Ethics, Culture, and Compliance Forum
SUMMARY OF THEMES

AUGUST 2021

The Ethics, Culture, and Compliance Forum's July 2021 Summit convened directors and senior executives to discuss board oversight of corporate culture, ethics, and compliance. Current company directors and chief ethics and compliance officers (CECOs) focused on insights from a recently published report, *Activating Culture and Ethics from the Boardroom*. Following are the key themes that emerged from the conversation.

For a full list of meeting participants, please see appendix.

Culture is critical but remains elusive

Directors emphasized that much of culture is implicit, comprised of unwritten rules and expectations that are rarely articulated. One director said, *"The deepest culture in a company involves the things we never discuss; they're never written down."* This makes it difficult for boards to gain comfort around oversight of culture, as another director explained: *"I fear that we don't have a clear grasp of the issue at the board level because sometimes even the executives don't really understand what's unsaid."*

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Culture is broader than ethics and compliance, but values and ethics are crucial underpinnings of any culture. Leaders who are committed to a positive culture will value integrity as highly as business performance goals. *"We have to make sure that employees recognize that winning and achieving financial results cannot be done at the expense of integrity and business ethics,"* a director said. This has to be embedded in expectations and demonstrated in practice. A director warned, *"What do we do if we say we value integrity, and we also have a culture that really wants to win? Most of us have seen people in organizations who are performing brilliantly but not coloring inside the lines. If we honor winning over integrity, the culture will get lost."*

Culture can vary across functions, geographies, and business units in a company. With that in mind, one director advised, *"What you have to do as a board is look at all the components of the culture. You look to the diversity and inclusion officer for that component, to business leaders for performance, to the ethics and compliance officer for*

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that component, to business leaders for performance, to the ethics and compliance officer for adherence to rules and regulations, and then from all that, you get some sense of the culture. It's a system."

The board looks to a variety of senior executives for insights on culture

Different executives report on different aspects of culture to the board, often working with different board committees. Boards then try to form a view of the health and culture of the organization. Participants emphasized the need for both formal reporting structures and informal interactions between directors and senior executives. While committee charters can formalize reporting cadences and relationships, participants emphasized the need for collegial relationships between directors and senior executives to encourage communication outside established reporting structures.

Achieving an integrated view

Boards often look to CEOs for an overall understanding of the culture. *"The only person who can give the board anywhere near a holistic view is the CEO because they are the general manager of the company and look across all those functions as the primary liaison with the board. They are able to give you that sense of how we're doing with the customers, and how we're doing with our performance, and how we're doing with diversity and inclusion, and how we're doing with ethics and compliance."* It then falls to the board to validate and challenge the CEO's reporting.

Even within management, culture requires significant coordination. A CECO said, *"Culture is more than ethics and compliance. We have a cross-functional team of HR, legal, and finance, where we meet quarterly to discuss programs and initiatives that can help affect culture."*

Directors pointed out that they also look to managers beyond the CEO, CECO, and chief human resources officer for insights on culture. For example, business unit leaders often report on the culture in their business. One director said, *"Any time we talk about culture or ethics or compliance, it's not just the compliance officer that's in the room; it's also the business owner."* Participants also pointed to the value of internal audit. One director said, *"I've expressed to our internal auditors that they really are there as my eyes and ears on the culture, so I ask them to talk to me about what they sense. They are in the field around the world. I meet with them privately, and I'll say, 'You have me; here's my email. I need to hear from you.' If they feel empowered to be your cultural detectives, then you'll hear from them."*

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The CECO and the board

Positioning the CECO as the owner of culture strategy may help elevate the board's understanding and insight into the company's culture, but it can take time and effort to build that level of engagement. One CECO said, *"I have direct access to the board as a whole and also to the audit committee, but that didn't happen overnight."*

Participants emphasized that the quality of the relationship between the CECO and the board—especially the level of trust—is more important than where the CECO reports. One participant said, *"Beyond the reporting structure, the question is, Does the company take it seriously and does the lead executive have a real relationship with the board?"* Another participant urged fellow directors to take ownership of building a strong relationship with the CECO. *"I think the onus lies with the board members to make sure that they are encouraging those relationships and lines of communication and that they're developing that trust."*

