harvey Weinstein damaged the careers of actresses who resisted his advances, according to testimony at his criminal trial.
- In 2014, PG&E replaced middle managers who reported that an ambitious program director was pressuring employees to report false progress on safety issues. The program director was subsequently promoted and the false reports approved.
- Wells Fargo terminated a number of employees who raised concerns about fake accounts. The organization subsequently acknowledged improper retaliation.

The organizations misled regulators.

- PG&E had a long history of inaccurate reporting to regulators, stretching back 15 years, and has now plead guilty to felony involuntary manslaughter charges for its role in starting the deadliest wildfire in California's history.
- Boeing employees mocked federal rules, talked about deceiving regulators, and joked about potential flaws in the 737 MAX as it was being developed, according to more than one hundred pages of internal messages reviewed by Congressional investigators.

Aggressive sales targets and deadlines negated established safety and ethical procedures.

- Volkswagen cheated on emissions tests to save production costs.
- Boeing engineers reported "go, go, go" pressure to design the 737 MAX to avoid time-consuming simulator training.
- Wells Fargo employees were under extreme pressure to meet aggressive and unrealistic sales targets by opening fake accounts.

These are just a few examples of the commonalities among the major scandals. They show that preventing misconduct requires a strong focus on ethical culture, one that values transparency, accountability, and integrity. Leaders must embrace and foster it; approaching ethical culture as a form of internal control, to be shaped, evaluated, and managed, is a governance best practice. Viewing ethical culture as a "nice-to-have" is not.

An organization's ethical culture determines whether its rules and procedures will be followed, ignored, or circumvented, no matter how thick the rule book may be.

ethical decision-making organizational justice freedom of expression



SECTION 3

MEASURING WHAT MATTERS

The LRN Program Effectiveness Index (PEI) was introduced in 2016 to evaluate the impact that corporate compliance programs actually have on workplace behavior (see “How We Quantify Program Effectiveness” on page 7). The study provides insight into the ethical culture of the organizations surveyed, not merely their E&C program structures.

The *2020 Ethics & Compliance Program Effectiveness Report*, based on a survey of 500 ethics, compliance, and legal experts around the world, continues on this track, and the findings bring to life the fundamental importance of ethical culture as a catalyst for ethical behavior.

The findings show that when leaders balance compliance risks that arise in pursuit of new business or greater revenue with effective mitigation measures and controls:

4.3x

Employees are 4.3x more likely to question decisions when they conflict with organizational values.

3.8x

Employees are 3.8x more likely to do the right thing, even if it's not in their personal best interest.

3.2x

Employees are 3.2x more likely to speak up or speak out, even in front of managers.

How We Quantify Program Effectiveness

LRN's Performance Effectiveness Index is a proprietary framework for analyzing the impact of E&C programs. Notable for its unconventional approach to program effectiveness, the PEI measures outcomes across three areas of critical workplace behavior:

PEI Score

The PEI Score is the average of the individual scores of respondents who rated a behavior or attribute.

- **Ethical decision-making:** are the choices employees make animated by values or expediency?
- **Organizational justice:** are senior executives and high performers held to the same standards of conduct as other employees?
- **Freedom of expression:** do employees speak up, contribute willingly, and exchange ideas freely?

The underlying survey, of 500 ethics, compliance, and legal executives and experts, measures the incidence of key behaviors in the workplace that strongly correlate to these fundamental elements of a healthy ethical culture. Respondents rated their organizations against the following eight statements using a five-point scale:

1. High performers who violate our Code of Conduct or values face disciplinary action.
2. Managers in my organization never act as if they are above the rules.
3. Our employees trust that their leaders consistently make values-based decisions.
4. Even under pressure, people abide by our organization's values and standards of conduct.
5. Employees in my organization speak up or out during team meetings even when their manager is present.
6. Employees in my organization question decisions when they conflict with our values.
7. Employees in my organization do the right thing, even if it's not in their personal best interest.
8. Employees in my organization are comfortable skipping levels or going to a level above their direct boss to raise ethical concerns.

For each of these statements, survey respondents chose one of the following responses as most accurately reflecting their point of view: Almost Always, Often, Sometimes, Rarely, Never. We combined and averaged these responses to generate an overall PEI Score for each survey participant's organization.

The PEI Score reported with respect to a behavior or attribute is the average of the individual scores of respondents who rated that behavior or attribute. LRN analyzed PEI scores across quintiles, using A, B, C, D, and F grades to promote clarity. We consider those programs that fall into the top two quintiles to have a "high impact" on organizational culture and strategy and those that fall into the bottom two quintiles to have lesser, or "low impact."



Significantly, highest-quintile organizations also reported greater success in operationalizing their E&C programs in light of the U.S. Department of Justice's (DOJ) 2019 criteria as discussed throughout this report.



principled performance
good corporate citizenship
culture of compliance

SECTION 4

REGULATORS ARE FOCUSED ON ETHICS AND COMPLIANCE PROGRAM RESULTS

Regulators have come to realize the limitations of “paper” programs and increasingly focus on the degree to which a program has an impact on ethical culture. That shift is reflected in the U.S. DOJ’s Evaluation of Corporate Compliance Programs (ECCP), which was updated in May 2019. The ECCP was created to assist prosecutors in assessing “whether, and to what extent, the corporation’s compliance program was effective.” One of the three sections of the guidance addresses whether the program at issue is well designed, but the clear weight is on the last two sections—“is the program being implemented effectively,” and does the program “work in practice.” The ECCP specifically asks how often and what means an organization uses to measure its ethical culture.

Regulators’ emphasis on ethical culture has been a long time in coming. In 2013, Mary Jo White, then Chairwoman of the Securities and Exchange Commission, challenged CEOs and their C-suites “to instill a culture in the biggest producer and the most junior employee that they are expected and encouraged to do the right and ethical thing and escalate problems if they are not resolved.” Her remarks reflected widespread frustration on the part of enforcement agencies that misconduct scandals continued to unfold despite the passage of Sarbanes-Oxley, Dodd Frank, and other stringent laws meant to curb unethical conduct.



In 2017, France's anti-corruption agency, Agence Française Anticorruption, published guidance that stressed that "an anti-corruption compliance programme relies on top management's commitment to establish a culture of integrity, transparency, and compliance."

Moreover, the ECCP's emphasis on practical results is not an isolated initiative by the Fraud Section. In its July 2019 "Evaluation of Corporate Compliance Programs in Criminal Antitrust Investigations," the DOJ Antitrust Division emphasized that "Division prosecutors should examine the extent to which corporate management has clearly articulated—and conducted themselves in accordance with—the organization's commitment to good corporate citizenship." In other words, do they "walk the walk" as well as "talk the talk."

