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Business Ethics and Compliance in the Sarbanes-Oxley Era

A survey by Deloitte and *Corporate Board Member Magazine*



Methodology

The ethics and compliance survey was jointly conducted by Deloitte and *Corporate Board Member* magazine in late July 2003. A detailed questionnaire was sent to 5,000 directors of the top 4,000 publicly traded companies. A 7.5% response rate was achieved, with 373 questionnaires returned.

Disclaimer

Although the ethics and compliance survey was conducted jointly, the comments, opinions, and interpretations contained in this document are solely those of Deloitte and do not necessarily reflect the viewpoints of *Corporate Board Member* magazine.

Corporate ethics is taking on increased prominence at U.S. companies, according to a recent survey by Deloitte and *Corporate Board Member* magazine. Eighty-three percent of companies surveyed have developed formal codes of ethics or conduct. And more than 98 percent of survey participants agree that an ethics and compliance program is an essential component of corporate governance.

These findings should come as no surprise, given the heightened attention paid to corporate ethics over the last couple of years, as well as the business imperative to strengthen ethics programs in response to Sarbanes-Oxley.

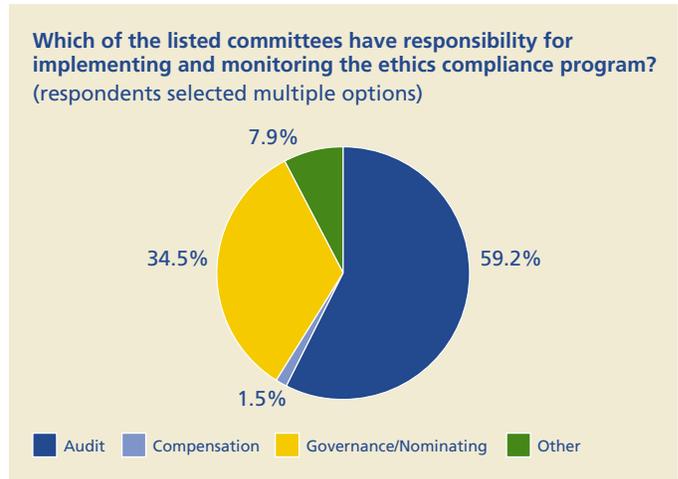
But although many companies have taken the fundamental first step of establishing a code of ethics, results are decidedly mixed concerning other activities designed to improve corporate ethics. For example, when asked if compliance with their code of ethics is tracked, only about 75 percent of companies that have a code said they actually check to make sure it is being adhered to.

Slightly lower numbers were recorded for corporate performance in educating their employees on business ethics. Only about 68 percent of companies surveyed provided training to their employees on the requirements and responsibilities contained in their code of ethics.

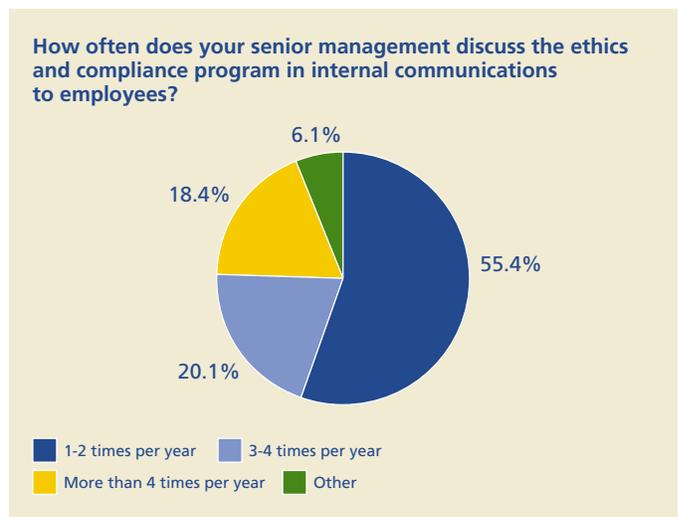
Further slippage can be seen regarding the allocation of resources to ethics activities. When asked if their company had an ethics officer (either full- or part-time), only 55 percent answered in the affirmative.

However, positive data also emerged from the survey, with progress being made on several fronts. For example, better than 95 percent of companies said their code of ethics applied to every member of their organization, including senior management and board members. And more than 90 percent of companies with global operations said their code covered both their domestic and foreign outposts.

Among the highlights of the survey are the following questions and responses, along with our comments on the results.

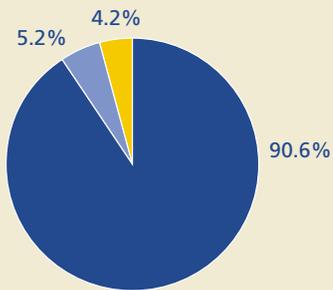


Under Sarbanes-Oxley, the audit committee is the best choice for implementation and monitoring responsibility, a fact reflected in these results. One caveat: The demands on the audit committee have been substantially increased since the enactment of Sarbanes-Oxley, so members must be vigilant that ethics gets proper attention.

