



WHY REPORTING HOTLINES ARE A BEST PRACTICE



Abstract

The impact of fraud in the workplace can be devastating. According to the recent **Report to the Nations on Occupational Fraud and Abuse**, a worldwide study comprising an analysis of more than 2,400 case of fraud in more than 114 nations around the world conducted by the Association of Certified Fraud Examiners (ACFE), the median fraud loss for United States and international organizations was \$150,000. Approximately 23 percent of the losses totaled at least \$1 million.

While total global fraud losses are estimated to be in the trillions of dollars each year, fraud isn't the only ethical issue posing a threat to organizations around the world. Ethics violations can and do occur in virtually every area of an organization. According to the first-ever Global Business Ethics Survey (GBES) generated by the Ethics Resource Center, 36 percent of workers in multinational companies indicated they witnessed some form of workplace misconduct in the previous 12 months. The survey indicates that lying to customers, vendors and the public and various forms of abusive behavior are the most commonly witnessed forms of misconduct in organizations in virtually every nation.

The GBES also points to change (merger, acquisition, management restructuring, etc.) as a significant factor regarding the rate of misconduct. In organizations where no major changes occurred, only 17 percent of survey respondents indicated they witnessed misconduct. By comparison, the rate in organizations that underwent 1-3 or 4-7 substantive changes was 40 percent and 59 percent, respectively.

How are organizations detecting occurrences of misconduct? Using fraud as an example, the survey indicates that, by far, the most common way organizations detect fraud is through anonymous tips received via ethics hotlines. According to the survey, 43.5 percent of frauds in U.S. organizations with 100 or more employees were discovered through tips, while only 18.6 percent were uncovered by internal audit and 12.7 percent by management review.

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43.5% of frauds were discovered through tips

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12.7% of frauds were found by management review



Industries

Anonymous hotline reporters work in a range of industries, including healthcare, not-for-profit, financial services, technology, manufacturing, professional services, education, biotechnology, retail, energy, entertainment, transportation, construction, government, real estate, insurance, manufacturing, hospitality and agriculture.

Resistance to Speaking Up

These figures clearly indicate organizations that fail to make available an internal anonymous reporting hotline are at greater risk of not detecting unethical behavior until it is too late. Additionally, a reporting hotline allows employees to report a host of other inappropriate activities they may witness or personally experience, such as discrimination, harassment, conflicts of interest and time theft, to name but a few.

The AFCE study points out that for organizations utilizing ethics hotlines, 47.3 percent of ethics violations are discovered through tips, compared to only 28.2 percent for organizations without hotlines. And regardless of whether the organization is the government, a private or public company or non-for-profit entity, tips are still by far the most common method of discovering ethical misconduct.



Common Methods of Fraud Detection

- Ethics Hotline
- Management Review
- Internal Audit
- Other

Interestingly, tips concerning ethics violations do not always come from employees. While the AFCE study indicates that 51.5 percent of tips are generated by employees, an organization’s customers, shareholders, competitors and vendors account for nearly 31.9 percent, while 14.0 percent are categorized as anonymous.

Organizations that do not implement reporting hotlines also incur much higher median losses than those which make use of them. Previous AFCE study results indicate that the median loss for organizations without hotlines was \$200,000, compared to only \$100,000 for those providing access to hotlines.

Organizations that seek top performance levels in all areas, including ethical behavior, need to follow what are commonly referred to as “best practices” to ensure that they are on the correct path to achieving their objectives. This paper sets the stage as to why an effective reporting hotline is considered to be a best practice for an organization.



To understand why a reporting hotline should be considered a best practice, it is necessary to gain an understanding of the term. Fletcher Challenge Energy Limited, an international entity that transforms natural resources into petroleum products, succinctly identifies best practices as “management practices and work processes that lead to world-class, superior performance.”

When this meaning is applied to ethics in the workplace, best practices could then be defined as management practices and work processes that lead to a high level of integrity and moral conduct on the part of an organization and its employees.

The Call for Stronger Ethical Standards

Attention to ethics in the workplace and the demand for ethics and compliance regulations gained momentum as a result of several highly publicized corporate accounting scandals that occurred in the early 2000s, most notably those involving Enron, Tyco and WorldCom.

