WHY A STRONG CORPORATE ETHICAL FRAMEWORK IS GOOD FOR BUSINESS

Culture is high on regulatory agendas across Europe; how high is it on your board's agenda? The benefits of a strong ethical corporate culture can include increased profitability fueled by customer, investor and employee satisfaction, and reduced loss from fraud or remediation programmes. This session will identify the common pitfalls and red flags of a poor corporate culture as well as how to overcome common obstacles. It will also provide specific actions your organisation can take that are in line with best practice guidance and measures to evaluate success.

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**INTRODUCTION**

Corporate culture is high on regulatory agendas across Europe. How high is it on your board's agenda? The benefits to an ethical corporate culture can include increased profitability fueled by customer, investor, and employee satisfaction, and reduced loss from fraud or remediation programmes.

The purpose of this session is to explain the global landscape and current UK regulatory agendas relating to ethics and culture. It will help you understand the benefits from a profitability perspective and to identify the common pitfalls and red flags that highlight poor frameworks. It will also provide specific actions your organisation can take that are in line with best practice guidance and measures to evaluate success.

Much has changed in recent times following Brexit and the election in the United States; both results are said to reflect the public’s dissatisfaction and mistrust of business, the financial services sector, and globalisation. To whatever extent you believe this to be true, it is indeed an interesting time to be presenting this topic, especially when one considers some recent cases.

**Recent cases:**
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GLOBAL LANDSCAPE
In this first part of the session, we will gain an overview of the global landscape and current UK/EU regulatory agendas relating to ethics and culture.

International Standards:
OECD:
The OECD states that corporate governance practices are essential elements in the adoption of fostering an appropriate culture of ethics within enterprises.

United States:
Department of Justice:
(Fraud Section)—Guidelines on the evaluation of corporate compliance programmes:
- Tone at the top
- Oversight
- Incentives for unethical behaviour

Securities and Exchange Commission:
- What directors should know about the SEC
- Dodd-Frank Act 2010

President/Deregulation:
- Outline of the current administrations plans for deregulation

EU:

UK:
Government:
- Green paper on corporate governance reform
  - Transparency in executive pay
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- Long-term executive pay incentives
  - Companies Act 2006
  - Bribery Act 2010

**UK Financial Conduct Authority (FCA):**
- CEO position
- FCA definitions
- Key priorities for 2016/17
- Senior Managers Certification Regime
- Behaviour and compliance in organisations (occasional papers)

**Industry Guidance/Best Practices:**
- ACFE
- COSO

**Corporate Failure to Prevent Economic Crime**
The UK Government is currently consulting on a new offence of corporate liability for failure to prevent economic crime (consultation ends on 24 March 2017).

**Responsible Business:**
- World Economic Forum in Davos: Compact for responsive and Responsible Business
- Bing votes on executive pay

### BENEFITS OF AN ETHICAL CULTURE FROM A PROFITABILITY PERSPECTIVE

**Stakeholder Management:**
Stakeholders will look at a number of areas when deciding whether to invest or work with or purchase from an organisation. A non-exhaustive list is below:
- Compliance with the law
- Paying appropriate taxes
- How an organisation treats its workers
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- How an organisation treats its customers
- How transparent the organisation is, especially with regard to open and honest reporting of wrongdoings
- Levels of corporate social responsibility and sustainability

**Financial Reporting Council (FRC)**

The FRC is the body in the UK responsible for regulating auditors and accountants. It recently completed an in-depth study on the role of boards in developing and maintaining the corporate culture that the organisation wants to achieve to meet its aims and objectives.