Additionally, the U.S. Treasury Department's Office of Foreign Assets Control issued program effectiveness guidance in May 2019. The guidance tasks senior managers with responsibility for promoting "a culture of compliance" and specifically ensuring that "personnel can report sanctions-related misconduct by the organization or its personnel to senior management without fear of reprisal."

Nor is this shift in emphasis limited to the U.S. regulatory community. For example, in 2017, France's anti-corruption agency, Agence Française Anticorruption, published guidance that

stressed that "an anti-corruption compliance programme relies on top management's commitment to establish a culture of integrity, transparency, and compliance." The French guidance goes on to recommend including ethical compliance in employees' annual objectives, performance reviews, and evaluating managers' initiatives to promote the prevention and detection of corruption by their teams.

In keeping with this shift of emphasis, LRN's 2020 *Ethics & Compliance Program Effectiveness Report* ranks programs by their workplace impact. The report identifies what best practices the most effective programs use to implement regulators' criteria and create an ethical culture—one that makes principled performance not just a goal but an outcome.

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2020

The 2020 findings show that organizations are moving toward developing E&C programs and cultures that inspire principled behavior, but potentially dangerous gaps remain.

SECTION 5

HOW ARE ORGANIZATIONS REALLY DOING WHEN CREATING CULTURES AND PROGRAMS THAT PREVENT MISCONDUCT

BEFORE DELVING INTO THE BEST PRACTICES AND CRITERIA FOR EFFECTIVE E&C PROGRAMS, IT IS WORTH LOOKING AT THE AGGREGATE RESULTS OF THE 2020 E&C PROGRAM EFFECTIVENESS SURVEY, WHICH, AS MENTIONED, INCLUDED 500 ETHICS, COMPLIANCE, AND LEGAL EXPERTS AND EXECUTIVES. THE 2020 FINDINGS SHOW THAT ORGANIZATIONS ARE MOVING TOWARD DEVELOPING E&C PROGRAMS AND CULTURES THAT INSPIRE PRINCIPLED BEHAVIOR, BUT POTENTIALLY DANGEROUS GAPS REMAIN.



ON THE POSITIVE FRONT, THE FINDINGS TELL US THAT:

75%

75% of ethics, compliance, and legal professionals believe that ethical behavior is taken into account at their organizations when it comes to selecting employees for promotion.

83%

83% say the E&C function has the ability to raise issues directly with the organization's C-suite or board.

80%

80% believe the E&C function has sufficient resources to effectively carry out the mission of inspiring ethical behavior and preventing misconduct.



ON THE NEEDS-IMPROVEMENT SIDE, THE FINDINGS TELL US:

31% // 57%

Only 31% of ethics, compliance, and legal professionals say their organization recognizes or celebrates notable ethical conduct or leadership when it comes to bonus allocation, and only 57% when it comes to performance reviews.

53%

Only 53% say senior leaders at their organizations take action and responsibility when there are compliance failures.

46%

Only 46% say their organizations' senior leaders support effective sanctions or penalties on senior executives, and high performers involved in misconduct.

39%

Only 39% say their organization makes ethics and compliance considerations a significant factor when they hire employees for managerial, executive, or control functions.

37%

Only 37% say the organization takes ethics and compliance into account when setting sales targets or business goals.

34%

Only 34% rate their organization's board of directors as "excellent" when it comes to supporting and overseeing the E&C function.

44% // 34%

When it comes to mergers and acquisition due diligence and planning, only 44% say their ethics and compliance functions are fully involved. And only 34% say their organizations track and remediate misconduct or misconduct risks identified during the pre-acquisition and due diligence phase of an M&A deal.

42% // 33%

Only 42% say their organization tests the effectiveness of its E&C training, and only 33% say their E&C training programs work on mobile devices.

36% // 30%

Only 36% say their E&C training program provides personalized learning options tailored to role, region, and seniority. And only 30% say it includes customized content addressing lessons learned from prior misconduct.

SECTION 6

WHAT DOES ETHICAL CULTURE LOOK LIKE IN PRACTICE

LRN's research reaffirms that organizations with values-based cultures have more effective E&C programs than those that do not.

Additionally, the programs of organizations with values-based cultures excel at meeting the DOJ's and other regulators' emphasis on workplace impact as the key discriminator between effective and "paper-only" programs. Ethical culture that is embedded throughout the organization in practice, not only in words, is a powerful demonstration that the organization "really means it."

For example, 50% of organizations with high-impact E&C programs take ethics and compliance into account as a significant factor when setting sales targets or business goals, compared with only a third of medium-impact and a quarter of low-impact programs. Given the serious and sometimes mortal consequences that can arise when an organization lacks a culture that operationalizes ethics and compliance, this is a critical differentiator.

We also found that organizations with high-impact programs meaningfully incorporate ethics and compliance considerations into many stages of the employee lifecycle, from hiring employees for managerial, executive or control functions (72%), to recognizing employees for their achievements (69%), and retaining employees (70%), much more so than low-impact programs.

To have an effective compliance program, organizations need to ensure employees not only see management's commitment to compliance, but are also asked to provide input on that commitment. The recent regulatory guidance strongly reflects what we've known for years—that employees must be convinced of the organization's commitment to a culture of compliance and that they have a voice in it.

The Ethisphere Institute's recent research shows that 61% of employees tend to raise concerns directly to their managers, compared to the 11% who tend to use hotlines. This underscores how important it is for managers to be equipped to handle such concerns. LRN's findings show that managers in organizations with high-impact programs are 80% more likely to deal effectively with ethics and compliance concerns raised by their teams, compared to low-impact programs.

Sustaining these efforts takes significant resources and dedication. Notably, culture must be continually assessed and feedback openly received.

30%

High-impact programs are about 30% more likely than low-impact programs to include ethics and compliance questions in employee engagement surveys.

60%

Round-table discussions about ethics and compliance are 60% more likely to occur in high-impact programs.

60%

High-impact programs are 60% more likely to utilize cultural diagnostics to determine the presence or absence of factors such as trust, respect, and transparency.

These ways of obtaining feedback provide valuable information and send a strong message to employees that their feedback and voices matter.



SECTION 7

DETAILED FINDINGS—BEST PRACTICES FOR BUILDING AN ETHICAL CULTURE

IN ANALYZING THE FINDINGS OF THE 500 ETHICS, COMPLIANCE, AND LEGAL EXECUTIVES AND EXPERTS WE SURVEYED, WE ENDEAVORED TO DETERMINE HOW HIGH-IMPACT PROGRAMS CREATE AND SUSTAIN AN ETHICAL CULTURE IN THE WORKPLACE.

OUR GOAL IS TO ARRIVE AT A ROADMAP FOR CREATING OR ENHANCING PROGRAMS THAT INSPIRE PRINCIPLED BEHAVIOR IN EVERY AREA OF OPERATION, PARTICULARLY WHEN IT COMES TO PREVENTING, DETECTING, AND REMEDIATING MISCONDUCT.