Similarly, participants agreed that one-on-one conversations between committee chairs and executives are crucial to effective oversight. One CECO said, *"No matter the structure, it's really about the engagement of directors in the committee meeting and, probably most importantly, outside of the committee meeting between managers and directors, especially your committee chair."*

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Board structure matters, but commitment matters more

Directors worry that despite the importance of these issues and the risks associated with missteps, culture often commands insufficient board time and attention. One director said, *"I think the risk of a restatement or material deficiency is far, far less than the risks from bad cultural elements. And yet the amount of time and energy we spend on financial reporting far exceeds the amount of time on ensuring we have the best culture. It seems counterintuitive to me."*

Compared with financial reporting, boards lack well-established frameworks, protocols, and processes for their oversight of culture, ethics, and compliance. One director said, *"I think the reason why there's so much more time spent on financial topics is because there's an established protocol for how boards should handle that, which is pretty much the same across companies. We don't have the same kind of processes for culture or ethics."*

Establishing ownership

Participants agreed that there is no universal model for board oversight of ethics and compliance. While most placed primary responsibility with the audit committee, several acknowledged that the scope of an audit committee's responsibilities can make it difficult to give ethics and compliance the requisite attention. One director said, *"There's no single place where the culture, ethics, and compliance issues necessarily ought to live, but I do think that if it's only sitting in audit, it probably is going to be given short shrift."*

> ***"The most important thing is to assign some level of responsibility within a board for oversight of these issues so that they don't get lost."***

Given the pressure on audit committees, some boards allocate primary oversight to the nominating and governance committee or create a separate compliance committee. But even before determining the right committee structure, participants emphasized that deciding to give ethics, culture, and compliance sustained attention is the first and essential step to effective oversight. One director said, *"The most important thing is to assign some level of responsibility within a board for oversight of these issues so that they don't get lost."*

Getting culture onto the board's agenda

While culture sometimes appears as a distinct item on board agendas, most participants stressed the value of embedding it into conversations about strategy, business plans, and performance. Participants agreed that effective oversight requires the board to explicitly allocate time to culture. One director said, "*Culture may not show up as an agenda item, but its elements are on almost every agenda in terms of what's important to the company."* Several directors pointed out that embedding culture in board risk oversight discussions can help give the issue focused attention. One director said, *"If we keep forcing discussion of risk and mitigation into the plans the business owners present to the board, we will have better conversations about what's really going on in the organization."*

Other participants want to see culture as a distinct agenda item. *"It's almost like culture is the implicit unspoken question that sort of underlies everything, and I think that's an issue that needs to be spotted and addressed directly and head on,"* said one director. *"I think it is wise for boards to periodically set aside explicit time on their agenda to step back and specifically address the issue."*

The way a board approaches culture can shift, especially during times of change or in the wake of a significant acquisition. For example, a director said that culture had come to the top of their board's agenda because the company was working to transform its culture. *"A year or two from now, I don't know that culture will be on the* *on the board agenda every meeting, but this year the CEO has determined that it's really important and critical to where he wants to take the company, and obviously the board is very supportive of that."* Another agreed: *"The last couple of years has seen major transformation. Many generations of people left the organization and more people came in, with a major impact on the culture—so of course the board was much more interested in discussing the culture."*

Boards seek a robust picture of company culture

The complexity and implicit nature of culture make it difficult for boards to assess. This is exacerbated in large global organizations, where culture can vary across business units and geographies. One director noted, *"The issues that I've seen in my director life have been around varying cultures, where you get a maverick culture that thinks they're doing better than everyone else. And it doesn't have to be the biggest unit in the world, but it can create the biggest problems in many cases. I think it brings up the fact that we need all the measurement tools we can get, we need access to people in many levels of management, and it just is a very difficult job."* To tackle the job, boards depend on a combination of measurement tools and opportunities for direct observation.

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Measurement tools

ECCF participants noted the challenge of measuring culture, although several pointed out that culture is more measurable than is often understood. Boards receive reports generated by a standard range of tools, including human resources data, employee surveys, and hotline data. Participants pointed out several aspects of the most useful reports:

- **Dynamic rather than static.** Data showing change over time is more useful than snapshot data. An executive said, *"Typically, management tends to get some sort of data and says, 'Here's a static look at the situation.' But if you're not presenting four quarters of data or, better yet, eight quarters of data, there's no way to contextualize."*

- **Granular and specific.** Granular data, broken down by business unit, geography, or demographic characteristics, can help boards find patterns hiding in the averages. Participants noted the value of reading comments on surveys, rather than just the numeric data; this can help them spot signals of deeper or more widespread problems. This requires directors to *"spend time in the trenches with data,"* as one director said.

