

# *Meeting the New Compliance Standards*

TheCorporateCounsel.net Webcast Transcript  
Tuesday, July 12, 2005

For many companies, the most challenging aspect of the revised U.S. Federal Sentencing Guidelines is the mandate to "promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law." This cultural requirement can seem like an amorphous concept – but how well companies respond to it may be essential to implementing an effective compliance program. Join our expert panel as they analyze this - and other aspects – of the new Guidelines as well as offer practical suggestions on how to promote an organizational culture that encourages ethical and law abiding behavior:

- **Jeff Kaplan**, Partner, Stier Anderson, LLC
- **Tom McCormick**, Director, Global Ethics and Compliance, The Dow Chemical Company
- **Steve Priest**, President and Founder, Ethical Leadership Group

Among other topic, this program covers:

- What is the connection between the culture requirements of the Sentencing Guidelines – and what are other crucial elements of an effective compliance and ethics program
- What are cultural "red flags" – and how to respond to them
- How to use alternative methods of analyzing ethics- and compliance- related aspects of a company's culture
- How best to use a company's cultural strengths to promote compliance and ethics
- How to develop an action plan to address culture issues and keep the company out of trouble

## Document Sections

1. The Revised Corporate Sentencing Guidelines
2. What is Meant by Corporate Culture
3. The Corporate Compliance Program at Dow
4. Understanding Cultural Challenges: The Role of Risk Assessment
5. Assessing Culture: What to Look For
6. The Culture Assessment at The Dow Chemical Company
7. Enhancing Corporate Culture: The Role of the Board
8. Addressing the Guidelines Culture Mandate
9. How Dow is Addressing the Guidelines Culture Mandate

Broc Romanek, *Editor of TheCorporateCounsel.net*: Hi this is Broc Romanek, Editor of TheCorporateCounsel.net. Welcome to today's webcast "Meeting the New Compliance Standards." Let me introduce the panelists: I want to thank Jeff Kaplan who put this panel

together and did a webcast for us last July. Jeff is a partner at Stier Anderson and has worked in the compliance field since the early 1990's, as well as being co-author on a book of compliance programs and teaching ethics at NYU's business school.

Steve Priest is President and Founder of Ethical Leadership Group and is considered one of the leading ethics consultants in the country. He has done work for 20% of the Fortune 200.

And Tom McCormick is Director, Global Ethics and Compliance at The Dow Chemical Company and Dow's compliance program is one of the best known programs. Tom is frequently quoted in the press. So without further ado let me turn this over to Jeff and I look forward to learning something.

## **Section 1 – The Revised Corporate Sentencing Guidelines**

Jeff Kaplan, *Partner, Stier Anderson, LLC*: What we'll be doing in this session is looking at one aspect of the revised corporate sentencing guidelines closely, and that is the aspect having to do with corporate culture. As Broc mentioned, a year ago we provided an overview of all the different elements of the revised sentencing guidelines with respect to compliance programs. And so today we're going to principally be drilling deeply down into one of them.

Before going through that, however, since it's been a year since we've reviewed the Corporate Sentencing Guidelines, I thought it would be useful to spend a couple of minutes for those who might not be aware of them to describe what they are, why they're important, and what the revisions are. And that will provide background for the culture part upon which we'll be focusing.

The sentencing guidelines first came into effect in 1991 and really broke new ground in the regulation of business by providing incentives for compliance and ethics programs, specifically, reduced penalties for companies that have an effective program but were prosecuted and also providing specific guidance for compliance programs.

The first could be referred to as the "why", the second, the "how" – and at the time it was considered by the government as something of an experimental approach, one that I think that a lot of people in the government had doubts about. But because it was seen as so successful in encouraging companies to follow the guidance on the types of programs that should be had, the model actually spread and indeed has spread pretty far a field.

So now 14 years later the Department of Justice uses a similar approach in deciding whether to prosecute a company, at least in part the effectiveness of its compliance program. The standards are relevant as well to the fiduciary duty of care. Under the Delaware Chancery Court's Caremark decision corporate directors can be liable for breach of such duty if they have not required their companies to implement a guideline style – compliance program – they can be personally liable.

Various agencies including the SEC, Health and Human Services, EPA, and others have adopted similar approaches. And some state agencies have as well. And even recently we're starting to see the application of these standards to the laws of other countries. For example, in Italy sentencing guideline standards are now part of a corporate criminal law.

So the approach is one that's been around for some time. But the reason that they are *revised* sentencing guidelines, which is where the culture component comes up, is that many companies were obviously seen as not having created effective compliance programs by virtue of the scandals of 2001 through the present.

