

Enter the Watchmen:

The Critical Role of an Ombuds Program in Corporate Governance

by Arlene Redmond & Randy Williams

When the CEO of HSMC (Hypothetical Services and Manufacturing Corporation of Anywhere, U.S.A.) met with the Board of Directors last week, the Board wanted to know how a staff writer at the *Wall Street Journal* heard rumors about inflated earnings reports and unaddressed safety issues at the company before the Board did. Specifically, the Board asked the CEO how the company's senior leaders could confidently obtain unfiltered information about problems or potential scandals in time to take action. It also wanted to know HSMC had taken all possible steps to prevent malfeasance and other

workplace problems. In addition, the independent director wanted three critical pieces of information:

- Do employees feel safe coming forward as soon as they perceive that an issue may be problematic for the company?
- Where can employees discuss options if they do not know where or how to surface potential wrongdoing or are afraid to come forward?
- If the HSMC Employee Help Line reports to a formal

channel (e.g., human resources, ethics, legal, audit) and the employee does not yet feel confident taking a formal step, does the employee have a place to seek guidance?

The CEO had been asking herself those same questions and was prepared to address them.

The CEO and the VP of risk management had met and had come to the following conclusion: HSMC has very good formal channels: risk, compliance, ethics, human resources, legal, audit, security, management and others. However, HSMC does not have an informal channel where an employee can seek off-the-record, confidential guidance about surfacing and resolving issues from a senior executive who knows the company and can remain neutral. HSMC realized that such a channel would allow employees to feel comfortable bringing sensitive issues forward early before they became serious problems. Such an option would complement HSMC's formal channels, helping HSMC reach its governance, risk management and compliance goals of avoiding injury to reputation or loss of company assets; complying with legislation and governance regulations and guidelines; and maintaining trust and an ethical work environment.

For HSMC, as well as its many real-world counterparts, however, there are barriers to meeting these goals. A 2003 survey by the Ethics Resource Center in Washington, D.C. found that 22% of employees reported that they had observed misconduct. In organizations that were going through change—restructuring, acquisitions, etc.—that percentage jumped to 33%. Moreover, 35% of those employees did not report observed misconduct because they believed no corrective action would be taken; reports would not be kept confidential; managers or co-workers might retaliate; or they did not know whom to contact. The types of misconduct observed included lies to em-

ployees, customers, vendors or the public; discrimination; stealing or fraud; sexual harassment; falsifying financial reports or records; and giving or accepting bribes, kickbacks or inappropriate gifts.

According to an Ethics Resource Center 2003 Survey, in addition to a 2002 *Time/CNN/Harris* poll and a 2000 KPMG LLP 2000 survey, the majority of the public does not trust corporate executives to solve



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problems. Nor do they feel that executives are approachable with bad news. Additionally, most of the public think that whistleblowers face negative consequences most or some of the time.

Capabilities of Organizational Ombudsmen

The key to reversing this mindset is establishing an organizational ombudsman. Acting as an informal channel through which employees can report problems, an ombuds program offers the neutrality, independence, informality and unqualified confidentiality needed in order to provide a safe place for employees to raise issues early and without fear of retaliation.

It supplements formal channels in identifying, surfacing, addressing and resolving malfeasance and other work-related issues. In addition, an ombuds assists the company in identifying and effecting improvements and preventative changes.

Complete Confidentiality. Employees observing serious workplace issues will bring them forward when assured that they can have a confidential discussion without fear of retaliation. Ombuds are able to provide unquali-

fied confidentiality because they are not part of any formal management structure. Moreover, the confidentiality privilege of an ombuds has been recognized on the basis of federal common law under Federal Rule of Evidence 501, and on the basis of implied contract. Further, according to a 2003 research report by the Hillsborough, New Jersey-based Ombudsman Association, 54% of the cases where an ombudsman takes the issue forward, the employee requests anonymity.

Resolution Options and Guidance. Often, an employee does not know where or how to take an issue forward. The ombuds has in-depth, organization-wide knowledge of the policies, procedures and resources for resolving

work-related issues. Unlike help lines which are often passive, the ombuds interactively provides neutral guidance in order to help the employee constructively take an issue forward.

Official Neutrality. An ombudsman is a designated neutral in an organization. An ombuds advocates for fair process, but not for any particular party. Employees value discussions with a neutral who has no vested interest in any particular outcome. When an ombuds surfaces an issue, he or she takes it forward as a neutral, not as an advocate. In order to support neutrality, the ombuds reports to an executive officer (e.g., CEO or president) and also the board of directors (usually the audit committee).

Informal and Off the Record. An ombuds office is independent and informal. Employees often are unwilling to take issues forward until they are comfortable with formal processes and potential outcomes. They want an off-the-record discussion with a seasoned professional about resolution procedures and implications prior to deciding on a course of action—formal or otherwise.

Duty to Bring Forth Serious Issues. Under professional standards of practice and code of ethics, an ombuds is

obligated to surface issues if there is an imminent threat of serious harm. An ombuds apprises the employee of this exception to confidentiality and will preserve the employee's identity, if possible, when surfacing the issue.

