

Learning to love whistleblowers

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By Darren Dahl

Some businesses that once feared whistleblowers are now giving workers new ways to report wrongdoing.

Marvin windows and doors is a family-owned business in Warroad, Minnesota, and one of the world's largest custom manufacturers of wooden windows and doors. In 2005, the company grossed an estimated \$500 million. As sales have increased, so has Marvin's work force, which now tops 5,500 employees spread among a dozen plants, including one in Honduras. To keep track of all these workers, the company recently implemented what software makers call a whistle-blowing system. It allows workers to anonymously submit tips, suggestions, and complaints to top executives in either English or Spanish about anything from safety conditions to bad managers to fraud and theft. "We want to demonstrate that we are serious about establishing an ethical culture," says senior vice president and general counsel Steve Tourek.

Marvin Windows is not alone in setting up a system that encourages whistle-blowing. An industry has sprung up to make it easy for employees to alert their bosses to trouble, and vendors report that clients include businesses of all sizes. One company with just nine workers recently signed up with EthicsPoint, a vendor that sets up toll-free 24-hour call centers and websites. Systems vary in price, but most start at about \$12,000 per year, plus a sign-up fee. (See "Whistle While You Work".)

The systems can also be used by companies to keep an eye on their top executives. Many systems will automatically route to a designated outside board member any tip that implicates a member of the management team like the CEO or the CFO.

The popularity of whistle-blowing systems is due in large part to the Sarbanes-Oxley Act of 2002, which compels public companies to establish procedures for identifying wrongdoing. Whistle-blowing software had been around for at least a decade, but after Congress passed the law, software firms created a lot of new applications, thinking that companies covered by the law would want them. To the surprise of many people in the industry, sales of whistle-blowing systems to private companies, which are not covered by Sarbanes-Oxley, are also on the rise. By using their employees as an early-warning system, employers seek to head off problems before they spiral out of control.

What Exactly Is an Internal Control?

The idea of companies soliciting whistleblowers would have seemed ridiculous a decade ago, when many executives viewed them as troublemakers and attention-seekers. Corporate scandals changed that. This year, 88 percent of respondents to a survey of public and private companies agreed that encouraging whistleblowers is good for business, according to Tatum Partners, a financial consulting firm based in Atlanta.

Whistle While You Work

These three companies are among the best-known makers of whistleblower software. Prices depend on how customized a system is and the number of users, but they typically start at \$2,000 per annually.

Allegiance SilentWhistle

www.allegiance.com or www.silentwhistle.com
South Jordan, Utah

Number of customers: 650

Recently completed merger; now expanding product line

EthicsPoint

www.ethicspoint.com

Portland, Oregon

Number of customers: 900

Founded by a group of forensic accountants

Global Compliance Services

www.globalcompliance.com

Charlotte, North Carolina

Number of customers: 1,500

Also helps customers write formal codes of conduct

These results contrast with the conventional hatred of Sarbanes-Oxley, which has been blamed repeatedly for a range of corporate maladies from overzealous auditing to the torpid market for initial public offerings. One requirement in particular--that companies establish adequate "internal controls"--has been held up for criticism because the law doesn't spell out what an internal control is. Software companies have positioned whistleblower software as a suitable control.

To some extent, this sales pitch has worked. Many public companies have purchased whistleblower systems in the past few years. So have some privately held businesses that are compelled to adopt Sarbanes-Oxley-related policies by publicly held joint venture partners or customers or lenders. Then there are private firms that install these systems simply because they see real value in them. In a recent survey, PricewaterhouseCoopers found that 60 percent of private companies that have voluntarily adopted the regulations did so because they thought they were the "best business practices," while 59 percent felt that they would help a company address potential problems.

A Way to Avoid Jail Time

Some evidence suggests that it's wise for employers to implement any kind of system that encourages workers to speak up. In a 2004 study of 508 companies where occupational fraud occurred, the Association of Certified Fraud Examiners found that companies that uncovered troubling activity were more likely to find out about it from a co-worker's tip than from an internal or external audit. Moreover, organizations that had anonymous reporting systems in place suffered less than half the financial losses from fraud sustained by companies without such systems.

There are other incentives for encouraging whistle-blowing. Sections 301 and 404 of Sarbanes-Oxley, which compel companies to maintain an ethical culture and a system of internal controls, have roots in the Federal Sentencing Guidelines for corporate crime and fraud that were established in 1991. These guidelines provide federal judges with a set of standards to use in doling out punishment for all companies, public or private, that are convicted of a crime. If a company can demonstrate that it has tried to develop an ethical culture, such as by adopting a whistleblower system, a judge may be lenient in handing out fines and jail time.

Fears of False Accusations

Nonetheless, there is one risk that most managers think long and hard about before they sign up. What happens if employees swamp the system with petty grievances? What if a worker fabricates an allegation? These were Gerald Massey's initial concerns. Massey is the CEO of Fios, a Portland, Oregon, company that lawyers hire to inspect computer equipment for information pertaining to a lawsuit. Because his firm was in the business of uncovering the misdeeds of companies involved in litigation or under investigation, Massey was predisposed to see the benefits of whistle-blowing software. And Fios had long since outgrown its trusty employee suggestion box, with 120 employees spread out among offices in four states. Even so, Massey says, "my board and I were worried that we would be opening a Pandora's box."

Massey's system went live in the fall of 2004, and some of his fears were certainly justified: Fios' 120 workers submitted more than 30 suggestions in the first 18 months. This usage was high. Most vendors say that the average annual volume of tips is a manageable four per every 100 employees. And, says Massey, all but two of these complaints were minor. This is typical. Vendors estimate that only about 3 percent of all tips involve a serious disclosure. For workers to trust the system to work, however, little gripes cannot be ignored, experts say. Every report must be taken seriously, and there can be no retaliation. Still, most managers are happy to field minor complaints about HR issues (which they should probably address anyway) in return for added vigilance about crucial legal and financial issues.

The enduring legacy of Sarbanes-Oxley and the recent scandals may be a change in the way companies look at employees who are unafraid to raise red flags. "We want the company to do the right thing," says Marvin Windows' Steve Tourek. "And we want to give our employees a place to tell us when we aren't."

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