So based at least in part upon that, the Sentencing Commission, which is the governmental body that created and sort of owns in effect the sentencing guidelines, undertook a long period of study with an advisory group to develop new, more thorough, more effective standards, and those are the ones which came into effect last November and about which we'll be discussing and which we introduced in last year's web cast. One of the things that the guidelines require is component of risk analysis. There's also a component of director oversight, greater responsibility for executives, more requirements related to training incentives, as well as a number of other things which we addressed last year.

But the part that we're talking about today is the requirement that in addition to the formal elements of compliance program a company must "promote an organizational culture that encourages ethical conduct and a commitment to compliance with law."

So that's the subject of today's discussion. Before turning to that and saying a little more about the guidelines and turning it over to Steve, I think it's important to emphasize that it's not alone the sentencing guidelines within the legal system which require companies to have ethical cultures.

The Department of Justice's 2003 Thompson Memo, which is a document that helps articulate what standards federal prosecutors should utilize in determining whether to prosecute a company for an employee's offense, also emphasize the role of culture.

The SEC in particular has focused much on culture in speeches by staff, saying for example, one that firms need to create a culture of compliance. And it comes up in other areas of law as well, including civil litigation.

So the idea of culture is very much out there in the legal system. The sentencing guidelines articulation are probably the most important part of that. But it's a developing area and now let me turn this over to Steve Priest who will look at the issue of what we mean by culture. And after that, Tom McCormick will talk about Dow Chemical's guidelines program before the revisions and the role culture played in that. Then we'll come back to some other parts.

## **Section 2 – What is Meant by Corporate Culture**

Steve Priest, *President and Founder, Ethical Leadership Group*: One of the articles that Jeff was just mentioning – "[Second Annual General Counsel Roundtable: Tone at the Top: Getting it](#)

Right" - by former SEC Enforcement Director Steven Cutler in early December. I think one paragraph in that speech is telling - and in a way, frightening for our audience today. He says, "In short we're trying to induce companies to address matters of tone and culture. We're trying to get the fundamentally honest, decent CEO or CFO or General Counsel – the one who won't break the law – to say to herself when she wakes up in the morning, 'I'm going to spend part of my day worrying about and doing something about the culture of my company. I'm going to make sure that others at the company don't break the law and don't even come close to breaking the law.'" I love that quote, "I'm going to spend part of my day worrying about and doing something about the culture of my company."

Broc didn't fully explain that Jeff and Tom are expert attorneys in addition to them having ethics and compliance expertise and worldwide recognition. I am not an attorney - so this is a once in a blue moon opportunity for me to lecture to attorneys.

I'm an ethics consultant and I have ethics MBA business background. And so I look at this from both the sentencing guidelines perspective but really a more practical, or a fundamentally practical perspective which is what works and what makes sense for the business.

And culture is of course fundamental, paying attention to organizational culture is fundamental to running a good business. Before I go further with that, though, I would like to – I think we should step back for a minute and address the question of - what is culture? What is this? Is it the thing we find in a Petri dish in a bio experiment? Or is it the thing that politicians rail about, the terrible popular culture we face?

I suppose it's both of those things but for today our real emphasis is on corporate culture, your corporate culture, the culture of the hundreds of people who are representing organizations for profit and non-profit on this call. And there are – let's start with what your corporate culture is not.

It's not the vision statement that's on the plaque in your company. It's not the mission statement or the set of values. Every big company now has values and they're all drawn from an approved list of 24 words like integrity and respect and innovation and quality and profitability and et cetera, et cetera.

And that's not what it is either. It's not what we'd like it to be. It's not what your CEO thinks it is. It's not even what you hope it is in your wildest fantasies. The culture is really the unspoken, the unwritten characteristics of your firm. It's what people talk about. It's what describes your firm, the essence of the firm, the underlying assumptions and values of employees at the firm.

And sometimes you see this in artifacts of the firm – what's on the wall or what people talk about in formal pronouncements. But it's more often the far less obvious things like what gets – who gets recognized? Who gets promoted? Who gets rewarded? What gets celebrated? What gets ignored? Asking those questions helps get at what a culture is all about.

Now culture is foundational for a business success. For business success – you’ve probably read about – is foundational for integrity – you’ve probably read about too but in different planes. Like in the "Wall Street Journal" I want to use two case studies to kind of tee up why culture is so important.

The first case study – both recent ones, both companies we have not worked with so I won’t get into any trouble here and I’m working just off of publicly available information – the first one is AIG. Recently in the news, lots of controversy about some of their practices, accounting practices, stock practices, perhaps antitrust issues. And I think it’s interesting to look back a couple of years ago where we get a glimpse of AIG’s culture by listening to (Hank Greenburg) at a 2003 conference on the Sarbanes Oxley Act, on corporate governance sponsored by the Wharton School.