Support of Legal and Regulatory Compliance. Legislation and governance guidelines call for ethical work environments, codes of conduct, and systems where employees can surface issues without the fear of retaliation. An ombuds program provides anonymity, confidentiality and guidance which help meet the following requirements:

- U.S. sentencing guidelines provide for reducing penalties for organizations that have "an effective program to prevent and detect violations of law." The recommendation currently before Congress to modify the language in the commentary and make it a sentencing guideline will more strongly link ombudsman program capabilities to compliance. Proposed guideline 8B2.1(b)(5)(C) specifically states: "The organization shall take reasonable steps...to have and publicize a system, which may include mechanisms that allow for anonymity and confidentiality, whereby the organization's employees and agents may report or seek guidance regarding potential or criminal conduct without fear of retaliation."
- The Sarbanes-Oxley Act requires each audit committee to establish procedures for "the confidential, anonymous submission by employees of the (company) of concerns regarding questionable accounting or auditing matters." The Act further mandates that a code of ethics for senior financial officers include mechanisms to affect "the prompt internal reporting to an appropriate person or persons identified in the code of violations of the code." The

Act also makes it a criminal offense to retaliate against or interfere with the employment of someone who provides truthful information relating to possible federal crimes.



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- NYSE Rule 303A(10) requires the adoption of a code of business conduct to "encourage the reporting of any illegal or unethical behavior. (To en-

courage employees to report such violations the company must ensure that employees know that the company will not allow retaliation for reports made in good faith.)"

- NASDAQ Rule 4350(n) requires adoption of a code of conduct that includes "such standards as are reasonably necessary to promote the ethical handling of conflicts of interest, full and fair disclosure, and compliance with laws, rules and regulations..." It further requires such code of conduct to contain "an enforcement mechanism that ensures...protection for person reporting questionable behavior."
- In May 2002, the Washington, D.C.-based Business Roundtable published its "Principles of Corporate Governance," stating "A corporation should have a code of conduct with effective reporting and enforcement mechanisms. Employees should have a means of alerting management and the Board to potential misconduct without the fear of retribution, and violations of the code should be addressed promptly and effectively."

Issue Resolution. An ombuds has a mutually cooperative relationship with formal channels in order to ad-

dress issues and help drive change. In fact, according to the Ombudsman Association, over 88% of the issues brought to a corporate ombuds office are addressed by line management, audit, compliance, human resources and other formal channels.

Even a few potentially serious problems surfaced through an ombuds office can have a major impact on the company's reputation and bottom line. Examples of such problems include misleading financial reporting, fraudulent vendor relationships, safety issues, inappropriate treatment of employees, sexual discrimination or other forms of harassment, violations of employment and local laws, and the defiance of control and compliance

procedures.

Change Catalyst. A significant aspect of an ombudsman's role is helping the organization identify and affect change. Knowledge of the organization's goals, strategies, business priorities and risk concerns allows the ombudsman to drive change through a systematic analysis of emerging and continuing trends. From this analysis, an ombudsman provides summary information such as issue categories; emerging and continuing issue trends; demographics, location and percentage of target population using ombudsman services; percentage of issues addressed by each formal channel; potential impact of the issues on the organization (e.g., financial or reputation); types of changes that resulted from cases; changes to prevent issues from recurring; and the overall effectiveness of the ombuds program.

Friendly Competition

Ombuds share best practices across business units and formal channels. They also provide training in such areas as conflict management, incivility, cultural diversity and change management. In addition, ombuds provide informal input on policies and programs (e.g., code of ethics, employee surveys and leadership development). They write internal and external arti-

cles for education and awareness as well as participate in cross-channel discussions with compliance, audit, ethics and human resources to share a holistic understanding of risk priorities and workplace issues.

An ombuds complements formal channels by serving as an additional listening post and early warning source. The formal channels hear of issues about which, without the ombuds, they would not have been aware or were not notified in a timely manner.

Formal channels all have specific missions and charters within a company. Generally, they are strategic partners to management, they set and enforce policy, perform formal investigations, are places of legal notice for the company, keep records and act as change agents. As such, formal channels cannot keep anonymity or confidentiality on certain issues; cannot have informal, off-the-record discussions; and are not ultimately neutral.

Unlike formal channels, the ombuds office is not a place of formal notice to the company. It is an independent, informal, off-the-record, neutral and confidential resource with a holistic, not function-specific, purview in the company. An ombuds only mission is assisting in surfacing and resolving workplace issues. Ultimately, the only area of overlap with an ombuds is the role of change agent or catalyst.

An ombuds program's capabilities also compare favorably to those of an employee help line. While help lines do provide another communications channel and enable anonymous re-

porting, they are passive and cannot provide the critical supplemental value that an ombuds does in five areas—issue identification, issue resolution, issue prevention, skill level and experience.

In contrast, an ombudsman has an extensive, holistic organizational understanding that helps identify and surface issues, and provide guidance. The ombuds probes to determine the exact nature and extent of the issue, as the issue presented is frequently only the tip of the iceberg. Therefore, an ombuds can identify for the employee the issue resolution options that are most appropriate. Ombuds also bring issues forward that they have directly observed in the company.


To help an organization resolve issues, an ombuds coaches formal channels on resolution options, provides informal mediation or shuttle diplomacy and follows up on important cases. Ombuds have access to all data and executives in a company, and the ability and stature to escalate issues if appropriate.

Unlike help lines, the ombuds is a proactive change agent. They provide leaders and the board unfiltered information regarding issue and outcome trends and opportunities for issue prevention. Additionally, ombuds link with formal channels to deepen organizational knowledge of current and emerging risks.

Ombuds are senior executives who have broad business knowledge, management experience and specialized training from the Ombudsman Association. They also are usually trained in

such areas as mediation and change management.

Making It Happen

For any organization that decides to establish an ombuds office, the key is chartering it to be informal, independent, neutral and confidential. These traits are in keeping with the standards of practice established by both the American Bar Association and the Ombudsman Association. Once established, the ombuds program will help the company surface information that may not otherwise be available, get the issue to the appropriate resources for resolution, and identify, recommend and effect systemic changes. With the establishment of the ombuds' office, risk managers can know that they are using every governance, risk management and compliance mechanism to ensure timely, unfiltered communication and early issue resolution. 

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