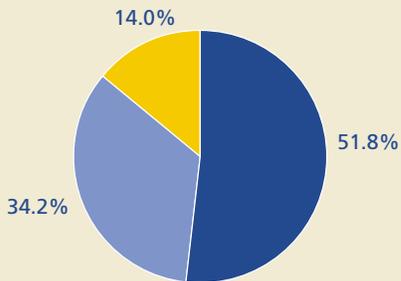


More than half of the companies surveyed limited their employee communications regarding ethics to fewer than three times per year. In this era, we view that response as inadequate. Communication is a critical success factor. Companies need to turn up the volume on ethics communications.

Does the code of ethics and/or conduct include a statement regarding obligations to employees, shareholders, suppliers, customers, and the community at large?



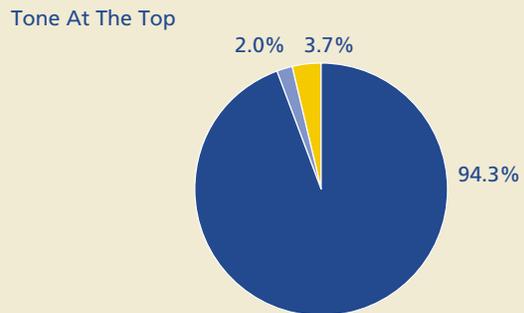
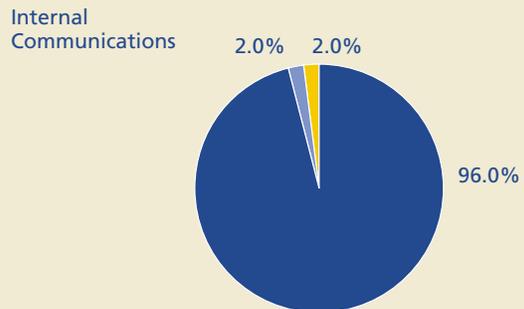
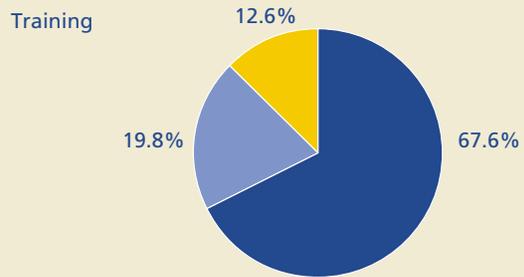
If "Yes," is the code of ethics and/or conduct distributed to all parties listed?



■ Yes ■ No ■ Not Sure

We see a bit of a disconnect in the responses to this question. Although over 90 percent of the companies include shareholders, suppliers, customers, and others in their codes, only 52 percent of respondents actually distribute the code to these parties. While it is true that codes of ethics and conduct can be weighty documents, distribution doesn't have to be expensive. An electronic version of the code can be posted on the corporate Web site, and concerned parties can be notified of its availability through notices printed on invoices, brochures, contracts, and elsewhere.

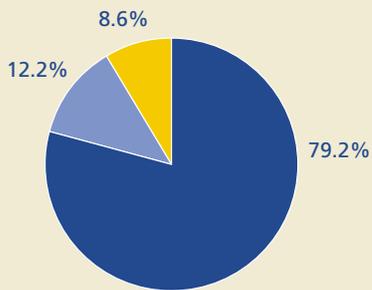
Has your company supported the ethics and compliance program through:



■ Yes ■ No ■ Not Sure

While training is essential, it doesn't have to be expensive or even extensive. Once the initial indoctrination (which admittedly should be more labor intensive) is complete, Web-based training on an annual basis is sufficient for reinforcement. Ethics training can be worked into everyday tasks. Every opportunity to meet is an opportunity to train. Even standard business materials can be utilized for the task. For example, a whistleblower helpline number and a summary of core values can be printed on employee ID cards.

Is there a reporting mechanism (helpline, hotline) in place to let all employees raise ethics and compliance issues?



