

# How to Make an Ethics Program Work

By H. Stephen Grace Jr. and John E. Haupert

The authors' experience studying corporate governance, oversight, and control has led them to the conclusion that a strong ethics program will not, by itself, ensure ethical behavior in organizations. It must always be supported by a strong system of checks and balances. Together, these two key ingredients can help produce a governance system that management and boards can rely upon.

The authors have developed a concept for building a program that promotes ethical behavior in an organization. This framework *encourages* everyone to work ethically, *supports* those inclined to work ethically, and *deters* those who may be tempted to veer from the path of ethical behavior. Named ESD, the framework builds on an understanding of human behavior and the personal governance systems inside each individual. The ESD framework also recognizes and responds to one of the most significant obstacles to building ethical behavior into an organization: unchecked concentrations of power within the organization.

## Philosophical and Spiritual Issues

For thousands of years, philosophers and spiritual leaders have provided guidance on the importance of ethical behavior and the benefits of living and working ethically. Another side of the story of human nature, however, is not so uplifting. Warnings abound about the temptations that cause people to act unethically. These warnings were well captured in the words of Ovid, who said, "The better things of life I see and approve; the worse things of life I follow." These warnings have made clear the tendency to stray from the path of ethical behavior. Numerous examples demonstrate how greed can tempt even the very rich, who

have no need for more money, to act unethically.

The search for power also tempts individuals to act unethically. History and current events point to politicians and executives who appear prepared to do just about anything to advance themselves, adding to their prestige and power.

This leads directly to the dangers of unchecked concentrations of power within an organization. Lord Acton put it aptly: "Power tends to corrupt, and absolute power corrupts absolutely." Acton also wrote a less-well-known essay called "Nationality," which brilliantly addressed the unchecked consolidation of power. Writing in the 1860s, Acton talked about how, when a nation is in a time of difficulty, very bright people decide that the solution lies in the creation of an ideal society which, in fact, is an all-powerful state. Acton pointed out that once this state is in place its decision-making power broadens, its tolerance for opposition and differences of opinion disappears, and there is a forfeiture of basic individual liberties and rights. While the efforts of these individuals who have seized extraordinary power have failed time and again, Acton correctly recognized the tendency of human beings to repeat the same mistake in their search for solutions to their problems. Acton was looking back at history, but in doing so he foreshadowed the creation of the Communist state, the Nazi state, and more recent regimes, such as that of Pol Pot in Cambodia and Saddam Hussein in Iraq.

The writings of Lord Acton deal with political governance, but the lessons apply to corporate governance and the challenge of building ethical behavior into an organization. What we need to prevent in any organization is the unchecked consolidation of power.

Through their work in many troubled situations, the authors have found that any organization that permits unchecked consolidations of power is an organization in danger.

When the opportunity exists, certain individuals or small groups of individuals will consolidate power, veil their activities, and manipulate and intimidate individuals within and outside of the organization.

This is not to say that this will happen to all individuals in the organization. Many people will continue to be guided by their own principles and will behave appropriately. If the organization permits unchecked consolidations of power, however, then inevitably someone will be tempted to take advantage. Decent people will be corrupted out of fear of the consequences if they do not follow along.

## The ESD Framework

To succeed at building ethical behavior, an organization must have a governance process that is built on a rigorous set of checks and balances and is characterized by transparency. It requires much more than simply talking about ethics or issuing guidelines for ethical behavior. It is not enough to talk and issue rules about ethics and stress "tone at the top." This may well *encourage* employees to behave ethically, but without more substance, ethical platitudes mean very little.

The ESD framework provides the substance: a governance process that not only *encourages*, but also *supports* and *deters*. ESD incorporates a proper set of checks and balances that will support employees who are trying to work in a correct fashion. Proper checks and balances help ensure a transparent working environment and keep ethical employees from being manipulated and intimidated by others. Furthermore, proper checks and balances prevent individuals from concentrating power, ignoring ethical guidelines, and veiling their activities. Such checks and balances are the best way to ensure transparency and subject each employee to appropriate oversight. That's what it takes to *deter* bad behavior.

An organization structuring a rigorous set of checks and balances needs an understanding of where problems might develop and how they can be nipped in the bud. A good place to start is a thorough risk profile developed by public accountants, internal auditors, risk-management and legal staff, and perhaps outside help from consultants and errors-and-omissions carriers. Once the risk profile is created, checks and balances to mitigate these risks can be developed. Importantly, transparency must permeate all facets of the business. The more people are aware of what is going on, the more difficult it is for incorrect behavior to be overlooked.

This process must start at the board level. What is needed are board members who are informed about the business they are in, are involved with it, have the experience and expertise to perform their duties, and are willing to devote the time required. They must understand their responsibilities and be held accountable.

Board members should bring an attitude of service, not entitlement, to their positions. Board members must always keep in mind that their job is to provide oversight to protect shareholder value. They must seek to ensure that every staff person, from those in the "C" suite down to the lowest-level employee, is performing ethically. What is needed throughout the organization is the proper understanding of responsibilities and the proper monitoring of how those responsibilities are addressed—a viable set of checks and balances. Everyone in the organization should know that tight controls are in place and that ethical lapses will be dealt with very severely. The object, after all, is not to catch someone guilty of malfeasance, but to prevent it from ever happening.

Management must follow the lead of the board by acting ethically and insisting that the staff do the same. Here again, words are not enough. Management must constantly be on guard for those areas where ethical lapses are most likely, and provide the checks

and balances to prevent them. As President Reagan said about agreements with Cold War adversaries: "Trust but verify." Transparency is necessary here as well. Management must continue to make it clear that strong checks and balances are continually being updated and new ones are being developed to deter unethical behavior. Staff must also have confidence that management will fully support those who report malfeasance by others, including their superiors. □

**H. Stephen Grace Jr., PhD**, is president of Grace & Co. Consultancy, Inc., and a former chair of Financial Executives International. **John E. Haupert** is a member of the board of advisors of Grace & Co. and served as treasurer of the Port Authority of New York and New Jersey prior to retirement. An earlier version of this article was delivered as part of the 2005 Ethics Week program at Baruch College, CUNY.

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