- **Combined with other data sources.** Data from various sources can be combined to identify patterns that might not show up in a single source. One director said, *"We looked at hotline data, safety data, diversity and inclusion data, and we were seeing certain correlations, identifying pockets where there may be some* *opportunities for help."*

- **Focused on deeper realities.** Effective employee surveys get beyond superficial questions to more profound matters. One director emphasized that the right kind of surveys will probe for underlying forces that influence culture, such as fear, openness to listening, willingness to come forward, organizational justice, and how executives and managers make decisions under pressure. Another participant said, *"The question for us is, How do we define what we mean by ethics to really get at some of those gray-area cultural issues?"* A good survey, one director pointed out, asks questions such as *"Do you feel comfortable bringing your full ethical awareness and moral reasoning to your job every day and having the conversations you need to have? And if not, why not?"* Another director suggested, *"Rather than asking generic questions like 'Are we an ethical company?' you ask a person specifically, 'Give me an example where you felt uncomfortable. Give me an example where you felt someone wasn't treated fairly.' When you read these comments, you hear a little more about whether your managers are walking the walk."*

Technologies such data analytics and artificial intelligence (AI) can reveal patterns that a human analyst might miss. One participant said, *"We've hired a vendor that incorporates AI and machine learning to help us with data correlation across hotlines, surveys, and HR data."* One participant spoke of a *"new era of predictive analytics"* that will enable companies to identify behaviors and even language that can predict ethical problems.

Observing culture

A director said, *"Culture may not be measurable, but it is observable."* Directors emphasized the necessity of complementing measurement and assessment tools with direct observation of company culture. One said, *"You learn more about culture from talking one level down in the organization over dinner than you do in the formal reports."* Another described his approach: *"I've had the opportunity to learn from middle managers who were involved in a decision that went wrong, trying to understand how they got to that decision. I learned far more about the culture than I would hearing from any individual in upper management. It's extremely time consuming and exhausting to go to that level of detail, but it is critical."*

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A director described a board's practice: *"We have open forums. At lunchtime during one of our board meetings, we invite 30 or 40 employees; sometimes, when we're visiting a plant, we put one director at each table. I find that firsthand data, data about their experience, gives you color on how things are going, what's on their minds, where we can improve."*

Boards must balance accountability, incentives, and compensation

Participants emphasized the need for boards to hold leadership teams accountable for outcomes on ethics, compliance, and culture. This extends to not just the CECO but also the CEO and business leaders. While participants acknowledged some value in linking incentive compensation to ethics and cultural outcomes, they expressed caution and suggested several factors for boards to consider:

- **Integrating culture and ethics risks overcomplicating compensation packages.** The proliferation of nonfinancial compensation factors—environmental, diversity and inclusion, ethics—can undermine a compensation scheme's ability to reinforce clear priorities. If everything is an area of focus, nothing is. One director said, *"When our board considered adding new nonfinancial factors into compensation, the bulk of the discussion and the hardest thing was around what factors to take away. We also had a CEO who felt very strongly that if we do everything in balance and we just add things to incentive compensation, then it's impossible to set priorities for the team."*

- **Compensation should avoid rewarding executives for simply doing the right thing.** Participants pointed out that integrating basics like safety or ethical behavior into compensation can obscure the message that ethical workplace conduct and doing business with integrity are expected at all times. Some boards reduce compensation for failing to reach benchmarks rather than paying bonuses for achieving them. A director said, *"In some industries, safety is really crucial for the board to oversee, but the way we treated that was to have it be a negative area. If they haven't reached the safety goal, we have a subtraction."* Another director said, *"I absolutely believe in punishments for failing on the metrics, as opposed to rewards for doing the right thing."*