1

Leaders and Managers Foster a Culture of Ethics and Compliance

As discussed previously, organizational justice—holding everyone to the same standards regardless of rank or results—is critical to ethical culture. When we look across programs, we find that high-impact ones are much more likely to have senior leaders that support effective sanctions or penalties on high performers who commit misconduct: nearly double the rate of those in low-impact programs. In light of recent misconduct scandals, this distinction is significant, especially in the context of needing to balance aggressive business goals with the risk of misconduct.

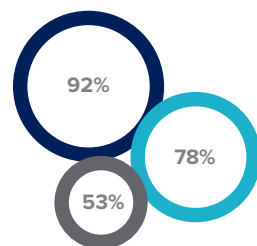
In my organization, senior leaders support effective sanctions or penalties on senior executives and high performers involved in misconduct.



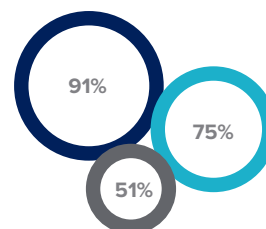
The findings also show that in organizations with highly effective programs the ethics and compliance priority cascades down from senior leaders to middle management, who also actively incorporate ethical considerations into their daily work.

In my organization, managers help operationalize ethics and compliance by (% always or often):

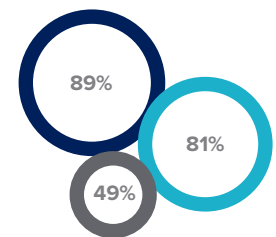
● HIGH IMPACT ● MEDIUM IMPACT ● LOW IMPACT



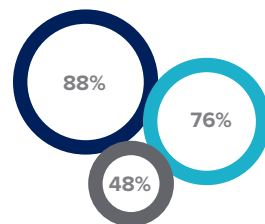
Identifying and managing E&C risk in their business operations



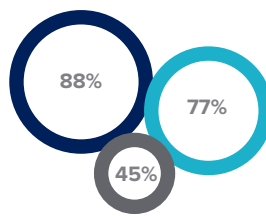
Taking responsibility and action for compliance failures



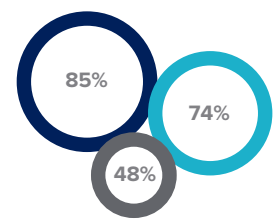
Understanding and modeling behavior based on organizational values



Dealing effectively with ethics and compliance concerns raised by their teams



Taking ethical issues into account when reviewing or promoting their employees



Initiating discussions of ethical issues in meeting or employee forums

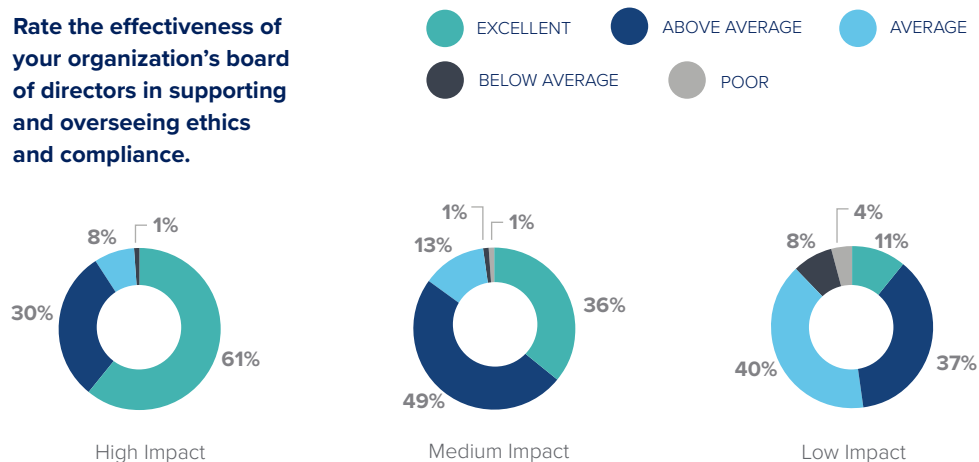
Finally, in organizations with high-impact programs, the responsibility for fostering values-based behavior and culture is also shared by the board of directors. These organizations have boards that:

- support and oversee ethics and compliance.
- participate in education and training sessions on critical ethics and compliance issues.
- hold senior leaders accountable.
- have a direct reporting channel from the CECO and conduct private sessions with audit and E&C leaders.
- review the results of employee surveys or cultural assessments.

The findings tell us that boards are becoming more effective at supporting and overseeing ethics and compliance of late, perhaps in response to recent scandals and the spotlight they've placed on boards.

Boards of high-impact programs are nearly six times more likely to be rated highly for their support and oversight of ethics and compliance than those of low-impact programs.

Rate the effectiveness of your organization's board of directors in supporting and overseeing ethics and compliance.



ARE BOARDS UPHOLDING THEIR E&C RESPONSIBILITY?

It is a given that boards of directors are required to oversee organizations' compliance with law and regulation. And boards also help set the tone from the very top for organizations' culture, values, and ethical approach to business. A common thread in many of the devastating compliance failures mentioned in this report are boards that failed to act upon complaints about senior executives and/or business practices.

LRN's research indicates that boards often fall short on ethics oversight and give the E&C function short shrift. An LRN survey conducted in 2018 among 26 sitting and former CECOs provided some insight on that matter:

- **Only 40%** of CECOs said their boards are willing to hold senior executives accountable for misconduct.
- **Only about 40%** reported that their boards have metrics in place for measuring E&C effectiveness.

- **Nearly half** said their boards have not received education and training on their E&C responsibilities.

- **More than half** said their boards spend two hours or fewer focusing on ethics and compliance each year.

Perhaps things are getting better: 83% of respondents in the 2020 E&C Program Effectiveness survey say their E&C function has the ability to raise issues or concerns directly to the board.

INCENTIVIZING ETHICAL BEHAVIOR WHERE IT MATTERS: REWARDS AND RATINGS

Another critical means of strengthening and building ethical culture is to include it as a factor in performance reviews, bonuses, compensation, and promotions. Doing that sends a clear message that staying true to the organization’s values is as important as meeting business goals. Since 2018, we’ve seen the following increases in the number of organizations that take this approach:

1.8x

1.8x as many organizations consider ethical behavior in performance management

2.5x

2.5x as many consider ethical behavior in selecting employees for promotion

2.8x

2.8x as many consider ethical behavior in determining bonus rewards

2

The Organization’s Values Permeate its Code, Policies, and Training

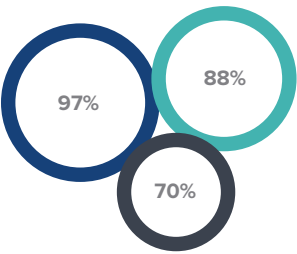
Having an engaging Code of Conduct is a good start, but it’s not enough. An organization’s Code of Conduct may look good, but what does it do? A leading Code inspires principled performance by connecting people to the organization’s purpose, guides employees in how to live the organization’s values, and enables them to be aware of risks and make ethical decisions. A highly effective Code serves as a useful resource that employees refer to throughout the year—not just during mandatory certification periods. High-impact programs score very well on these key criteria.