Key findings:

- Needs to be a concerted effort to improve trust in the motivations and integrity of business
- Purpose and strategy need to be connected to culture
- Corporate values need to be aligned to incentives
- Boards need to assess and measure how values permeate through the organisation to ensure that those that are important are monitored to achieve appropriate outcomes

The FRC made observations in seven areas:

- Recognise the value of culture.
- Demonstrate leadership.
- Be open and accountable.
- Embed and integrate.
- Assess, measure, and engage.
- Align values and incentives
- Exercise stewardship
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| The links between greater emphasis on ethics and culture on the following: |
| Greater consumer trust |
| Employee Engagement |
| Increased Market Share |
| Reduced Vulnerability to Misconduct and Financial Crime |
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### Benefits of an Ethical Corporate Culture from a Professional (CFE) Perspective
For those conducting counter-fraud practices for or within a business, doing so when that business has an ethical corporate culture can be highly beneficial:

- Board-level and senior management endorsement
- Anti-fraud culture of honesty and transparency
- Dedicated anti-fraud resources
- More comprehensive personnel files
- More robust anti-fraud controls
- Fraud and risk appetite have been defined
- Applicable laws, regulation and standards identified and documented
- Reliable financial statements

### COMMON PIT FALLS AND RED FLAGS
Some of the common pitfalls that firms face in developing an effective corporate ethical framework are outlined below:

- Culture isn’t a consideration.
- The board and senior management do not live the desired company values or behaviors.
- Lack of two-way and effective communication between the board, senior management, and employees.
- There is a poor (or lack of) code of ethics, anti-fraud policy, anti-corruption policy, and whistleblowing policy. Associated procedures are unclear or not defined
- The policies and code of ethics in place are poorly implemented and there is lack of monitoring and measurement on how effective they are.
- No emphasis on staff taking ownership for detection and reporting.
- Ineffective (or lack) of reporting procedures and channels when misconduct is identified.
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- Poor personnel policies around recruitment, incentivisation, and remuneration, leading to unfair and inconsistent treatment of staff.
- Poor or lack of due diligence on third parties, such as suppliers.
- Poorly designed training and awareness programmes surrounding ethical behaviour and misconduct, including financial crime.
- Lack of training around misconduct red flags and indicators.
- No internal audit or quality assurance function.
- No emphasis on compliance with law, regulation or industry best practice.

EVALUATING SUCCESS
Organisations can have all the components of a corporate ethical framework in place; however, without a mechanism to both monitor and measure their effectiveness, there is no way of knowing whether they are working for the benefit of the business:

- Tools and practices
- Key factors to consider, through the lenses of
  - Employees
  - Customers
  - Operational environment
  - And what could indicate your firm is at risk of a poor ethical culture with respect to each.
- What to measure

This information should not be analysed independently but considered as a whole to identify any correlations, trends, or repercussions of events or change.
## Questions for Boards

This list is not exhaustive, but some questions to consider are:

- Is your code of conduct (or similar) fit-for-purpose and how is it communicated to employees and other key stakeholders?
- How do you assess that relevant codes and policies are understood by those who need to abide by it?
- What training is provided to employees and relevant stakeholders on ethics and culture? Is this embedded throughout the employment lifecycle?
- How does your organisation reward and incentivise risk-taking behaviours?
- How could pay awards from the executive through the shop floor undermine or support culture?
- Is the board clear about the company’s risk appetite, and is it communicated effectively throughout the organisation?
- What risks does your current operating model and existing corporate culture create for the organisation?
- When there is an ethical/risk dilemma, how do employees manage that in line with the values of the organisation?
- What MI do you capture on risk?
- How do you ensure that lessons are learnt throughout the organisation?
- Does your organisation work in silos?
- Is there significant pressure to meet unrealistic targets?

## CONCLUSION

Boards and non-executives should ensure that their organisations:

- Accept that culture underpins organisational performance as well effective risk management—a strong culture aligned to the strategic vision of an
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organisation will facilitate the effective delivery of short and long-term business objectives.

- Assess the risks that you are exposed to based on the type of business you are doing, the markets you operate in, and the structure of the business.

- Ensure that you have a wide view of the ethical frameworks and culture that underpin your organisation through a number of lenses: commercial, customer, and employee.

- Understanding and measuring culture is not about defining whether it is good or bad in absolute terms. It is about assessing whether the culture is fit for the purpose to take the business on its strategic journey.

- Indicators of unethical practices/ regulatory breaches/ non-compliant behaviours/decision making that are not aligned to the values of your organisation should become evident as part of any effective overall cultural assessment.