In the wake of these financial debacles, public outcry demanded that the federal government step in and take strong, swift action to prevent these corporate improprieties from occurring again. This led to the enactment of Sarbanes-Oxley (SOX), federal legislation that set forth a host of new standards for corporate accountability regarding financial practices of publicly held companies, as well as penalties for non-compliance.

Another important piece of ethics-related legislation is the Dodd-Frank Wall Street Reform and Consumer Protection Act. Passed by Congress in 2010 in response to the financial misconduct that played a contributing role in the economic recession of 2007-2009, Dodd-Frank includes a number of components intended to encourage employees to report wrongdoing and protect reporters against retaliation.

Other examples of significant legislation that impacts ethical conduct in the workplace include:

- Securities Act (1933) and Securities and Exchange Act (1934): These laws were instituted following the 1929 stock market crash and stipulate various disclosures regarding securities trading.
- Foreign Corrupt Practices Act (FCPA, 1977): Includes anti-bribery provisions pertaining to the making of unlawful payments to foreign government officials.
- Health Insurance Portability and Accountability Act (HIPAA, 1996): Originally designed to enable workers to maintain their health insurance coverage for a period of time when leaving or losing a job, HIPAA also contains a provision (Title II) that requires healthcare organizations to comply with stringent standards for securing electronic access to private health information (PHI) and other privacy regulations.

Major Ethics-Related Legislation

Securities Act of 1933

Securities Exchange Act of 1934

Foreign Corrupt Practices Act of 1977

Health Insurance Portability and Accountability Act of 1996

Sarbanes-Oxley Act of 2002

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010



Specific Ethical Concerns

While fraud understandably receives much of the focus in terms of ethical breaches, there are a number of other ethical issues that are of concern to organizations these days. Examples include:

- Financial irregularities: Inadequate accounting controls, audit issues, billing errors or violations
- Bribery: In today's global business climate where many organizations engage in business in foreign countries, there is a heightened concern about bribery and other potential FCPA violations.
- Privacy and security issues: The use of electronic recordkeeping systems creates concerns about identity theft and other data breaches that violate customer confidentiality and expose their personal information. Healthcare providers in particular face the risk of staff members inadvertently releasing PHI, which jeopardizes HIPAA compliance.
- Workplace safety: Employers that do not do everything possible to create a safe workplace environment could place their employees in harm's way and also be found in violation of Occupational Safety and Health Administration (OSHA) laws.
- Ethics and compliance: Ethics and compliance issues include code of conduct violations, conflicts of interest and criminal misconduct such as theft, vandalism and sabotage, as well as potential violations of SOX or Dodd-Frank.
- Human resources issues: HR professionals must address a litany of ethics-related issues on a daily basis such as:
 - » *Drug and alcohol abuse*
 - » *Misconduct*
 - » *Insubordination*
 - » *Discrimination*
 - » *Harassment*
 - » *Aggressive behavior*
 - » *Hostile work environments*
 - » *Abuse of authority*
 - » *Retaliation*
 - » *Time theft and attendance policy violations*

In an effort to combat unethical practices and detect them in the early stages, many organizations now encourage the reporting of inappropriate behavior as soon as it occurs. An effective and reliable reporting method used by organizations of all types is an anonymous reporting hotline.



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Compliance

Sarbanes-Oxley requires public companies to appoint independent audit committees to oversee the procedures for receiving and handling confidential whistleblower reports. Specifically, SOX Section 301 requires the implementation of procedures for: (A) The receipt, retention, and treatment of reports received by the issuer regarding accounting, internal accounting controls, or auditing matters and (B) The confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.

A reporting hotline helps companies meet these criteria by providing a mechanism for an employee to report these issues in an anonymous and confidential manner.

Access to Privacy

Employees who witness or experience unethical practices can understandably be reluctant to engage in whistleblowing while at work, regardless of the promise of the confidentiality of the reporting mechanism. The possibility exists that a phone call might be overheard, a sensitive email might be intercepted or the employee is seen entering or exiting the office of a human resources representative or ethics and compliance officer.