And Hank Greenburg said, and remember it’s in a Sarbanes Oxley conference, he said, "Too much time is being spent on corporate governance and accounting issues and not enough on strategies to build the business." And then again in this same Sarbanes Oxley conference he says, "I think Sarbanes Oxley in many ways has put a chill on decision making in companies." And finally when describing the kinds of people that he would hire, he says, "You want people who want to win. You want people who are smart, people who are entrepreneurial. You want people who are self-starters."

Where’s integrity? Where’s ethics? I think it’s telling in hindsight what is omitted from his remarks. And the other big example that we’ll come back to is Citigroup. Citigroup is a great case study in terms of culture and instead of looking at culture (unintelligible) I think we’ll refer to a hardnosed financial analyst. A Merrill Lynch bank analyst said, described Citi as, "It’s one of the most aggressive corporate cultures in banking, no doubt about it."

And he said, "These people grow up with claws and fangs." He charged that Citi’s aggressive profit incentives are overriding judgment and issues of ethical standards and control continue to compromise Citi’s image with customers and government. He said that when he downgraded the bank’s shares to neutral from a buy. So culture matters. Culture even matters with financial analysts. And culture even matters in stock evaluations.

So we’ll get into a little bit more of that in a few minutes. Let me turn it over to Tom.

### **Section 3 – The Corporate Compliance Program at Dow**

Tom McCormick, *Director, Global Ethics and Compliance, The Dow Chemical Company*: I’m going to talk for a few minutes about Dow’s program, pre-guidelines revisions and the role that culture played in that. The history of our ethics and compliance program really started in 1998 when we formally adopted a global ethics and compliance program.

Having said that, I should point out that it’s not like Dow decided to become an ethical company all of a sudden in 1998. We were driven, as a lot of companies were in that time frame, by looking at the sentencing guidelines of 1991 and the Caremark case of ’96 and just deciding that we needed to more formalize our program.

But we already had a 100 year history of a company that was used to doing business ethically. Probably our safety and our environment health and safety culture historically and operating in small towns gave us a good foundation for how we should conduct ourselves. So that when we did this in 1998 we weren't starting out from any kind of a crisis and we had a good foundation to build on.

We used the sentencing guidelines, the '91 sentencing guidelines benchmark to gradually build and improve our program kind of in a learn-as-you-go mode. We from the beginning had a formal reporting relationship with the Board of Directors, specifically the Audit Committee.

And that evolved into a Audit Committee oversight role where we report to them on a four times a year basis. I would say that it was a very centralized approach to an ethics and compliance program run out of our company headquarters. And not - even though it was a global program - the activities were pretty much done out of a central function.

Even though our program was values based from the beginning, I would say our experience over the last several years has taught us how complex the effort is and how important culture is, especially leadership culture. And I've come to believe that effective programs are a combination of culture and controls. And I would even go so far as to say that culture is a control and it's probably the most critical of the controls that you have in place.

Pre-amendments, the kinds of things that we did that would involve looks at culture. We have a – the company has an annual employee opinion survey. Dow has had one for several years. Given the breadth of that survey it's hard to get a lot questions in a particular area so we would typically get one or two questions in the survey and would often, or would usually focus on whether people felt they could report misconduct without fear of retaliation.

So we could track that as part of the overall company survey but it was insufficient to tell us all the things we need to know about culture. We also monitored our hotline trends and other matters that we became aware of in the ethics and compliance office. But again in the early days of our program and even until fairly recently we - knowing what was happening coming in on the hotline or otherwise knowing about cases probably only represented 20% of the ethics and compliance situations that occurred in a company globally.

So we needed to get better at understanding more about how the company operated and what that meant in terms of culture. We also worked with leaders in the company, subject matter experts, et cetera to try to understand what cultural trends they saw.

For example, several years ago we worked with recognizing the importance of leadership in culture. We worked with our human resources function and executive management to modify what we call at Dow our future leader process where on an annual basis every business and function identifies a very small percentage of their people as future leaders and they're singled out for increased resources and training and development.

And what we did was incorporated at the – at the top of the evaluation criteria for future leaders' performance against company values and the code of business conduct. So those are the kinds of things that we would do.

The other example I would give is that we focused on leadership communications. Although I would say that initially and early on most of the communications about ethics and compliance and culture either came out of the ethics and compliance office or we worked closely with the office of the CEO to focus on CEO communications.

But other than those two groups we didn't focus a lot on communications and tone. So that's something that we've continued to improve on which I'll describe later. Jeff?