My organization’s Code of Conduct (% agree):

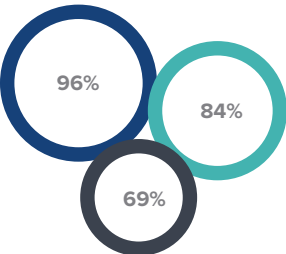
HIGH IMPACT

MEDIUM IMPACT

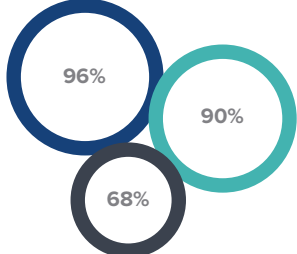
LOW IMPACT



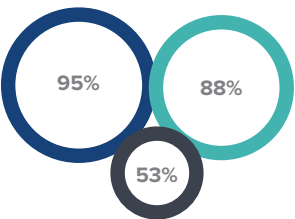
Explains and highlights organization values



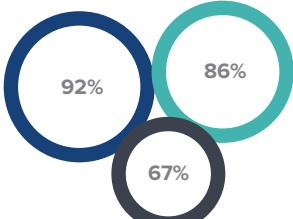
Connects people with a clear sense of the organization’s purpose



Heightens risk awareness and enhances decision-making



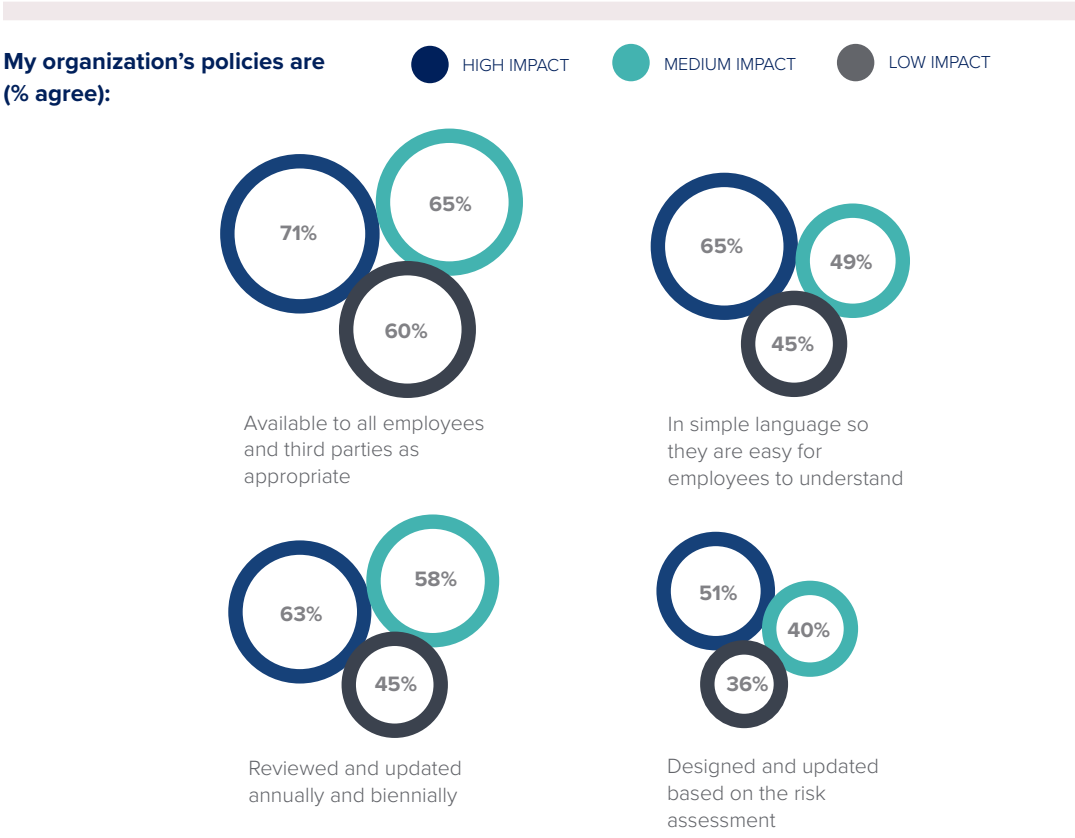
Serves as a resource that employees refer to throughout the year



Illustrates desired behaviors using relevant examples

Indeed, our research shows an increase in the degree to which Codes seek to heighten employees’ risk awareness and enhance their decision-making ability: overall, 82% of Codes achieve this goal, according to respondents to the most recent survey.

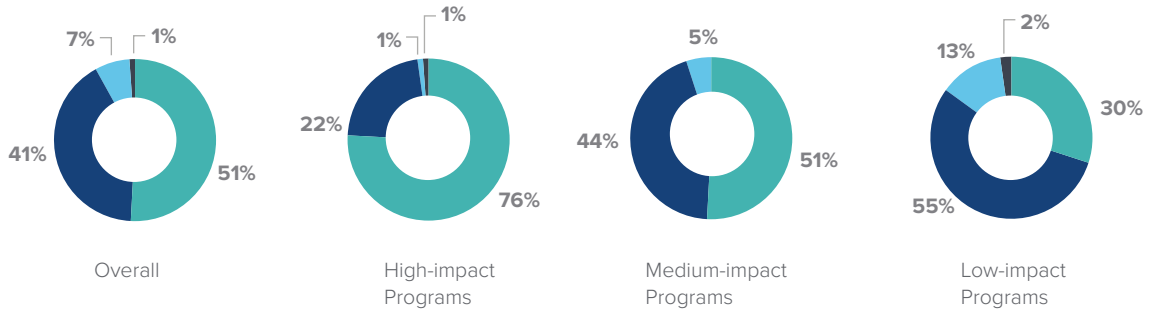
An effective Code of Conduct is supported by a set of policies that addresses key ethics and compliance issues. But simply having those policies and the Code in place is not good enough. Employees need to know where the policies are and how to access them. For policies to have a positive impact on culture and behavior, they need to be grounded in values and written in simple, clear language that anyone can understand. High-impact programs do this quite well, as we’ve seen over the past three years of collecting data on the subject.



