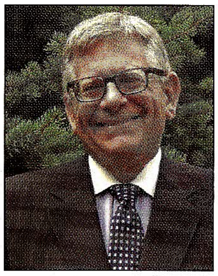
Why Board Members are Responsible for Ethics

By John Levy

This summer, bankers learned of a new kind of risk not taught in business schools or learned in boardrooms – that the risk political changes pose to the profitability of an enterprise may be as large, and have as much impact, as more typical business risks.



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Within most organizations, the board of directors must take responsibility for ethical conduct of the business. First, the board must set "the tone at the top." The Certified Fraud Examiners defines "setting the tone at the top" as "the ethical atmosphere that is created in the workplace by the organization's leadership."

Organizations ranging from sports teams, to corner convenience stores, to large corporations take on the characteristics of their leaders. The Green Bay Packers of Vince Lombardi were big, powerful and coldly efficient. Bill Walsh's San Francisco 49ers were smooth, classy and appeared to win with more guile than brawn.

If a local convenience store has poorly stocked shelves and dirty floors, the owner probably does not take pride in his or her appearance. The store's employees, through the owner's verbal and non-verbal actions, set their work habits to meet the owner's implicit standards. This is true even if the owner explicitly states that appearance and cleanliness are important. Employees know it is not "do as I say" but "do as I do" that is important.

Enron famously had a corporate code of conduct, to which every employee was required to adhere. What message did the Enron board send to all Enron employees when they specifically exempted CFO, Andy Fastow, from complying with the Enron code of ethics? There is probably no better example of a blatant failure to provide a high ethical tone at the top.

Most employees know that CEOs can be replaced, but the board is a continuing presence. Even if board members change, the board as an institution continues to oversee the actions of the business. In other words, perceived failure by the board to abide by ethical standards is recognized as a failure to set a proper tone at the top that can have devastating effects on the ethical actions of the corporation.

If the employees and the public understand not only by its words, but also by its deeds, that the board will not condone unethical behavior by anyone within the organization, then the effects can be profound. Whatever tone the board and management set will have a trickle-down effect on employees of the company. If the tone upholds ethics and integrity, employees will be more inclined to uphold those same values. However, if the board and upper management appear unconcerned with ethics and focus solely on the bottom line, employees will be more prone to commit fraud, because they feel that ethical conduct is not a focus or a priority within the organization.

The public recognizes that directors are responsible for setting the ethical examples for their organizations. The *Report of Investigation by the Special Investigative Committee of the Board of Directors of WorldCom, Inc.* stated among its findings that the board should have been, but was not, "communicating throughout the company the value of high ethical standards..." Congress revised the U.S Federal Sentencing Guidelines for Organizations (1991) to provide substantial relief to companies, which "... promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law."

Board members are not managers. A director's role is to see the big picture, addressing strategy, risk succession, governance and other large issues – such as corporate ethics. In the midst of the moment, managers can make decisions, which, upon reflection, are ethically questionable or clearly unethical. The board should never be in a position to react without contemplation and should always have the time and resources to reach an ethical consensus. Directors may be held legally accountable if it can be proven that they made decisions without "due care," which includes having the time and resources to adequately evaluate and make informed and reasoned decisions.

Directors are also able to make ethical decisions because they are independent of management, in not only form and substance, but in thought. Directors must understand that circumstances may call for them to make difficult and unpopular decisions, which could require them to resign either quietly or publicly. Because of their independence from the business, directors are ideally suited to identify, understand and decide on ethical issues.

In many organizations, the directors are older and have more experience than most of the managers, including the CEO. While age alone, or even past success, does not magically instill wisdom, most of us are taught to respect our elders. As the "adults in the room," it is incumbent on directors to provide stability and grounding to management, which includes asking management to squarely identify and tackle ethical issues. ■

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