#### **Section 4 – Understanding Cultural Challenges: The Role of Risk Assessment**

Kaplan: For the second part of this web cast we'll be talking about responding to the culture mandate of the revised guidelines. Let me kick off that discussion by talking about risk assessment. I said earlier on that one of the new components of the sentencing guidelines compliance and ethics definition was a requirement of risk assessment. And in some ways it is the most foundational of the elements, because what this requires is that in is that a company must assess the risk of wrongful conduct and use that assessment for designing and modifying all the other elements.

So it's properly seen and I think even presented by the Sentencing Commission as a foundational element. Now there are a number of ways in which one can conduct a risk assessment, and that really can be the subject of a whole other web cast.

Essentially companies tend to use a combination of confidential interviews, document reviews, sometimes focus groups, sometimes surveys, and a number of other things. But the key point about this is that a company needs to understand not only what the risks of the conduct are but what the causes of those risks are. In other words, they must gather not just the "what" information but really what could be called the "why" information regarding non-compliance.

Because unless it understands why risks occur, it will have a hard time effectively modifying its compliance program elements. And by the other elements I mean such things as training, auditing and having policies and taking the kind of personnel reviews that Tom described a second ago.

Absent that "why" information, tailoring compliance and program ethics elements won't be as effective as it should be. So how do we connect that to culture? In conducting a risk assessment it's important that a company seek to get more information which would include organizational culture issues.

And so the types of things that companies tend to look for in risk assessments and the following is reflected in a survey that I conducted for the Ethics Officers Association: performance pressures, incentives to engage in wrongdoing, other organizational

culture issues, as well as things like controls, lack of appreciation of ethical standards, third party risks, and other factors as well.

So companies need not only to ask for such things as: do we have antitrust risk, is there a corruption risk,. They also need to understand the underlying causes of those risks. And in considering what those causes might be some of the areas that I've looked some of the following:

Pressure to perform within a company. Are they unreasonable? Obviously there are pressures to perform in pretty much any organization but there's a sense I think that most of us have and most of the employees of the companies with whom we deal have of when performance becomes unreasonable.

And certainly conducting a risk assessment that's one of the things one looks for. And the same thing is true that the ease with which employees can ask questions or raise concerns. Where that is hard to do that the likelihood of unethical or unlawful conduct is obviously greater, as we have seen from experience.

Certainly when compliance and ethics and law department personnel - or the requirements that they're responsible for - get denigrated or marginalized, that's a cultural red flag.

Going to one of the issues that Steve mentioned -- and will talk to more as we go on -- when bad conduct is tolerated or rewarded, particularly at the senior level. That's risk causing from a culture perspective as well.

Companies, or parts of companies, can almost be said to have habits of mind, sort of ways of thinking. And as one finds such short-term thinking as opposed to longer term thinking, that's conducive to a precarious organizational culture from a compliance perspective.

When employees identify with a company in the company's interests, the shareholder's interests, that's a cultural positive. And when they don't it's a cultural negative. It's cause for concern. And certainly if one has customers, as most companies do, of some kind or clients, the extent to which employees understand and care about the needs of customers or clients. That is a cultural safeguard, the same way that identifying with shareholders is as well.

If one finds the opposite of that and lots of instances in companies where employees don't share that much about the needs of customers or their stakeholders and obviously there's risk.

And then, one of the others is when the quality and products of services is a low priority which ties into the one I mentioned about customer needs. That's a red flag from a culture perspective and obviously the opposite of that is a plus.

So those are some general areas. I think there are other more specific ones that one can find in certain industries. Tom mentioned a second ago in talking about the Dow Compliance and Ethics Program and how its roots were in part based on the safety program,. They have other cultural advantages too because the habits of mind there that go with safety are

conducive to broader compliance and ethics program thinking. So this is just some of the things that one looks for. And I'm going to now then turn to Steve to talk more about the how to of diagnosing company's culture. And then Tom again will speak to the Dow experience. And then we'll finally come back to and conclude with a third round talking more about how some of the culture elements tie into the other parts of the sentencing guidelines.

## **Section 5 – Assessing Culture: What to Look For**

Priest: So by this point we're supposed to have you convinced that culture's important, culture's important if you're an attorney, in a company for all kinds of reasons. But how do you know? How do you know what the culture of your company is?

It's a great question and in five minutes I can't answer it thoroughly but I'll tell you there are informal and formal ways to do it. And each has some plusses and minuses. And there are internal and external ways to do it. And each has some plusses and minuses.

All of them start with the goal of finding out the truth, right? Of really understanding what is going on in terms of the corporate culture so that you design, as Jeff just said, the elements of your program to address the risks posed by your culture.