- **Tying ethics and culture goals to strategy can bring clarity.** A director and former CECO said that compensation on culture can only succeed in the presence of a well-defined culture strategy: *"To the extent that there really is an overarching culture strategy to move things in a certain direction, I think it's very fair to include that for the CEO and senior executives and to have some metrics around that, because that's a big-picture, whole-company strategy. On my board, we asked each senior executive to talk about their objectives related to ethics, compliance, and culture—things they felt they could do, that would*

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advance the ball in their own area and in their own behaviors, and things they were willing to be held accountable for. "

- **Metrics are critical.** If boards want to reward executives for achieving ethical or cultural outcomes, it is necessary to be able to measure those outcomes. One director said, *"I want to emphasize the importance of having some metrics with this; otherwise, it becomes a very subjective discussion."*

Beyond compensation, participants pointed out that the issues the board devotes time and attention to and what it asks management to report on send important messages to executives. One director said, *"For one of my boards, the fact that the board and management had such an intensive discussion on it signals to management that ethics and compliance are important."* Another director said, *"A very effective approach in one of my companies was to have the business unit leaders incorporate several culture factors into the dashboards that they had to present to the board, including quarterly goals on things like turnover and employee engagement scores. The competition between business unit leaders about who had to put a red mark on their dashboard was powerful. Having the board see that data every quarter was a driving factor for accountability."*

Building relationships of trust and transparency is crucial

ECCF participants emphasized repeatedly that trusting relationships—among board members, between the board and senior leaders, and among the executive team—are crucial to an effective culture. Participants identified critical components in building trust:

- **How directors react to mistakes and bad news.** *"If you cannot and are not admitting your mistakes, owning your mistakes, and saying, 'Here is how we're going to do better next time,' then you've got a culture problem,"* said one executive. How the board responds when management brings it bad news plays a key role in developing trust. *"Leaders need to be very intentional about how they respond."* It is essential for other employees to see the organization acknowledge mistakes as they are made and to see that improvements are needed. Staff need to see that it is safe to bring mistakes or failures to the board. Senior leaders walk a fine line in this area. They can't react too harshly when confronted with mistakes, but they also need to take appropriate action against misconduct and communicate that action was taken. Failure to do so can erode trust throughout the organization and risks leading employees to conclude that it is not worth speaking up about misconduct. One director said, *"If people think that mistakes result in termination, they will hide mistakes and the mistakes of others. But if employees think no action will be taken at all, they will also not report."*

- **Transparent communication regarding misconduct.** Participants discussed the impact of communicating transparently on organizational justice. Several directors shared experiences in which a senior leader was terminated for ethical reasons or code of conduct violations. In those cases, participants emphasized the need to resist pressure to obfuscate the reason for the termination and to be as transparent as possible in order to send a clear signal that such misconduct is not tolerated. While legal constraints may limit what can be said, *"employees are entitled to some understanding of the context,"* said one director.

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- **Transparent and open board leadership.** Directors emphasized the key role played by independent board chairs or lead directors in maintaining open channels of communication. Several noted, for example, that because the lead director is a crucial conduit by which the board can deliver feedback and coaching to the CEO, the quality of the working relationship between those two individuals is critical. It also falls to the lead director to ensure that when independent directors convene, all have an opportunity to give input and raise concerns.

- **Opportunities for establishing personal relationships.** Participants noted the importance of informal interactions, both among directors and between the board and management. A few directors commented that board strategy retreats provide a forum for taking a step back to look at the big picture in a way that both builds relationships and aligns executives and the board in developing forward looking plans.

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Directors agree that ethical culture is critical to the performance and reputation of their businesses and recognize that boards are ultimately accountable for the cultures of the companies they oversee. While discussions in the Ethics, Culture, and Compliance Forum surfaced a range of insights into good practice, the conversations also revealed that there is no universal framework or approach to board oversight. Boards vary considerably in how they assess culture, structure themselves for oversight, integrate culture into board agendas, and engage with management. Factors such as size, industry, and global footprint add complexity. Directors and senior executives emphasized that fulfilling the board's responsibility to asses, monitor, and shape culture requires more than tools such as rules, procedures, and programs. It requires an intentional commitment—from the board as a whole and individual directors—to devote significant time, attention, and resources to these issues.

ENDOTES

[1] Tapestry Networks and LRN, **Activating Culture and Ethics from the Boardroom: The 2021 Ethics, Culture, and Compliance Forum Report** (Waltham, MA: Tapestry Networks, 2021).

