

The Vital Role of Good Governance and Integrity Reporting in the Fight Against Financial and Economic Crime

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Aims of the presentation



- ✦ Very brief background: The Agency and Good Governance and Integrity Reporting Act
- ✦ Conditions for financial crime
- ✦ Combatting financial crime: Two key components of Good Governance
- ✦ Motivation, psychological profiles of fraudsters and the relevance of Good Governance
- ✦ Examples of the ethically challenged

Context - Economic Crime



- ✦ 2015 Transparency International Estimate
- ✦ 75 million people in Sub-Saharan Africa paid bribes to police or courts to obtain desperately needed basic services
- ✦ OECD 2014: corruption costs exceed 5% of Global GDP US\$ 2.6 trillion
- ✦ Over US\$ 1 trillion in bribes paid per year (World Bank)

Financial Crime Fundamentals



- Assets of value
- Motivation - Perceived need and rationalization
- Opportunity - Access and skill

Types of Fraud



- Depends on differential of opportunity
- The higher up the tree you are - the dumber you are
- No motivation = no fraud
- But circumstances and motivations can change over time
- Some people's "factory setting" is to commit crimes (more later)

Fraud: Two Key Contributory Factors



- Poor ethical stance
- Procedures, standards, policies lacking or not enforced

Good Governance: Attitudes



Good Governance



- ✿ Not restrictive but liberating
- ✿ Sound framework: structure, order, confidence, adaptability, risks identified and managed, clearly defined responsibilities
- ✿ Best brakes are in fast cars: more control, more speed

Definition



Ethics:

- ✿ The philosophical study of the moral value of human conduct and the rules and principles that ought to govern it

Moral:

- ✿ Concerned with human behaviour, especially the distinction between good and bad or right and wrong behaviour

Problems



- National and cultural backgrounds
- Anglo American culture (US 48% of employees admit acting illegally or unethically in the past year (Ferrell et al))
- US/UK promote your own interests above others'
- Sweden: employees value welfare of the group over the individual (Kirkman and Shapiro)

Business Ethics



- Business malpractices have the potential to inflict enormous harm on individuals, on communities and on the environment (Crane and Matten)
- If business is to stamp out corporate scandal, business schools need to include ethics as part of the core curriculum (Baroness Howe)

Business Ethics



Applies ethical values to all business behaviour:

- Boardroom strategies
- Suppliers, customers, accounting
- Environmental issues, supply chain (sweat shops)
- Exceeds legal requirements: discretionary!
- Applies to conduct of individuals and to the organisation as a whole

Lack of Business Ethics



- Breeds: internal fraud, destroys morale, livelihoods, pensions and the organisation
- Media scrutiny (reputation, share prices)
- Legislation, knock on effects (Enron, WorldCom)
- Problems: socially responsible investment
- Does not meet changing consumer and employee expectations
- Bad for business - unethical companies do not survive long-term

Advantages of Business Ethics



- "Ethically motivated" customers
- Reassures investors and other stakeholders:
Approach to non-financial risks
- Good for socially responsible investment
- Accommodates changing consumer and employee expectations

Ethics: Problems



- National Interests, Foreign Policy, Huge Sums
- Quality of employees
- Nature of bureaucracies
 - Group behaviour, loyalty, culture
 - Systems of rewards

US Business Students



Typically Low Moral Development

🌀 Kenneth Lay ("Kenny Boy") late Enron chief - student ethical dilemma

"If your products were proven to kill people would you still sell them?"

Answer: "YES"

"My job is to sell products and increase profits, It's the regulator's job to protect people"

Explains everything (where is ENRON?)

Enron US Energy Company: Exploitation



- 🌀 Hid US\$ billions of debt - from failed deals and projects
- 🌀 Share price US\$91 mid-2000; November 2000< US\$1 SEC investigated
- 🌀 Arthur Andersen (World top 5 audit firm) destroyed documents. Went out of business
- 🌀 December 2001 Enron bankrupt US\$63.4 billion assets largest corporate bankruptcy in U.S. history (Overtaken by WorldCom in 2002)
- 🌀 Led to Sarbanes-Oxley Act

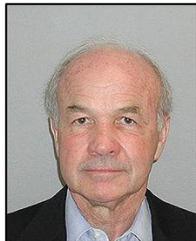
Kenneth Lay: Exploitation



Died in 2006 before Sentencing

Ranked as the third-worst American CEO ever.

His actions catalyzed fundamental corporate reform in regard to "Standards of Leadership, Governance and Accountability"



WorldCom: Exploitation



- Booked expenses as capital expenditures
- Inflated revenues with bogus accounting entries
- In 2002, internal auditors worked secretly, often at night, to investigate and reveal US\$3.8 billion fraud
- Company's total assets inflated by about US\$11 billion
- Bernie Ebbers ex CEO convicted 2005 sentenced to 25 years in jail

Bernie Ebbers: Exploitation



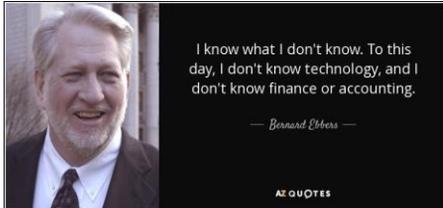
Before & After



Bernie Ebbers: Exploitation



Now 77 must serve another 11 years



Tyco CEO: Dennis Kozlowski : Victim?