However, the data points to one critical area for improvement: only a little more than a third of respondents say their organizations integrate their policies with related control and approval procedures. Doing this is critical to ensuring that employees can **“do compliance at the speed of business.”**

Effective ethics and compliance training programs go beyond just reiterating policies; training is an opportunity to help reinforce behaviors, present real-life scenarios, and make the topics relevant for each employee. High-impact programs are 2.5 times more likely (76% compared to 30%) to utilize training to encourage and guide employees—to give them the tools to identify risk and make better decisions.

To what extent is your training program increasingly focused on guiding and encouraging ethical behavior as well as educating employees on regulatory topics?



While ethics and compliance training is improving at many organizations, only a small percentage of respondents say their organizations are integrating elements that make training easy and personally relevant, and therefore as effective as possible. The statistics below illustrate that there's room for improvement in the training area.

My organization's training program:

50%

Provides training translated into the principal local languages spoken by employees

36%

Provides personalized learning options tailored to role, region, seniority

33%

Works on mobile devices

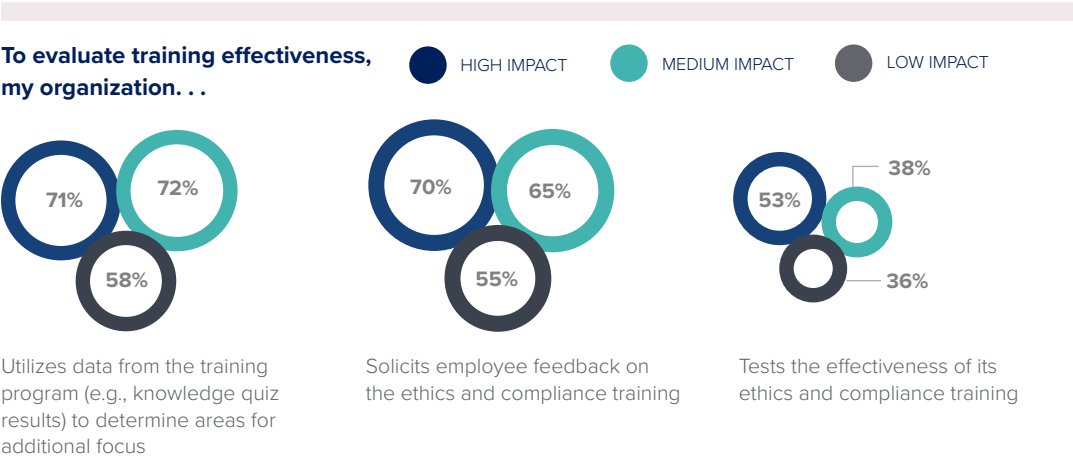
30%

Includes customized content addressing lessons learned from prior compliance incidents

18%

Offers a "test-out" option for employees who believe they have mastered the material

Once the training is implemented, high-impact programs are more likely to undertake comprehensive reviews of the results of the training to ensure effectiveness. It is important to go beyond completion measures and discover what areas of each risk topic are or are not sticking.

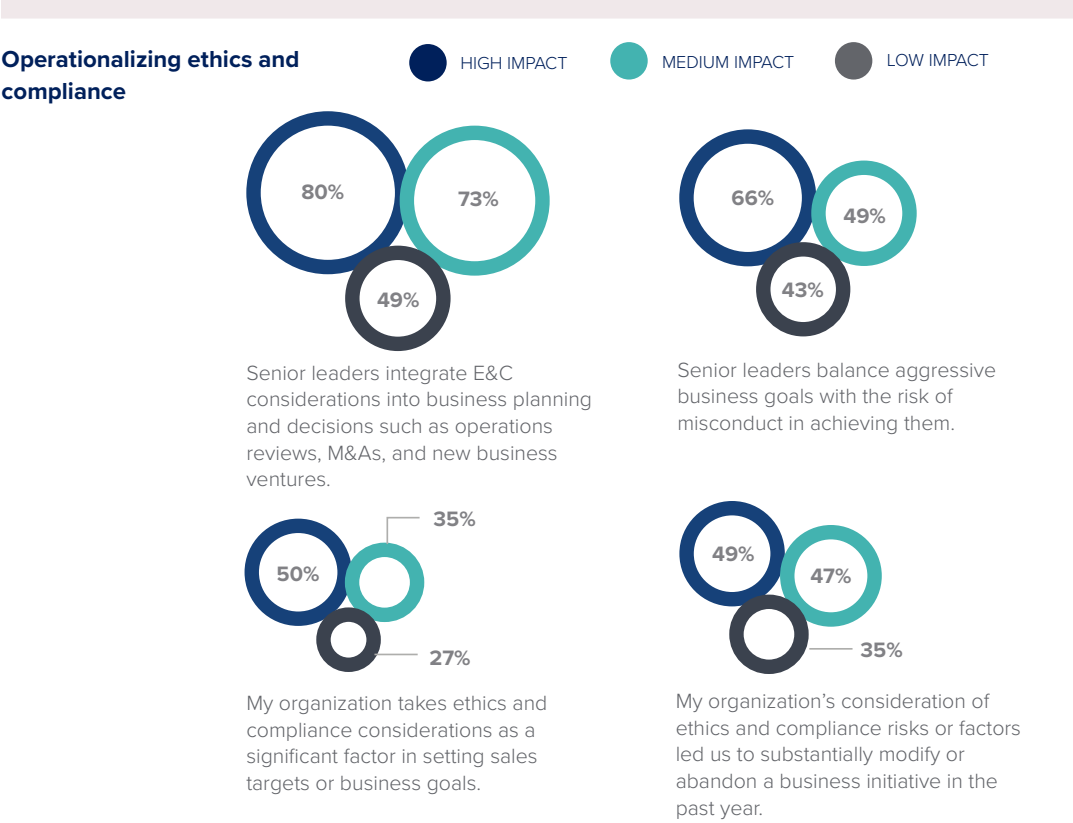


3

Ethics and Compliance Is Integrated into Business Decisions, Planning, and Operations

High-performing organizations have values-based governance models that emphasize accountability, transparency, and effective risk mitigation. Their values are reflected and reinforced throughout the organization—not just during annual training or Code of Conduct certification requirements. They ideally flow through to business decisions, and become part of the organizational thought process.

As the chart below illustrates, high-performing organizations reflect this principle throughout their business operations.