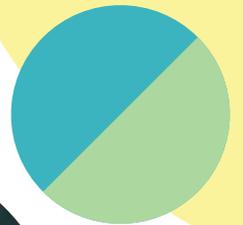
A reporting hotline can eliminate these concerns by providing the employee the opportunity to submit a report outside of the workplace. The employee will have access to the reporting hotline 24 hours a day, seven days a week, meaning a report can easily be filed outside of normal working hours. In addition to a toll-free hotline, the employee can submit a report via alternative methods like fax, email, or internet.

Confidentiality and Anonymity

By having access to a reporting hotline staffed by an impartial third-party provider, employees are assured of reporting irregularities in complete confidence without the need to reveal their identity unless they choose to do so. This is particularly important when reporting sensitive issues that may subject the reporter to discrimination or harassment. The ability to remain anonymous can also reduce the likelihood of retaliation against the reporter.

Trained Specialists

Human resources workers may be well-versed in many areas of employer-employee relations. However, they may not possess the specialized knowledge to deal with ethical issues. A third party entity that deals specifically with ethics in the workplace provides employees with access to individuals who are specially trained in dealing with caller concerns, stress, and frustration. In addition, these trained specialists are typically required to pass background checks and agree to non-disclosure employment provisions. This provides the employee with the confidence that the person who is receiving the report is also of high moral and ethical character.





Proactive Approach

If unethical practices are not discovered and dealt with in the early stages, they can continue to be perpetrated over the course of several years. This is due in part to the fact that no effective mechanism is in place for employees to report their suspicions in confidence. One example of how hotlines can provide employers with a proactive approach to controlling unethical behavior is by reviewing their impact on the dollar amount of loss and the duration of misconduct. According to the AFCE survey, organizations that detected fraud via hotline tips experienced a median loss of \$147,000 and a median duration of 17 months. In contrast, when fraud is detected by external audit, the median loss is \$470,000 and the median duration is 24 months. Also, according to Fulcrum Inquiry, employees are often the first to know of wrongdoing before upper management becomes aware of it. If employees have an anonymous means of reporting irregularities, management can find out about them sooner and take corrective action before the situation can escalate.

Ensuring Transparency

A significant feature that contributes to financial fraud is the lack of transparency in accounting practices. The use of a reporting hotline can lead to greater transparency and limit the temptation to engage in the practices of “creative financing” or attempting to hide accounting irregularities. The existence of a hotline can also promote more transparent business practices in general, which can help to reduce occurrences of inappropriate acts such as bribery by overseas workers.

Incident Type Screening

Not all ethical issues are the same, and depending on the nature of the organization, it may have more than one means of handling them. Some organizations may determine that certain issues should be handled by human resources while others may require legal attention. The trained representatives offered by a third-party reporting hotline can serve in an effective screening capacity by ensuring that the report is routed to the proper company representative, as well as to the ethics and compliance officer for final disposition if applicable.

Expediency

Expediency of report handling is another example of how a reporting hotline constitutes best practices. Reporters need to feel that their reports are being handled and addressed in a timely manner as opposed to being stored in a desk drawer. A reputable third-party reporting hotline will process the information and prepare a report expeditiously, typically within minutes of receipt. The completed report is then promptly forwarded to the designated representative within the organization.

Case Management

Larger organizations may receive a high volume of reports, which can complicate the process of tracking and analyzing hotline reports. As part of its service, an effective third party reporting hotline includes a Case Management System (CMS) that allows the program administrator to track the report from receipt through resolution. Additionally, a CMS allows the administrator to assign incidents for investigation, document investigative actions, engage in anonymous dialog with the reporter, create reports and charts and establish an audit trail for added internal control.

Whistleblower Protection

Per SOX Section 806, whistleblowers are provided with protection against retribution from management or other employees. The act states that a whistleblower who “alleges discharge or other discrimination by any person” is entitled to file a report with the Secretary of Labor. In addition to the legal protection offered by SOX, whistleblowers who may still be uncomfortable reporting ethical improprieties can find additional protection from the confidentiality afforded by the hotline.

