

# COMPLIANCE WEEK

A Weekly Newsletter On Corporate Governance, Risk And Compliance

## Proper Nurturing Of Whistleblower Hotlines

By Melissa Klein Aguilar — October 31, 2006

**W**histleblower hotlines may be one of the more demanding details of compliance with the Sarbanes-Oxley Act, but it turns out that the proper care and nurture of such hotlines does deliver a nifty boost to corporate-governance efforts.

Research by the Association of Certified Fraud Examiners shows that companies have much to gain—or more precisely, less to lose—by having such mechanisms in place. The ACFE's 2006 "Report to the Nation" found that organizations with a hotline typically cut their fraud losses in half: Organizations without a hotline lost an average of \$200,000 while those with a hotline lost \$100,000.

Ronald Berenbeim, a researcher at The Conference Board, says companies go through three stages in the design, implementation, and monitoring of whistleblowing systems. First comes a small flood of complaints, partially as a result of pent-up demand but also because many workers don't understand that hotlines are not for all manner of complaints. In the second stage, more of the complaints are focused on appropriate subject matter and a larger number of callers are seeking advice before some malfeasance happens.

Finally, Berenbeim says companies may get fewer complaints because employees don't need help finding the right person to contact for advice. "Over time we see a divergence; requests for advice goes up and complaints go down," he says. "People realize this is not an opportunity to complain about what a terrible person their boss is—unless their boss has been bribing the prime minister of Indonesia."

Still, experts note that what companies get out of their whistleblower hotlines depends a great deal on what they put into them. Those who spoke with Compliance Week say many companies don't see a large number of frivolous reports.

Robert Biskup, assistant general counsel and compliance director at Ford Motor Co., says Ford is in that majority. He credits a concerted effort to explain the hotline's purpose to employees and discourage them from abusing it.

"I suspect Mr. Berenbeim's observations are absolutely true for many companies," Biskup says. However, he says, "we've tried to make it clear that the primary purpose of the hotlines is to report possible wrongdoing in the organization, and not to displace, for example, the local HR, security, and legal functions ... It really boils down to taking a thoughtful, considered approach to the kinds of system inputs you want, versus those you don't want, and your communication strategy."

Tony Malone, CEO of The Network, which manages hotlines for 2,500 corporate customers, agrees. "We don't see a lot of frivolous activity," he says.

He cites a forthcoming benchmarking study that his firm conducted with the Association of Certified Fraud Examiners based on four years of data. The study, which looks at more than 200,000 reports filed at 500 companies, shows that 83 percent of all reported incidents warranted some type of investigation. It also found that one-third of incidents reported via hotline already had been reported to management.

Malone and others says companies typically don't see a "big onslaught of reports" when a reporting hotline is activated; rather, the companies usually see increased activity when they send out alerts to employees that the hotline is available.

“Most companies don’t get a large number of complaints.” says David Childers, chief executive of EthicsPoint, which makes compliance software. “A hotline should be just one way organization reaches out to stakeholders. It’s a back stop for most of our clients.”

### **Most Complaints Are Middle Of The Road**

Childers cites an Ethics Resource Center study which found that 12 to 15 percent of reports companies get are frivolous and unfounded, while 15 to 18 percent are truly actionable. “Everything else falls in the middle,” he says.

A company’s view of the hotline and how it implements the hotline can have a large effect on the volume and type of reports it receives, notes Rick Wolf, former head of global compliance at Cendant Corp. and founder of consulting firm Lexakos.

“The reaction inside an organization is often that people will use these systems to tattle-tale on their neighbor or for other frivolous activities, rather than the reason they’re required,” Wolf says. For that reason, many companies—and human-resource organizations in particular— “are leery of putting in these systems and may be overly prescriptive,” he says.

For example, Wolf says, companies might instruct employees to use the hotline only to report a financial reporting problem, “but people don’t report financial fraud. They report other things that are symptomatic of larger problems, which may include financial reporting.”

“It’s short-sighted from a management perspective,” he continues. “They never get to see the 20,000 foot view of what’s going on and they’re not in a position for the early detection of fraud.”

On the other hand, he says a “tell us” approach where employees feel free to call the hotline when they detect any type of problem can generate trust in the organization. “A program that has a wide open hotline is one that would be in position to detect a problem.”

Still, Childers says companies are likely to see a drop off in reports over time, because the longer a hotline is in place, the more a company should see fewer—but more actionable—reports.

### **Examining Trends May Be Key**

Childers recommends aggregating report data and examining overall trends, such as a potential breakdown of internal controls, or geographical or managerial hotspots. Then they can refine the questions they ask when anonymous reports are made.

For instance, companies initially only may identify reports under the broad category of “fraud,” but after a year, they can study the reports to identify the specific types of fraud reports they get. “Companies that are in-tune with this information will re-work their hotline so they have three or four specific questions to ask callers related to the types of fraud they’re seeing,” says Childers.

Dennis Muse, chief executive officer of Global Compliance, which provides hotline services, says companies “need to tie it into what they’re doing from the standpoint of their overall compliance and ethics programs ... those that launch a hotline because it sounds like a great idea, but don’t put any structure around it from standpoint of their Code and what they put in place to do tend to get the sort of things they didn’t intend.”

Like Childers, Muse says companies are likely to see their report volume increase when they conduct and awareness campaign.

“If they don’t refresh and support their program, the volume of reports trends to trail off again,” he says. For that reason, Muse says, frequency of messaging is key, and not just communicating to employees that the company has a hotline. “Companies need to communicate and reinforce their core values and expected behaviors on regular basis,” says Muse.

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**Report** (sidebar)

*An excerpt from the ACFE's 2006 report on occupational fraud and abuse follows.*

This Report includes organizations representing a wide range of industries. The industries with the highest median losses per scheme were wholesale trade (\$1 million), construction (\$500,000) and manufacturing (\$413,000). Government organizations (\$82,000) and retail organizations (\$80,000) were among those with the lowest median losses.

\* The size of the loss caused by occupational fraud is strongly related to the position of the perpetrator. Frauds committed by owners or executives caused a median loss of \$1 million. This is nearly five times more than the median loss caused by managers, and almost 13 times as large as the median loss caused by employees.

\* Most of the occupational fraud schemes in our study involved either the accounting department or upper management. Just over 30% of the occupational frauds were committed by employees in the accounting department, and slightly more than 20% were committed by upper management or executive-level employees. The next-most-commonly cited department was sales, which accounted for 14% of the cases in our study.

Source: 2006 ACFE Report To The Nation On Occupational Fraud & Abuse

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ACFE's 2006 Report To The Nation

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Non-Profit To Develop Whistleblower Hotline Standards (July 19, 2005)

**Related Column:**

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