4

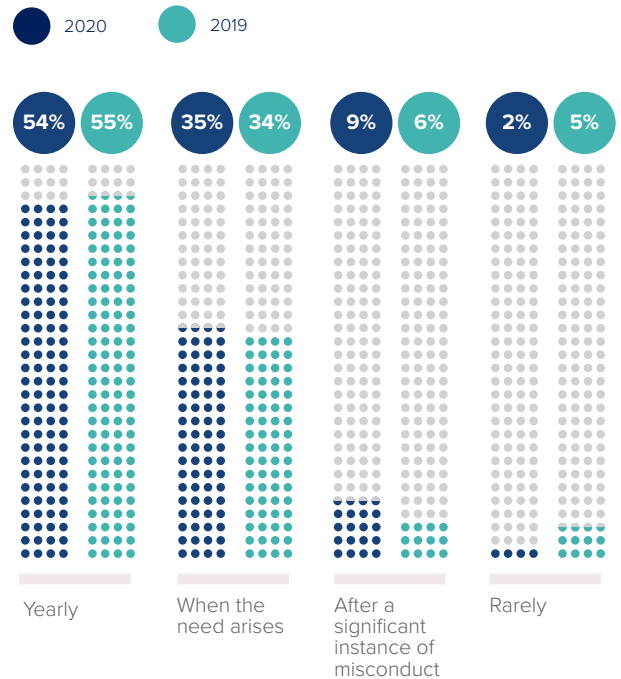
High-performing Programs Emphasize Audit, Evaluation, and Risk Mitigation—and Learn From Their Mistakes

Building and maintaining ethical culture requires ongoing accountability, risk mitigation, and continuous improvement. The DOJ's 2019 ECCP (discussed previously) states clearly that an effective E&C program addresses broad compliance risks and conducts periodic audits to ensure it is functioning well. Despite this, our survey data reveals that not much has changed on these points since the guidance was released.

Just over half of all programs evaluate their ethics and compliance procedures yearly. A third of all organizations represented in our survey evaluate their procedures only when the need arises. Similarly, only 42% of respondents indicated that their organizations' audit programs always address compliance risks as well as financial controls.

The scandals discussed at the beginning of this report illustrate the danger in assuming that existing procedures and rules are being followed, or are actually mitigating risk. Testing the degree to which ethics and compliance practices are effective is critical to preventing misconduct. If there is a gap, addressing it should be a high priority.

How often does your organization review its ethics and compliance procedures to ensure they reflect and address key risks?



5

Effective E&C Programs are Tailored and Updated to Address the Organization's Risks

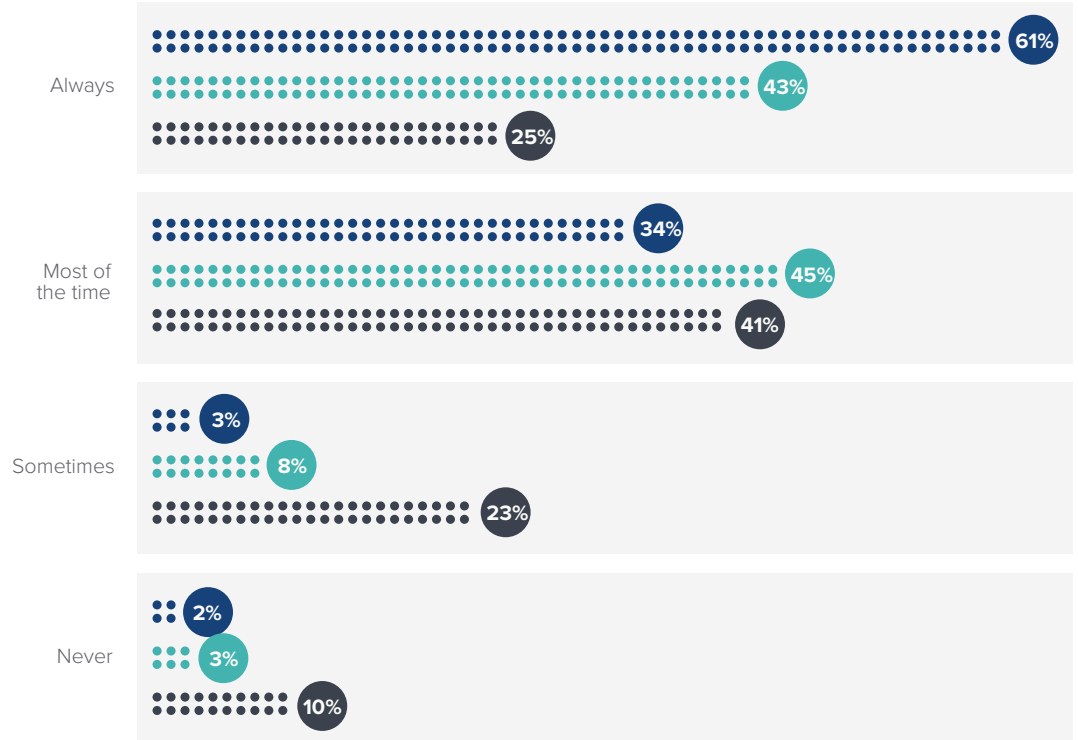
DOJ's ECCP also emphasizes the importance of tailoring all aspects of an E&C program to identify risks and ensure they are mitigated. Many different types of compliance risks, not just financial ones, can disrupt or threaten an organization's operations, which explains why high-impact programs consistently and regularly address a broader range of risks in their audit programs.

Does your organization's audit program address compliance risks as well as evaluate financial controls?