[2] *Summary of Themes* reflects the forum's use of a modified version of the Chatham House Rule whereby names of meeting participants and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Italicized quotations reflect comments made by partcipants in connection with the meeting.

Appendix

Participants

Virginia Addicott, Non-executive director, CDW and Element Fleet Management

Vanessa Benavides, Senior Vice President, Chief Compliance and Privacy Officer, Kaiser Health Plan and Hospitals

Alan Bennett, Non-executive director, Fluor Corporation, TJX, and Halliburton

Michael Bramnick, Senior Vice President, Corporate Affairs, Chief of Staff & Chief Compliance Officer, NRG Energy

Phyllis Caldwell, Non-executive director, Chemonics International, JBG Smith Properties, and OCWEN Financial

Patrick Condon, Non-executive director, Entergy

Don Cornwell, Non-executive director, AIG, Natura & Co, and Viatris

Tracy Davis Bradley, Acting Chief Compliance and Business Integrity Officer, U.S. Department of Veterans Affairs

Forrest Deegan, Vice President, Ethics & Compliance, Victoria's Secret

Nicole Diaz, Global Head of Integrity & Compliance, Snap

Paulett Eberhart, Non-executive director, Vine Energy, Fluor, Valero Energy, and LPL Financial

Kathleen Franklin, Global Ethics & Compliance Strategy Leader, Sony Corporation of America; Non-executive director, Bank OZK

David Greenberg, Special Advisor, LRN; Non-executive director, International Seaways

Phyllis Harris, General Counsel, Chief Compliance, Ethics and Government Relations Officer, American Red Cross

Sandra Helton, Non-executive director, Covetrus, Optinose, and Principal Financial

Sophia Hudson, Partner, Capital Markets, Kirkland & Ellis

Sarkis Jebejian, Partner, Mergers and Acquisitions, Kirkland & Ellis

Clay Jones, Non-executive director, Deere & Company and Motorola Solutions

Julie Kane, Non-executive director, Siga Technologies

Cathy Lego, Non-executive director, Cirrus Logic, Guidewire Software, and Lam Research

Brad Lerman, Senior Vice President, General Counsel, and Corporate Secretary, Medtronic; Non-executive director, McKesson

Diana Lutz, Lead Counsel, Corporate Integrity & Compliance, FedEx

Les Lyles, Non-executive director, KBR

Leo Mackay, Senior Vice President of Ethics and Enterprise Assurance, Lockheed Martin; Non-executive director, Ameren and Cognizant Technology Solutions

John Mahoney, Non-executive director, Bloomin' Brands, Chicos FAS, Burlington Stores, and Michael's Stores

Appendix

PARTICIPANTS *CONTINUED*

Kevin Michielsen, CEO, LRN

Cindy Moehring, Non-executive director, Pyxus International

Henry Nasella, Non-executive director, PVH

Gina Nese, Vice President, Global Compliance & Ethics Officer and Counsel, Align Technologies

Neil Novich, Non-executive director, Beacon Roofing Supply, Hillenbrand, and WW Grainger

Elaine Pretorius, Vice President, Global Ethics & Compliance and General Counsel, Molson Coors

Diana Sands, Non-executive director, PDC Energy and SP Plus

Gloria Santona, Of Counsel, Baker & McKenzie; Non-executive director, Aon

Larry Thompson, Of Counsel, Feinch McCranie; Non-executive director, Graham Holdings

Henri Van Elewyk, Group Senior Vice President, Ethics and Responsible Business Conduct, Sodexo

David Vitale, Non-executive director, United Airlines

John Weiland, Non-executive director, Cardinal Health

Amber Williams, Vice President Legal, Global Ethics & Compliance, L Brands

Kim Williams, Non-executive director, The EW Scripps Company, Xcel Energy, and Weyerhaeuser

Dona Young, Non-executive director, Foot Locker, Aegon, and USAA

Donna Zarcone, Non-executive director, Cigna and CDW

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Tapestry Networks is a privately held professional services firm dedicated to helping leaders – directors and boards in particular – do their work more effectively.

About LRN

LRN is a global firm committed to fostering principled performance and inspiring, rather than requiring, people to do the right thing.