Question number one: do we do it internally or do we do it externally? Here I walk a fine line because a big part of the business of Ethical Leadership Group, my company, is assessing cultures. And I have a bias both because of that self-interest and because I think (Alexis de Tocqueville) illustrated back when he wrote Democracy in America is that the outsider, only an outsider can really fully grasp what is going on inside the culture.

So from that perspective bringing in somebody from the outside or someone who's relatively new to the company to try to get them to look with their own – with their objective lens and uncover what's going on in the company, what the culture is really like I think can be extremely useful.

Internal lenses, especially those who don't fit in as well; you have some people in your company who are the non-conformists who look at things a little bit differently. Having them dig in and think about what are the characteristics of our culture? What are the unspoken rules? What is talked about and recognized and rewarded and valued? What is penalized? What does it take to get fired here? What does it take to get ahead here?

Thinking about those kinds of questions with that objective perspective, whether inside or outside, is very, very important. And you can do it informally or as Tom mentioned you can do it formally with surveys. If you're already doing an employee survey you should have ethics and compliance related questions in that survey.

Questions about not just retaliation as Tom said was traditional and a big – a standard practice in many companies – but talking about people feel like they could bring up concerns and that they would be addressed seriously. Or whether how high of a priority ethics and

integrity really are in this company. Are they in ninth or tenth or twentieth place after all these other business drivers?

What happens to people who are good performers who violate the rules? Are they promoted or tolerated or are they disciplined? And so you can do those – in surveys when we do formal work we do surveys and we do focus groups and we do interviews. But there's a spectrum of approaches that smaller companies can employ to get at these same issues.

Pick someone who's trusted, pick someone who employees will open up to and take them out to lunch. Ply them with a couple of drinks. I'm kidding, you don't want to do that.

But help them – help get into what's in their heads. Cutler even talked about what's really important is what employees will talk about around the water cooler, around the cafeteria, what do they think is important.

It's important to recognize that there is no perfect culture. Every culture brings its own positive attributes to integrity and brings its own risks. A high performance culture is a great thing as long as you don't tip the balance into we're going to meet numbers at all costs regardless of rules.

A culture of discipline is a great thing as long as we don't move into a mode that we're going to cover up mistakes, sweep violations under the rug, that we're going to not bring up bad news. We have two companies we've worked with – great examples of those first two.

First one we did focus groups with employees and we said, "What's the highest priority in your organization based on actions not words because talk is cheap?" And employees said, "Well highest priority is to make plan." We said, "Fair enough, capitalist enterprise. Highest priority should be to make plan. What's the second highest priority?"

"Make plan." And the third? "Make plan." There was no other priority. That is a company that was out of balance and by the way they have changed through concerted efforts of CEO and others and metrics will talk about later they have moved their culture from make plan at all costs to make plan and do it the right way. And change is possible.

Another company, highly disciplined company, they had one person in a focus group captured the culture wonderfully. He said, "Our culture is like a whaling – like a seacoast culture, whaling culture, except in ours the first whale to the surface gets the harpoon." Dangerous, dangerous culture.

You might have a high entrepreneurial culture, a high innovation culture. And then you have people who say, "the rules weren't meant for us or we're smarter than the rules or we can get around the rules." And this was one of the reasons that Enron came down.

Or in a kind of culture we don't experience very often because we don't do government work, you can have a high bureaucratic culture. And then the rules and regulations, the letter, the intricacy of the rules and regulations become way more important than the spirit of them.

So there is no perfect culture. Understanding it, getting a handle on it informally or formally, and then taking steps to address it is the key. And one organization that's done that better than almost any is Dow. Tom, tell us about it.

## **Section 6 – The Culture Assessment at The Dow Chemical Company**

McCormick: Prior to the last year, we would periodically perform self assessments of the overall ethics and compliance program against the sentencing guidelines criteria and then report that to the board. So that was an internal exercise. We did one in 2001 and we did another one in 2004.

But the Board of Directors about a year ago decided that it wanted to have done for us a third party assessment of our overall ethics and compliance program against US Sentencing Guidelines Criteria, Thompson Memo criteria, and similar benchmarks and focusing on culture specifically.

In fact in discussions with our CEO and chairman he basically put it this way. He said, "I know what my expectations are for ethical conduct and I communicate that to the people around me. But how do I know that the message is getting down five or six levels in the organization?"

And that kind of said it all in terms of what the board was looking for for an assessment. So we went through a process beginning about a year ago of commissioning a third party assessment of the program.

We prepared a scope of work, documented what we would have the outside firm do, went through – between the General Counsel and I – went through a initially fairly extensive list of potential third party firms, assessed their capabilities on paper and other things we could learn about them, interviewed a number of them, and then got down to a short list. The Audit Committee chair personally interviewed and retained the firm that we ultimately selected.