Tyco CEO: Dennis Kozlowski



- ☛ Served 100 months in jail
- ☛ Principal charge: Stole US\$ 80 million unauthorised "bonus"
- ☛ Lavish life style: MUR 70 million party, MUR 210,000 shower curtain
- ☛ Bad timing: Just after Enron and World Com
- ☛ Prosecutors: Wanted convictions not justice (withheld evidence)

Tyco CEO: Dennis Kozlowski



- ☛ Bonus correctly calculated and reported to auditors
- ☛ "Not authorised" by Compensation Board: Minutes written before meetings by someone who did not attend meetings
- ☛ No Board or Audit Committee Board Minutes or Minutes incomplete
- ☛ Board Members: "Could not remember" Or "Did not approve"
- ☛ But Tyco liable to pay Kozlowski US\$ 500 million if no conviction
- ☛ Kozlowski victim of poor governance, weak board, zealous prosecution, bad timing

Organisations



Modern corporations:

- Subjugate individual morality (what is "right" is what your boss wants)
- Distance individuals from the consequences of their actions (head office in one country closes factories in another)
- Dehumanise constituents affected by decisions (corporate "speak")

Corporate "Speak"



Language loses moral content

- "Downsizing" "Rationalising" (closing factories & sacking people)
- "Letting You Go" (we're sacking YOU)
- "Cost Minimisation" (cutting salaries, wages and benefits, closing the canteen)

Moral Language



Moral language triggers moral thinking:

- "integrity" "honesty" "fairness" "stealing" "lying"
- **"We do not employ liars"**

Managers avoid moral language:

- Avoids conflict (threat to harmony)
- Personal confrontations
- Leads to "moral amnesia"

Simple Ethical Tests



Fairness:

- Would those affected by my decision believe it to be fair?
- New York Times test: Would others agree with your view?

Key Areas of Ethics Code



One Size Does Not Fit ALL

- Purpose and values of business
- Employee relations
- Customers, suppliers, shareholders and other stakeholders
- Society, wider community, environment
- Implementation

Implementing Code



- Endorsement: Chairman, CEO
- Integration: Integrate in running of business
- Circulation: To all employees
- Personal Response: How to react to breaches
- Affirmation: Understand and apply code
- Employment Terms: Adherence, disciplinary, appraisals, annual declarations for key positions

Implementing Code: How to fail



- Fail to follow up breaches
- Fail to set a good example
- Don't publicise the code
- Make it difficult for staff to access the code or to discuss or report issues

Anomie: Key Fraud Motivation



- French sociologist Emile Durkheim: Study of Suicide
- Anomic Suicide: Breakdown of social standards for regulating behaviour
- Result: futility, lack of purpose, emotional emptiness, despair

Anomie: Fraud Application



- No standards, or sense of obligation, rejects social bonds
- Cannot acquire wealth / status legitimately;
- Uses illegitimate means (US sociologist Robert K. Merton)
- Balance: personal advantage vs fear of punishment

Anomie: Psychological Usage



Make people desire what they have no means of getting their hands on, and the result is what Durkheim calls anomie, a condition of normlessness

(Dave's Part 2008 Blog)

US Traitors



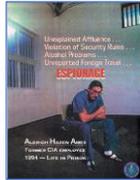
Robert Philip Hanssen FBI



- Archetypal Quiet Neighbour
- Betrayal 20 years extraordinarily damaging
- At least 2 executions, 6000 documents etc.
- A nice profile fit

Aldrich Ames CIA

- Betrayed 25 agents during 9 year career
- 10 deaths 100 operations compromised
- Perfect profile fit



Aldrich Ames



- Had every defect, perfectly presented
- Alcohol abuse / complete lack of self control
- Grandiosity
- Impulsiveness, arrogance
- Self centered and ruthless



Aldrich Ames



- ☛ Money indicated success, self-esteem undermined by lack of career success and inability to support his new wife
- ☛ Ames gained satisfaction from outsmarting superiors who had failed to recognize his abilities
- ☛ He was bitter about being passed over repeatedly for promotions, especially since he thought he was smarter than his peers

Aldrich Ames - Had some Self-Knowledge



- ☛ "The barriers to stop me from betraying my country were gone". The CIA was morally corrupt (**Rationalisation**)
- ☛ These actions do not excuse mine, but they helped make and grease the slope
- ☛ But the sad truth is that I did what I did because of the money and I can't get away from that

Hanssen and Ames



- ☛ **Infractions Ignored / Not properly Investigated**
- ☛ **Failure of corporate governance**

Conclusion



- Good Governance will drastically reduce motivations for financial crime and can help lead to its early discovery
- However, some people are beyond the pale
- Therefore codes must be rigorously & universally applied

Thank You



Any Questions?