 HIGH IMPACT

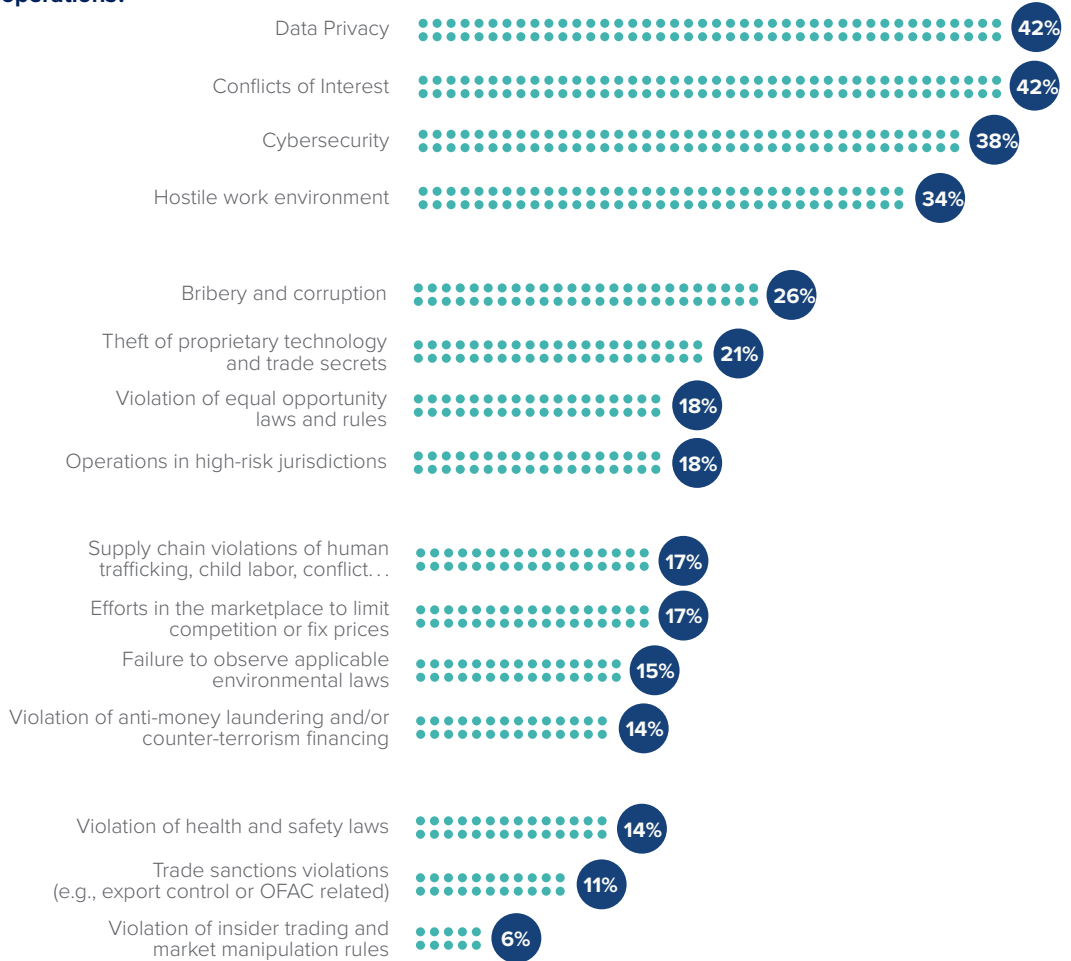
 MEDIUM IMPACT

 LOW IMPACT



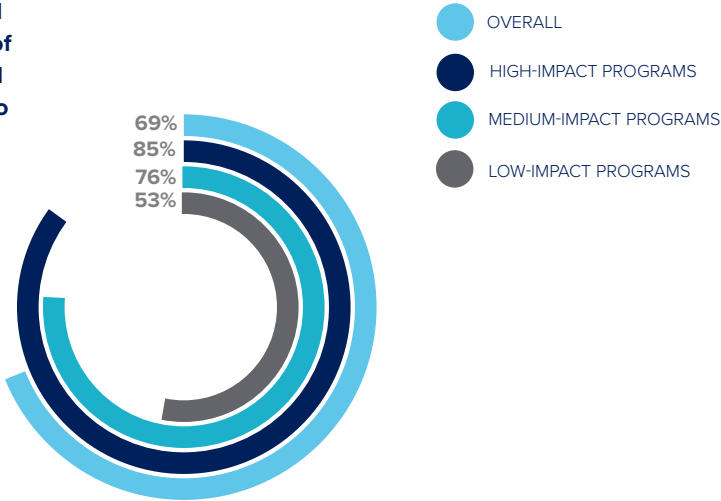
E&C programs cover a wide range of risks, which one might expect would vary from organization to organization. Interestingly, however, all organizations, regardless of the impact level of their E&C program, chose the following as their top five E&C risks: conflicts of interest, data privacy, cybersecurity, hostile work environment, and bribery and corruption.

What are the most significant areas of ethics and compliance risk to your organization's operations?



The management of third-party relationships is an especially critical component of an effective E&C program. Third-party risks remain top of mind for high-impact organizations, with 85% indicating they train third parties about compliance risks.

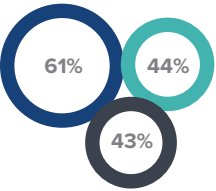
My organization has trained the relationship managers of third parties about potential compliance risks and how to manage them.



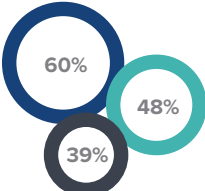
When it comes to third parties, training alone is not enough; an effective E&C program must include additional controls and monitoring. Our data show that about half of organizations' third-party controls include specific requirements that address payment terms. Beyond that, high-impact programs focus significantly more energy on a wide variety of third-party controls—far more than medium- and low-impact programs do. On the negative side, very few organizations incorporate change orders or tracking third parties that have been terminated in their controls and monitoring efforts.

My organization's third-party controls include specific requirements that address:

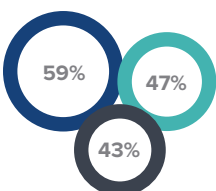
● HIGH IMPACT ● MEDIUM IMPACT ● LOW IMPACT



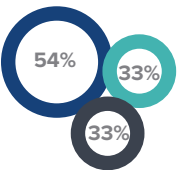
Tracking red flags in due diligence process and resolving them



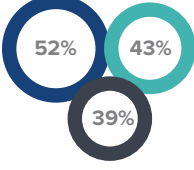
Business case for justifying retention of each third party



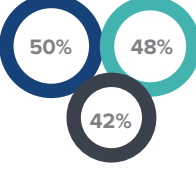
Ongoing supervision and oversight



Audit rights to analyze the books and accounts of third parties



Contract scope

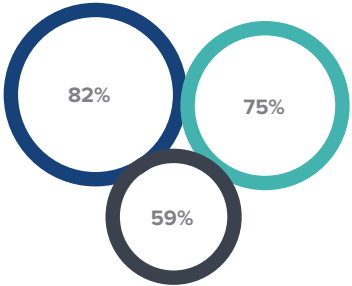


Payment terms

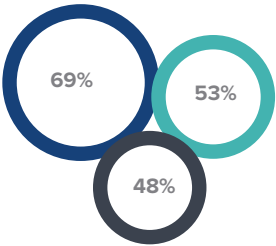
The ECCP recommends that an E&C program should include comprehensive due diligence of its acquisition targets, focusing on whether they are able to remediate misconduct and enforce internal controls effectively. Not surprisingly, high-impact programs scored the highest in this area.

Merger and Acquisition Due Diligence

THREE YEAR AVERAGE OF DATA COLLECTION



My organization conducts a due diligence review on the target's ethical reputation and that of its key stakeholders prior to closing the transaction



My organization tracks and remedies misconduct or misconduct risks identified during the pre-acquisition phase, due diligence process

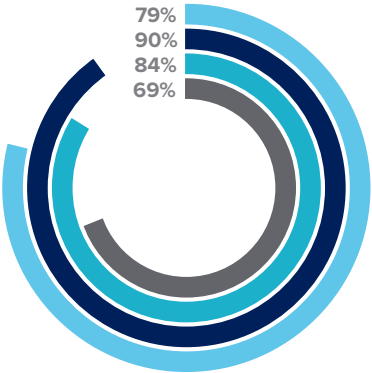
6

Taking Responsibility for and Learning from Mistakes

Regulators increasingly stress the primacy of root cause analysis as a feature of an effective E&C program. This makes sense in light of recent misconduct scandals. Many scandals, including those involving fatal consequences, involved problems that were known, discussed, and often raised by employees without any constructive action to resolve them. Understanding why an organization's governance system failed is the key to improving its ethical culture. Determining if problems are isolated mistakes or evidence of a flawed culture at odds with ethics, compliance, and health and safety policies is critical.

