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IN DEPTH: CORPORATE GOVERNANCE & BUSINESS ETHICS

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The integrity institute

People pay the highest cost for ethical failures

Lynn Brewer

When most of us think of the cost of compliance these days, we think of the costs associated with the Sarbanes-Oxley Act, which, according to AMR Research, will cost Fortune 1000 companies approximately $2.5 billion to be compliant with the law this year. Add this to the 400 percent increase in directors-and-officers insurance rates that many companies are experiencing, and suddenly we understand the high cost of low ethics.

As a former Enron Corp. executive who witnessed bank fraud, espionage, manipulation of power prices and the blatant overstatement of Enron's financial position to the media and analysts, I can't help but realize there is a higher cost of compliance.

Last week, Jamie Olis, a 38-year-old midlevel executive at Dynegy, received a 24-year sentence for his role in Project Alpha, a structured financing deal not unlike the ones I had seen at Enron. Ironically enough, it was Dynegy that turned up at the 11th hour, offering to save Enron from itself just weeks before its implosion, and yet it was a Dynegy executive who received the first of what is likely to be many stiff penalties under the new Sarbanes-Oxley laws.

As I saw Mr. Olis after his sentencing, I was struck by the picture of a man in the prime of his life, with his wife, holding their 6-month-old daughter. I'm sure I'm not the only one who found himself or herself saying, "There but for the grace of God go I." It is then I came to appreciate the high cost of compliance.

Before Mr. Olis, there was Betty Vinson, also a midlevel executive, at WorldCom Inc. Originally, when asked by her bosses to make false accounting entries, she protested, but eventually became compliant. Over the next six quarters she continued to make illegal entries, according to her testimony. In the end, she would help falsify at least $3.7 billion in profits. In the end, she, and two others, were indicted and pleaded guilty to securities fraud. She faces up to 10 years in prison.

While most of us look to hold the CEO or CFO accountable, few of us stop long enough to recognize that without loyal company employees, like Mr. Olis or Ms. Vinson, who become compliant, the massive fraud that has occurred in the past few years would not be possible. I would argue that for every senior executive who actively partakes in the corruption, there are hundreds, if not thousands, of midlevel employees, who, at the very least, become complacent with the culture that demands their compliance. In fact, surveys taken prior to Sarbanes-Oxley indicate that 75 percent of employees who witness acts of fraud simply remain silent.

If we seek to understand how deep the cone of silence was inside Enron, we need only look at the presentation made to Enron's board of directors in September 2001. The presentation shows there was a 300 percent increase in whistle-blowing reports between 2000 and 2001.

Among the 2001 incident reports received, 31 percent were reports of "alleged" criminal activity, of which 75 percent were cases of fraud. While one could certainly argue that Andrew Fastow had simply become more active in committing fraud, the truth was the lack of integrity throughout the culture had spread like cancer.

In fact, to demonstrate just how dysfunctional Enron's culture was, we need only look at the company's performance-review system. Fondly referred to internally as "Rank and Yank," the forced-ranking system was created by McKinsey & Co., and brought to Enron by Jeffrey Skilling.

Although certainly intended to separate the wheat from the chaff, the process resulted in back-stabbing and served to chip away at the foundation for a healthy corporate culture, as one employee was pitted against another. And those willing to break the rules, or worse yet, those who directly contributed to the corruption, were promoted above those who wanted desperately to maintain integrity.

Those who had entered into the organization with high moral values quickly learned that "good guys finish last."

If you were to look further into the whistle-blowing reports in the months concurrent with Enron's semiannual performance review undertaken in April and May of each year, the number of reports dropped dramatically. The reports then rose again after the completion of reviews in June and December. Employees, who feared retribution at review time, would remain silent until the completion of the review process.

I should clarify, throughout my tenure with Enron, that I blew the whistle no less than five times. At each and every turn, my concerns were dismissed, including personal conversations with Skilling and other members of senior management. Just weeks before offering my final letter of resignation, I would call Enron's "hot line," only to be told they were unable to take my call; I would have to hire a private lawyer.

Ultimately, long before the world had heard of Sherron Watkins, I was working with class-action lawyers and calling the U.S. government to blow the whistle. However, throughout my tenure I also chose to turn a blind eye, for the financial benefit of stock options, which only strengthened the ability of other executives in the company to commit fraud.

While I can't speak to the culture inside WorldCom, I know Dynegy, whose corporate offices were only two blocks from Enron, became a dumping ground for Enron employees who failed to make the cut in Enron's review process. The cancerous culture at Enron soon spread to Dynegy.

When we compare the cost of Mr. Olis' 24-year prison sentence with Andrew Fastow's 10-year prison term, we might find it odd to realize that while Andrew Fastow received a $2.4 million annual salary (along with his stock-related compensation and $50 million in "ill-gotten" gains), Mr. Olis received an annual salary of $162,000, while Ms. Vinson's was $80,000. While senior executives who may have relied on lower-level employees to carry out their plans to cut corners may have been highly compensated, they are suddenly at risk as junior executives everywhere recognize the cost of compliance is too high.

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