Board Champions for the Ombudsman

By Jonathan E. McBride and James S. Hostetler

Grievances cannot be redressed unless they are known, and they cannot be known but through complaints… If these are deemed affronts and the messengers punished as offenders, who will henceforth send petitions?…Where complaining is a crime, hope becomes despair.
– Ben Franklin

In the December 2007 issue of *Directors Monthly* (DM), Gary Edwards issued "A Call to Action for Board Leadership" to strengthen and enhance the compliance, ethics, and corporate culture of an organization. After noting problems with the structure and function of most current corporate ethics and compliance programs, Mr. Edwards offered an action plan for boards of directors to improve their ethics programs. We applaud and support his analysis and conclusion that "understanding why and how boards must reengage on the critical topic of corporate ethical culture is essential to their success."

In this article, we offer a significant additional building block, perhaps one of the most powerful governance tools available to corporate boards today if they are to effectively promote best practices in governance, risk management, and compliance. This tool is the "organizational ombudsman" (ombuds). Providing a safe space for employees, free from intimidation or retaliation, to surface issues of concern, particularly those that expose the organization to risk, is precisely what an organizational ombudsman does.

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Director Summary: Recent studies have shown that though corporate ethics compliance programs are on the rise, reporting violations are on the decline. One way to remedy this is by establishing an ombudsman office and providing employees with an informal channel for reporting unethical activities that may be putting your company at risk.

Background

Employees need to be able to let the board of directors know when they see something that threatens performance or exposes the company to risk. Only when corporate boards know what's really going on in their organizations can they protect the company's financial assets, and an equally important asset—its reputation.

Corporate directors are acutely aware that they expose themselves to liability if they fail to keep abreast of emerging best practices in governance, risk management, and compliance. Responsible boards, increasingly concerned about what they don't know, are expending significant time and resources in identifying, quantifying, and mitigating risks.

Sarbanes-Oxley, the NYSE, and NASDAQ mandate that companies provide channels of communication through which employees can act as "whistleblowers" free from fear of retribution. The U.S. Sentencing Guidelines stipulate the same thing. In response, many boards have instructed operating management to provide mechanisms through which employees can disclose their concerns in a manner in which they feel safe. The result often has been the establishment of formal internal functions, such as ethics, compliance, internal audit, legal, and human resources, or hotlines, among others.

Formal vs. Informal Channels

Mentally draw a line under that list of internal functions. Everything above the line represents a "formal" channel of communication where agents of management make policy, enforce policy, and keep official records, as well they should. When appropriate, they also conduct formal investigations. If an employee reveals wrongdoing to any of these formal channels, the organization is "on notice"; that is to say, the company "knows" and, depending on the nature of the issue, is obligated to initiate an investigation.

Now drop down below the line. That is where the organizational ombudsman lives. The office of the organizational ombudsman

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offers an "informal" channel of communication, independent of management's formal chain of command. The ombuds is an independent, neutral, and confidential resource. The ombuds is neither the company's advocate nor the employee's advocate; rather, it is an advocate for fair process.

As the ombuds is not an agent of management, it does not make or enforce policy, does not perform formal investigations, and does not keep records. The ombuds' function is to listen, help analyze options, and coach concerned employees. Based on sensitive information that flows to the ombuds and establishes statistical trends, the ombuds is in a unique position to identify areas of weakness and provide the board with periodic recommendations concerning systemic changes that can benefit the entire organization.

Companies that focus only on the formal programs, which "protect" the company by satisfying criteria mandated by Sarbanes-Oxley and other legislative and regulatory requirements, often don't get access to the very information they need. Ironically, in many cases, the stronger and more "effective" management makes the formal channels, the higher the intimidation factor and the less employees use them.

In the 2007 National Business Ethics Survey (NBES) conducted by the Ethics Resource Center, it is noted that in recent years the number of formal programs such as hotlines has increased, as has the percentage of employees who have observed unethical behavior—e.g., conflicts of interest, abusive behavior, and lying. At the same time, the percentage of employees willing to report the unethical behavior has decreased. The survey also found that most employees who do report misconduct prefer to reveal it "to a person… rather than to a company 'hotline.'" Ombuds utilization rates are generally three to ten times higher than those of a hotline.