More and more organizations conduct a root cause analysis when misconduct is discovered. This is true of 90% of high-impact programs. A root cause analysis helps identify the underlying factors that contributed to the misconduct and aids in the implementation of corrective and preventive measures.

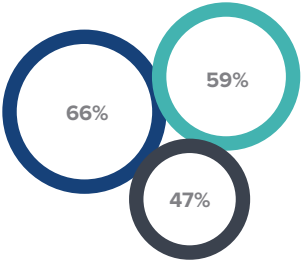
My organization does a root cause analysis when misconduct arises (e.g., an in-depth review of causation, actions of all parties involved, and the adequacy of internal controls).



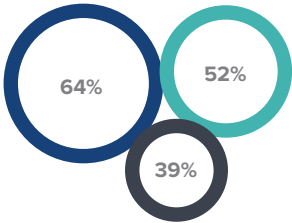
High-impact programs more frequently hit all the elements required in an effective root cause analysis and remediation plan.

My organization's root cause remediation plan includes the following:

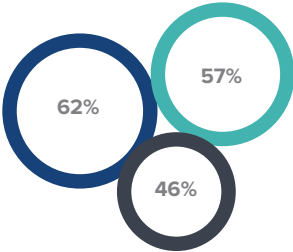
● HIGH IMPACT ● MEDIUM IMPACT ● LOW IMPACT



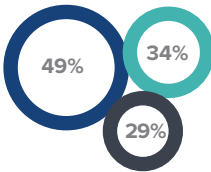
Supervisor responsibility for overseeing employees and/or third parties involved in misconduct



Gaps in policies, procedures, or risk mitigation measures related to the misconduct at issue



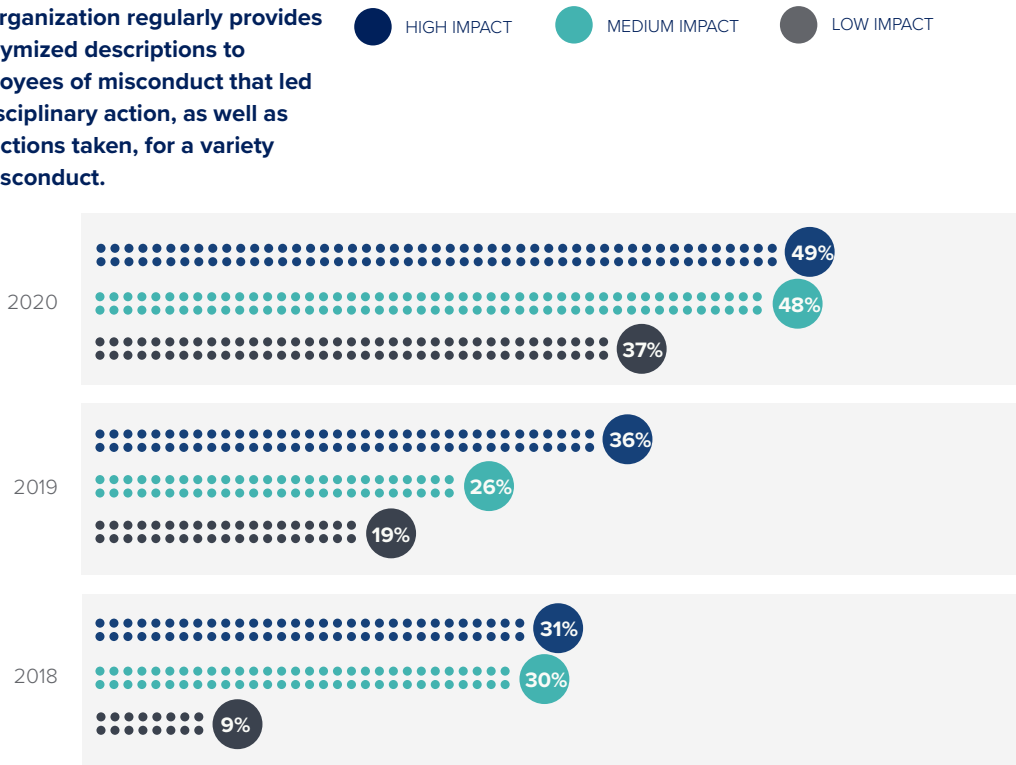
The reasons why any prior indications or reports of control failures or potential misconduct were not effectively addressed



Gaps in training and communication strategies related to the misconduct at issue

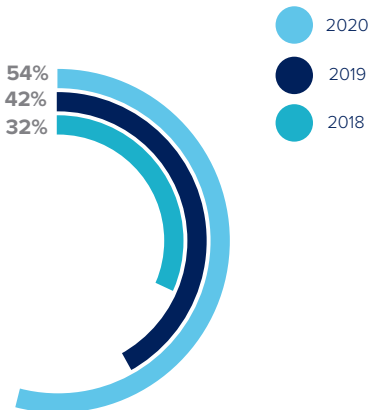
Organizations that conduct root cause analyses when misconduct arises are more confident in their efforts to remediate the underlying process issues and culture problems. They do not just penalize a few employees, who may be just a symptom rather than the problem itself. Over the past few years, high- and medium-impact programs have become more open to providing anonymized descriptions of misconduct, thus owning mistakes and learning from them.

My organization regularly provides anonymized descriptions to employees of misconduct that led to disciplinary action, as well as the actions taken, for a variety of misconduct.



High-impact programs now use data analytics to predict when such problems might arise again. The number of organizations utilizing analytics to recognize patterns of misconduct and act proactively appear to have increased significantly over the past three years. The analytics are comprised of a range of data points. This strengthens the ability to be proactive in addressing compliance risks.

My organization uses data analytics to analyze patterns of misconduct and/or identify red flags proactively.



Conclusion

As LRN's founder, Dov Seidman, wrote in 2007, "human beings are natural problem solvers and enjoy the challenge of puzzles. We will always invent new loopholes, and no rule can govern all the cracks." Devastating ethics and compliance failures are further proof of this point, showing once again that the only effective defense against misconduct is a values-based culture, sustained and led with moral authority.

When organizations embed values, not just ethics and compliance rules, at the heart of everything they do, they "both inspire alignment and eject elements that don't fit in."

This report is a call to action for organizations seeking to embed values at the heart of everything they do. That effort requires going beyond reliance on rules and procedures, and having the courage to ensure its actions match and measure up to its ethical commitments.

values-based culture
moral authority
ethical commitments