Then the assessment itself was about a six month, five or six month process altogether. It consisted of a comprehensive document review, so the firm looked at all of the paper elements of the program. Also an extensive cultural assessment. The firm met with 79 focus groups of employees worldwide in a number of countries.

Also included in that were, in addition to the focus groups, interviewed about 80 or so people ranging from operators, plant operators to executives to subject matter experts to Board of Director members and really candidly captured the Dow cultural environment as part of the overall assessment of the program.

So what we got out of that was a good analysis of each element of our program against sentencing guidelines and other benchmark criteria, and a very deep drill into the cultural aspects of our program. So the Board of Directors got the comfort it was looking for. I

think it's fair to say that the assessment reinforced a lot of what I thought I knew about our program, that it is a good program with a very good culture foundation.

But there were some surprises even to me and most importantly some very valuable recommendations for improvement that we can implement in our program.

## **Section 7 – Enhancing Corporate Culture: The Role of the Board**

Kaplan: Now for the final act, Steve and Tom and I will talk about what companies can do about culture. Having assessed this, having gotten a handle on what is a company's cultural strengths and cultural challenges are, I'll talk a little about the Board of Directors and management reporting aspects of this and a little about discipline.

Steve's already talked about discipline. Steve will talk about a number of the other elements of the revised compliance program mandates and sentencing guidelines. And then Tom will close by talking about what Dow is doing.

So the first thing I want to say is that among the other elements of effective compliance program as dictated by the revised sentencing guidelines is that of board oversight. As the sentencing guidelines indicate, the oversight can be principally lodged in a board committee. And Tom mentioned a second ago how Dow's program is overseen by the Audit Committee.

Audit Committee oversight, by the way, is the predominant mode in corporations, though many also have governance and governance type committees overseeing their programs and that's entirely proper. It's whatever works best for a given company.

The sentencing guidelines have implemented formal compliance oversight responsibility for directors. It's not entirely a new thing, as I think I mentioned earlier. The Caremark decision in the Delaware Chancery Court in the 1990s did opine that such oversight is required under the common law of fiduciary duty of care.

In the Department of Justice's Thompson Memo, which we also mentioned a second ago, which requires federal prosecutors to look at company's compliance programs in making organizational charging decisions, board oversight is one of the articulated elements. It wasn't originally when the policy was announced in 1999 but was added in 2003.

And then there are other board oversight elements as well. And certainly one can read Sarbanes Oxley Section 301(4), the part having to do with audit committees having procedures for the receipt of complaints on financial and other Sarbanes-related concerns.

To effectively have a complaint reporting system one needs the other elements of a compliance program to go with it, including publicizing the system, training employees on it, disciplining for violations. So in effect that calls into play other compliance program elements even though it's under a narrow heading.

So, Boards of Directors do have heightened compliance program oversight responsibilities. And the point I want to make here is that there's a lot of areas that are too detailed for boards to really get into much. There are other things that would be hard for a board to reasonably oversee.

But one area where boards can play a critical, critical role is in – is with respect to organizational culture. Because when there are culture problems those are problems that often emanate either directly from a high level or they're not being fixed because of inattention at a high level.

And so in designing or reviewing reporting protocols for boards, one of the areas that's essential to build into those reporting protocols is the element of culture. Tom mentioned that the Dow Audit Committee commissioned a third party assessment. Whether it be through that means or just some of the more routine reporting, it is essential that boards receive information about corporate culture meaning what the culture is, management's understanding of what the cultural challenges are, and then a response of how are we going to deal with this.

If we have certain of the kinds of cultural challenges that Steve has referred to or I referred to earlier with the red flags. What's the company's strategy for dealing with this? Is it partly training related? Is it partly having senior managers speak more to culture? And Tom mentioned a second ago the CEO's role in Dow in speaking on cultural issues.

Is it something that has to do with incentives which Steve will talk to in a second? Whatever the strategy is, it's imperative that the board be made aware of it. What the challenges are and what the strategy is. Because absent that oversight it's very hard for the typical compliance and ethics officer to deal with cultural challenges herself.

Making the kind of resource decisions, broader decisions that have to underline effective culture – response to cultural challenges is something that really requires the board's involvement.

The one other thing I'd say about the new guidelines, and this part of it really isn't new, before turning it over to Steve to talk about other guidelines elements and how they interact with culture, is that the area of discipline is absolutely key. It is, as Steve indicated, something that the SEC has indicated as very, very important to promoting a law abiding and ethical culture.

And it's certainly one of the things that prosecutors understand when they review compliance and ethics programs. That is, that if a company doesn't effectively discipline for violations, particularly at a high level – violations at a high level – that sends the kind of a message that from a cultural perspective can be utterly poisonous.