Companies that provide an ombuds office actually gain more timely access to needed information. According to Edwards, "Employees are less likely to report misconduct if they fear that doing so will result in being deposed and exposed." Because an ombuds office provides a safe haven for individuals to discuss issues of concern, employees are more likely to surface issues that expose the corporation to risk. They know their identities will not be revealed.

So why is the ombuds function, which can quench the board's thirst for independent knowledge of potential risks, not on the radar screen of most directors and management executives? It has been our experience that many board members feel that when they have one or more formal channels in place, they have covered their bases. They also perceive that an ombuds function would duplicate, or compete with, the formal channels.

The Critical Role of the Ombudsman

Why bother establishing an ombuds function?

One reason is that because of the "informal" nature of the office, communications made through an ombuds function do not constitute formal "notice" to the company, thereby requiring an investigation where none may be warranted. In the event of litigation, courts normally uphold the ombudsman's privilege and issue protective orders to shield the ombudsman from testifying. As a consequence, the ombuds function represents a safe place for individuals to take problems or concerns to better understand the issues and assess options for resolving the matter.

Stephen P. Norman, corporate governance officer of American Express, has observed: "One of the surest ways to prevent brand damage is to identify problematic behavior at its earliest stage. Our employees are often in the best position to raise issues, but they won't unless there is both the perception and the reality that they will be supported. An active ombuds office does that for us, as one of our key channels for helping surface issues."

Second, the ombudsman provides early warning to the board by identifying "hot spots" or areas needing managerial intervention. Statistics provided by the ombuds function can result in periodic recommendations concerning organizational change that might benefit the enterprise as a whole. This can resolve contentious issues early, and can prevent their recurrence.

Herb Allison, former chief executive of financial services company TIAA-CREF, notes that an ombudsman can tie together a company's directors and employees and help assure that when problems do arise, directors can know about them and take steps to address them. "An ombudsman provides another avenue for a company to surface and address concerns so they reach the board sooner rather than later."

Third, statistics indicate that when there are multiple reporting channels in place, including an ombuds function, the formal channels can be more efficient. Not only does the informal ombuds function not compete with the formal channels, but by coaching and directing employees to use them, the ombuds complements the formal channels. When employees speak with the ombudsman first, sometimes their concern is resolved simply by being "heard." If, after initial consultation with the ombuds, they elect to approach a formal channel, they will better know what they want to say and what outcome they seek. This saves the formal channels valuable time from addressing or investigating issues that belong elsewhere.

Dennis Muse, CEO of Global Compliance, a leading provider of integrated ethics and compliance solutions, states, "As a best practice, Global Compliance counsels our clients to implement multiple vehicles and channels for the reporting of business misconduct or noncompliance."

Fourth, from a return-on-investment (ROI) perspective, an ombuds function makes demonstrable good sense. Statistics generated by John Zinsser of Pacifica Human Communications, LLC, a leading expert on ombuds program performance metrics, show on average a fourteen dollar return per one dollar invested—and this is before savings from legal fees that would otherwise be spent on employee-initiated litigation are taken into account. While the ombuds function is sometimes dismissed as a "cost" center, we challenge boards to show comparable ROI results from more conventional "profit" centers.

What Boards of Directors Should Do

Edwards has issued a strong call for leadership by boards to promote an organizational culture that encourages ethical conduct. We urge boards to take ownership of the organizational ombudsman concept as an important tool in meeting not only this responsibility but also in resolving conflicts which, if left to fester, undermine morale and erode performance.

Indeed, this emerging best practice in governance must be directed and led by the board, not delegated to one of the formal channels which plays a complementary role to the ombuds. To practice governance and risk management powerfully and effectively, CEOs, boards, and audit committee chairs must integrate effective ombuds programs into the DNA of twenty-first century corporations. Ultimately, directors should become "champions" for the critical role organizational ombudsmen can play in corporate America. ■

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