

# Benefits of an Ombuds Program to Corporate Governance

**By Arlene Redmond and Randy Williams**

As part of corporate governance strategy, directors know they need timely, unfiltered communication and effective resolution of unethical behavior in order to achieve legislative and regulatory compliance, protect financial assets, and preserve reputation.

Some feel that help lines, ethics officers, and other formal channels, such as human resources, legal, audit, and compliance can meet legislative and regulatory requirements. They also assume that these formal channels are sufficient to facilitate communication of wrongdoing. However, formal channels have specific missions that may not provide the environment and mechanisms for confidential, anonymous communications.

Ombuds functions are informal channels that complement formal ones by offering neutrality, independence, informality, and unqualified confidentiality, thus providing a safe place for employees to raise issues at an early stage without fear of retaliation.

Ideally, an ombuds reports directly to the CEO and to the board, usually to the audit committee. The ombuds addresses an inclusive range of work-related issues, provides data to directors about early warnings and issue trends, and brings them specific issues, if necessary. The ombuds's neutrality allows an unfiltered flow of information. Ombuds assist companies to resolve issues of concern, serve as change agents to help the organization avoid potentially damaging events, and deter recurrence.

**Director Summary:** An ombuds program is an important addition to a compliance program. Its informality and confidentiality encourage employees to come forward. Imminent harm to the company must be revealed; however, the employee surfacing it may remain anonymous.

## **Challenge: Employees' Reluctance to Report Malfeasance**

Recent research indicates that employees observe but do not always report misconduct. Their reasons for not coming forward are:

- They do not know whom to contact.
- They fear retaliation from a co-worker.
- They fear retaliation from supervisor/manager.
- They fear that reports would not be kept confidential.
- They believe that no corrective action will be taken.

## **Solution: Ombuds Neutrality, Informality, and Guidance**

An ombuds is a neutral individual with whom an employee can have an informal, off-the-record conversation before choosing a resolution option. Once employees go to a formal channel, they can no longer control what happens; an investigation is likely, with concomitant action. In contrast, if the employee goes to an ombuds, the employee makes the decision to either take the issue forward, to have the ombuds take it forward, or to defer action.

Employees bring troubling observations to an ombuds because they do not know which formal channel is relevant to address a particular issue. The ombuds has a holistic understanding of all programs, policies, and processes, and can help employees choose the best option for resolution of an issue.

The ombuds role differs significantly from help lines, which are often staffed by employees who do not have the experience and capability to probe and obtain sensitive information. Employees are unlikely to trust a remote resource enough to feel comfortable coming forward.

## **Solution: Ombuds Confidentiality**

Confidentiality is a unique capability of the ombuds office. The informality, independence, and neutrality of the office eliminate any conflict of interest for the ombuds and present a



## Wrongdoing may go undetected if an organization does not have a confidential, neutral, informal, and independent communications channel for employees.

safe haven, a critical condition for an employee to feel comfortable coming forward with a sensitive issue. The confidentiality privilege of ombuds communications has been recognized both on the basis of federal common law under Federal Rule of Evidence 501 and on the basis of implied contract.

More than half of those who want the ombuds to carry the issue forward want to preserve their anonymity. This is why wrongdoing may go undetected if an organization has only formal channels that are strategic partners to management—which must admit to notice for the company, formally investigate, and are obligated to keep records. Employees may not come forward because they believe they will jeopardize ongoing business relationships or suffer retaliation.

### Ombuds Support of Compliance

Corporate governance rules make it clear that organizations have specific duties. Sarbanes-Oxley sections 301, 406, and 1107, U.S. Sentencing Guidelines section 8A.1.2 comment 3(k)(5), NYSE proposed rule 303A(10), and NASDAQ proposed rule 4350(m) all cite the need for reporting and documentation of wrongdoing, and the formal channels provide that. They also cite the need for systems where employees can bring issues forward without the fear of retaliation. An ombuds provides the anonymity and confidentiality to meet these requirements.

### Ombuds as an Agent of Change

Ombuds' anonymity and confidentiality allow gathering of critical early warnings and information. Ombuds drive change by using this information to provide specific business-unit and department reporting to senior leaders, summarizing trend data, analysis, and change opportunities. This information is distilled from cases and key messages, but no confidential information is revealed. Ombuds link trends with business-unit and department goals and performance. From this analysis, ombuds identify early warnings that are potential barriers to executing strategy or causes of performance gaps, and make suggestions to address them.

In addition, ombuds serve as change agents by helping organizations address emerging and continuing risk and ethical issues.

### Duty to Bring Forth Serious Issues

It is important to note that the ombuds is obligated to disclose certain issues. If there is a threat of physical violence or of material harm to the corporation, the ombuds advises the inquirer that this constitutes an exception to confidentiality. The ombuds, in this case, will surface the issue but keep the inquirer's anonymity if at all possible. This duty is important to the board, as financial malfeasance will be disclosed. In addition to acting on information emerging from an inquirer's case, ombuds can bring issues forward that they have observed directly.

### Change and Issue Prevention

Outcomes of issues surfaced and addressed, and presented to the board may include:

- Compliance problems fixed:
  - Company policy, code of conduct, and legal violations halted.
  - Incorrect financial reporting corrected.
  - Discrimination and harassment lawsuits avoided.
  - Fraudulent vendor relationships stopped.
  - Health and safety issues resolved.
- Employee retention and productivity improved:
  - Leaders terminated/reassigned due to inappropriate behavior.
  - Conflicts resolved.
  - Business processes improved.
- Systemic changes initiated:
  - Improved performance management processes.
  - Improved control/compliance systems.
  - Greater accountability for compliance.

### Summary

It is to the board's advantage to use every mechanism that enhances risk mitigation in order to comply with regulations, uncover issues that could be damaging to corporate assets or reputation, and foster appropriate change. The ombuds is the one entity that is chartered to be independent, neutral, informal, and confidential. As such, an ombuds helps surface information that may not otherwise become available, directs information to the appropriate place for resolution, and serves as an agent of change. ■

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