This is by the way something that ties back into the Board of Directors oversight role to effectively oversee a compliance program., A Board of Directors, should receive information about discipline for violations, not only with respect to Sarbanes Oxley issues -- that's happening anyway -- but with respect to really anything significant that can relate to

the code and ethics and compliance policies or that can have reputational impact of real moment..

The sentencing guidelines do specifically require that the compliance and ethics program be promoted consistently throughout the organization through disciplinary measures. So I think it's essential that on a management level and a board level attention be given to that.

And then there's something else before – just my last comment before turning it over to Steve --that I think has been too often missed. And it's actually not from the revised sentencing guidelines but from the original 1991 sentencing guidelines.

And that is they require discipline not only for those who serve as sort of I guess principal violators of a code, but also for managers who culpably, fail to prevent and detect violations.

One of the things that I think it's important both because of this specific provision in the guidelines but also because it's imperative to having a culture where managers not only are acting ethically but watching out to make sure that others aren't acting unethically is for a company to build that element into its compliance program.

That's not to say that every time there's a lapse some manager has to be punished too. But the issue should at least be considered as part of the disciplinary process.

So now let me just turn it over to Steve who will talk about some of the other elements of compliance programs and how they relate to culture.

## **Section 8 – Addressing the Guidelines Culture Mandate**

Priest: And to dovetail with what Jeff was just talking about. I picked on Citigroup earlier. Chuck Prince, their CEO, gets this big time. He last year talked to his – said to all of his employees, "We have to have the moral compass to deliver profits and growth responsibly and honestly. Citigroup's culture must be synonymous with integrity."

One of his first moves in that respect was to fire three people who were not involved with the scandal associated with Citigroup's private banking in Japan, but should have – in Chuck Prince's view – should have known about it, should have overseen the culture better, should have been able to recognize that that culture was not one that was facilitating good business practices. And since they didn't, he whacked them.

And he knew that this kind of message would be felt more palpably than any speech or any other kind of message that one could give. So just to put an emphasis, an exclamation point on what Jeff just talked about.

We see in 2005 with big companies which is most of the work we do, we see four main cultural weak spots. And I want to highlight those and then talk about what to do to address those weak spots.

The first one is a lack of understanding by employees on the rules and roles and responsibilities. This is the easiest one to address. It's the one that compliance programs have traditionally been designed to address. This needs good codes of conduct, good policies, good training.

We need to overcome employees who say I don't know what's required of me, these rules don't apply to me, these are somebody else's job or somebody else's responsibility. All those kinds of perceptions or weaknesses in a culture can be addressed through the standard levers of ethics and compliance communications and training.

So that's an important one, a big one, pretty easy to check the box on. The next three are much harder. Second cultural weak spot as Jeff and I and Tom have all talked about this in various ways, this kind of culture that's a "make the numbers period" culture. It's the only thing that matters is to make the numbers.

You can hit this in speeches by line executives. Speeches by General Counsel or CFO or HR or anybody else won't work. Speeches by line executives can begin to address this. But really the only way that effective change happens here is in the anecdotes we've just talked about in the Citigroup story is that people who make the numbers the wrong way need to face negative consequences and they need to be visible.

Sometimes it might be public hangings like in Citigroup's case. More often it will be communicated in other ways through the grapevine, or anonymously that these kinds of behaviors which, let's face it, in a period of time in the '90s when some people were massaging earnings was not just generally accepted but applauded, but being aggressive outside the lines with numbers was rewarded.

Sending concrete messages through actions that these kinds of behaviors are not rewarded in fact they will be punished is really the only way to hit that – make the numbers piece of the culture which means what? It means that HR has to be all of your best friend. Lawyers need to be working very closely with HR to not only in the communications and training pieces but in these disciplined pieces which you're going to see coming up in all three of these most difficult culture weak spots.

The third culture weak spot we've talked about it - this lack of candor, the lack of upward reporting. The – by the way the most common reason employees give for not reporting is not fear of retaliation. That's the second biggest and it's huge. But the biggest one is the belief that management won't do anything anyway.

If I take the risk and bring up an issue, if I knew that management would act but I don't think they'll act so I'm not even going to risk it.

So building in systems and a lot of these issues are HR issues that people bring up. Over half that are brought up to most outlines are HR type issues. So making sure that HR and line management is responding appropriately to decisions which might take HR training and management training, addressing the retaliation issues which is not just a retaliation issue but having a standard – I love the irony of this – that we will retaliate against anybody who

retaliates is essentially the standard. That's the one thing that won't be tolerated is retaliation within a company.