■ Yes ■ No ■ Not Sure

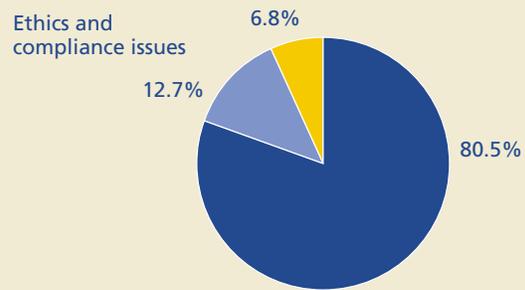
If "Yes," which of the following describes the company's ethics and compliance reporting mechanism (helpline, hotline)?

| | |
|--|-------|
| The company's reporting mechanism is managed by an outside third party | 33.1% |
| The company's reporting mechanism receives calls from 1% or more of the employee population | 5.9% |
| The company's reporting mechanism provides reports to the board at least quarterly | 40.6% |
| The reporting mechanism allows for anonymous, confidential reporting and follow-up on issues raised | 90.0% |
| The reporting mechanism is available to non-employees (i.e., vendors, contractors, shareholders, general public) | 19.2% |

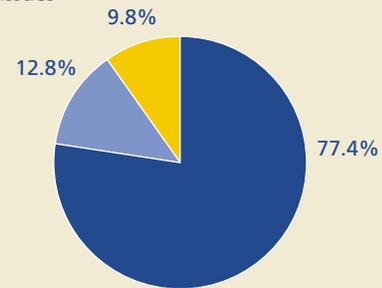
If whistleblower helplines are not managed by a third party, companies may have an issue with the anonymity requirements of Sarbanes-Oxley. These requirements are based on the premise that true anonymity of reporting can only be attained if the calls are fielded by someone outside the organization. We expect that in-house managed helplines may become a thing of the past.

The relatively low percentage of respondents who received calls at a level greater than one percent of the population may mean that the existing helplines may not be effectively marketed or utilized. Worse case, it may indicate an unwillingness of the employees to utilize the program.

Is there a defined process to keep the board informed on:



Actions taken to address such issues



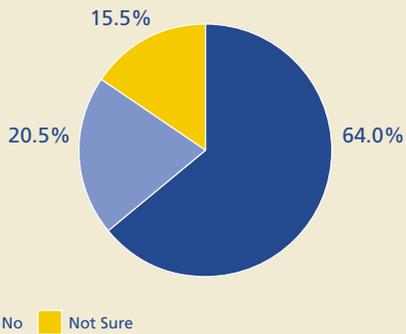
■ Yes ■ No ■ Not Sure

How often does the board review ethics and compliance failures?

| | |
|---|-------|
| 1-2 times per year | 22.7% |
| 3-4 times per year | 16.3% |
| More than 4 times per year | 6.7% |
| When failure is brought to the attention of the board | 52.3% |
| Other | 2.0% |

Ethics and compliance should be a regular agenda item at all meetings of the audit committee or the board of directors (whichever has oversight responsibility for ethics compliance). The board should review helpline calls and other ethics issues at every meeting, and should document this review in the meeting minutes.

Has the ethics and compliance program been reviewed by outside consultants/experts for possible improvement?

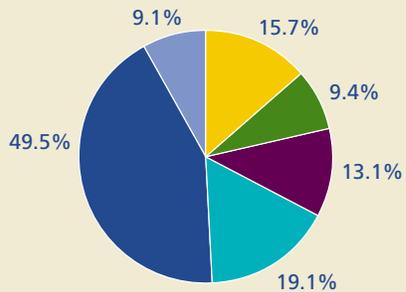


Companies should consider using outside resources for an objective perspective and a fresh eye. The review can be as extensive or as limited as time, budget, and preferences dictate. At a minimum, we recommend a review of the code of ethics and how it is disseminated. Consultants may have ideas for including new risk areas or may make suggestions to improve code readability. (Ideally, a code of ethics or conduct should be written at a 5th grade level.)

We believe this survey provides a realistic snapshot of the state of ethics compliance at U.S. public companies. Interestingly, it does not vary drastically from a survey Deloitte conducted three years ago. Many trends are positive. Awareness of the critical need for corporate ethics is high. Activities to bring about improvement are many. Sarbanes-Oxley, combined with investor pressure, has clearly been an effective catalyst.

Where we do see a discrepancy is between words and action: acknowledgement of the need for an ethics program is almost universal, yet tangible evidence of program implementation and accountability lags behind. However, we attribute much of this gap to the multiple obligations and tight timetables imposed by Sarbanes-Oxley. We believe that as deadlines pass and new internal control and corporate governance measures become integrated into the everyday activities of companies, ethics and compliance programs will assume their rightful prominence. Investors and regulators will accept nothing less.

Do you have plans to:



- Develop a code of ethics and/or conduct
- Appoint an ethics and compliance officer
- Implement a compliance program
- Conduct ethics and compliance training
- All of the above have been accomplished
- The company has no plans at this time to address any of the above

We contend that all of the activities listed in the question are essential for an effective ethics program. The nine percent of companies that don't have any plans to implement programs may not be acting in the best interests of their companies. Ethics problems that are unaddressed will likely fester; negative consequences may be exacerbated if issues are not dealt with in a timely and vigorous manner.

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