Saving Face

Previous financial scandals have demonstrated that not only can unethical practices lead to an organization’s financial devastation; they also serve to damage its reputation. A data breach caused by employee misconduct or negligence can destroy a company’s good name and standing. Early detection of unethical practices through hotline reporting allows the organization to take corrective measures before information can become public.

Cost Savings

An ethics hotline is one of the easiest and most cost effective internal control systems a corporation can implement. By outsourcing to a competent third-party ethics hotline provider, an organization reduces the need to hire its own staff. It can also realize the savings that result from eliminating unethical practices.



Keys to Effective Hotline Implementation

As top management sets the ethical tone for the organization, it plays a crucial role in ensuring effective hotline implementation. Education is essential for a successful implementation; management personnel needs to emphasize its commitment to an open door policy that encourages the reporting of wrongdoing, while also providing assurances that reporters remain anonymous and receive protection against retaliation.

Management should make use of mass communication methods such as company-wide meetings, signage or e-mail distributions to introduce the hotline and to stress its importance to every employee and the organization as a whole.

In addition, management should ensure the hotline plays a primary role in an organization's ethics programs. Information concerning hotline use should be incorporated into ethics training for existing employees as well as the new-hire orientation process. Displaying posters in high-visibility locations throughout the facility and providing employees with wallet cards containing hotline contact information will serve as constant reminders of its availability and help to reinforce the organization's ongoing commitment to creating an ethical culture.

Future Implementation

There are potential future implications for organizations that do not take a proactive approach by implementing safeguards such as a reporting hotline.

The GBES identifies several areas of concern regarding ethics and compliance as the business landscape continues to become more global in scope. For one, as more organizations continue to make the transition to a multinational operation, it introduces an element of change that can create a work environment that is more conducive to misconduct. Organizations that engage in mergers, acquisition, or management restructuring, or that implement significant cost-cutting measures to remain competitive are highly susceptible to unethical behavior.

In addition, fear of retaliation remains an obstacle to the reporting of misconduct. While organizations must continue to provide employees with opportunities to raise concerns, they must also make a stronger effort to protect those who come forward. The GBES points out that 59 percent of those who choose not to report misconduct do so because they fear retaliation from management or coworkers.

Recommended methods for reducing the risk of retaliation – and thereby encouraging reporting via third-party hotlines – include training leaders on how to listen and respond to employees who voice concerns. Employers should also provide protective monitoring of reporters, especially during the first three weeks after making a report, which is when the risk of retaliation is at its highest.

Yet another factor that continues to negatively impact the effectiveness of reporting hotlines is the tendency of managers to engage in unethical behavior, especially at the middle and top levels. Specific managerial behaviors identified by the GBES include abusive or intimidating behavior toward employees, accepting bribes and kickbacks, actions that constitute a conflict of interest, anti-competitive behavior and hiding compliance violations from inspectors and auditors.

Organizational leadership is responsible for setting the tone at the top – a reporting hotline can only be considered a best practice if managers behave ethically and work to create an organizational culture built on integrity and trust.



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Conclusion

A reporting hotline is considered a best practice for any organization that wants to improve the ethics of its culture. A reporting hotline provides company employees with a means to report inappropriate actions anonymously and confidentially, which can greatly reduce the fear of retribution that can result from whistleblowing. The AFCE calls fraud reporting methods such as hotlines a “critical component” to any fraud prevention system.

Reporting hotlines give employees access to an impartial third-party provider whose representatives are trained to handle reports expediently, thoroughly and with sensitivity. Through the use of a Case Management System, employers have the ability to effectively manage hotline reports and enhance internal controls.

Organizations that are currently satisfied with their level of ethical behavior may be experiencing a false sense of security. As the trend continues toward globalization and constant change becomes the norm, it can open the door for unethical practices to commence unless a proactive approach is taken.

In summary, organizations that are truly committed to best practices, or management practices and work processes that lead to world-class, superior performance, must not underestimate the importance of ethics in the workplace. Implementing a third-party reporting hotline is one way a company can demonstrate its commitment to ethical behavior.





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