And then, and this shifts into the fourth cultural weak spot, the lack of accountability. The belief that it's not my job or it's someone else's job. Or that I know the company says this thing but based on their actions I know people can get away with just about anything along as they're good performers.

Here is where building integrity into your HR processes from the hiring process. And the screening – not just the background screening process but the factors, the personal characteristics you're looking for in the employees you're selecting – critically important.

In the performance appraisal and promotion process go check with your HR people, see where integrity is on the performance appraisal system and ask them if it's really, really utilized in making decisions about people. You may be surprised by those answers.

Then one last little takeaway, in the exit interview process, people who are leaving of their own volition who you don't want to leave, asking them if there's anything that the company would want to know about to protect its integrity, to protect its reputation, to protect its sense of values, a key way to build integrity into that piece of the HR system.

One last story, I'm the ethics guy. I'm supposed to be the soft guy. Some of our recent work has made me – I've had to be the tough guy with HR and lawyers who are like, "Well we don't want to – we can't really fire that person because we don't have – we haven't proven that he did something wrong beyond all reasonable doubt."

Or, "Well that person's been around a long time. We owe it to them to keep them around until retirement." These kinds of decisions really undermine every other ethics and compliance message that you're trying to send. And I'm not for cavalier punishments, but the standard of good HR and good lawyers and good ethics and integrity in a company has to be someone if is promoting the culture of ethics and integrity in the company we will take that into account.

But if they're not, that is the kind of behavior that is not consistent with being an employee of the company and we will take real action. So being the bad guy – not my usual role. But recently it has been.

Tom – definitely not a bad guy, one of the great guys in ethics and compliance - how do you guys deal with these challenges?

## **Section 9 – How Dow is Addressing the Guidelines Culture Mandate**

McCormick: Some of the things that we're currently working on, first of all on the theory that tone at the top really is the most important aspect of an ethical culture which I firmly believe. Our new CEO as of last November has a huge emphasis on ethics and compliance and integrity and has published to all of our employees this year as part of his and his

executive management team's strategic objectives, a goal to be best in class in ethics and governance. So he's stated it. His leadership team and others' personal goals and compensation systems will be aligned with that. And like any important initiative in a company that importance will be felt down in the organization.

So it starts with that. We also have – are finishing the development of an ethical decision making training module that is designed to be leader led so that each people leader in the company will deliver this module to their people. In effect, looking their people in the eye and giving them an aligned leadership tone about what expectations are and helping them understand how to operate in the gray areas and make the tough decisions.

Third thing, Steve mentioned the HR systems. We have a couple of things going on that we're working with our HR function. One is the company's whole performance management and compensation system is being modified. Not solely for this reason but we're part of it to modify it for this reason.

And in the new system there is more emphasis on the "how" of performance, not just the "what" of performance. And the "how" of performance in accordance with company's values and the code of business conduct especially for leaders.

Secondly our leadership development process is being modified as well so that we are spending more time training our leaders to make sure that we're developing the right kind of leaders who are setting the example and setting the right tone for ethical behavior in our company.

So we're trying to train our leaders to set the right tone and then use the performance management system to screen out the behaviors – the wrong kinds of behaviors so that the right ones are the kinds of people who are long term going to be leading our organizations.

So those are the HR things that we're working on. In January our CEO appointed what we call Regional Ethics and Compliance Committees. Globally we operate in 14 regions around the world and so for each one of those regions we appointed a basically four person committee that reports back to our ethics and compliance office.

And they generally consist of the regional president, the regional general counsel, regional finance director, and regional HR director. They're closest to the local culture. They deliver the aligned message from headquarters about expectations but also understand the local culture. They set the tone. They oversee our investigative process which I'll mention in a minute. And they're responsible for training people in the region.

Our investigation process – we've spent a long time developing a globally standardized investigation process so that we will get consistency in terms of how we do investigations but also consistency of how we discipline people so that we're avoiding double standards.

So this investigation process is global. It's designed to be used in any investigation of a potential violation of a law or company policy no matter what the subject matter. And it goes all the way from the intake of initial information to after a violation is substantiated.

The HR process at the end which we call employee review meeting to determine what the discipline or other remedial action should be, including as I think Jeff mentioned earlier—look at how did this happen. Not just what did this individual do but was there management negligence and what other kinds of remedial action should take place.

Finally, we are developing or licensing a variety of tools to do cultural surveys and certifications around things like our code of business conduct or questionable and illegal payments or records management or other kinds of things that will help us track our trends overall in terms of how we're doing in these areas.

Kaplan: Great. Thanks to Tom and Steve and Tom for taking part in this second annual webcast on Sentencing Guidelines and Compliance Programs. Have a good night.