HR'S ROLE IN CORPORATE GOVERNANCE: PRESENT AND PROSPECTIVE

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Corporate wrongdoing is damaging investor confidence and tarnishing the credibility of the U.S. business community, guilty and innocent alike. Some misdeeds are clearly criminal, others simply unethical or damaging to reputations. They range from "massaging" numbers ("managed earnings"), which tests the limits of financial prudence, to outright fraud. Caught in the limelight are U.S. corporate giants representing some of the world's best-known brands and most famous CEOs, many only yesterday lionized in the business press.

We have explored this issue from the perspective of the HR function through a survey of the senior HR professionals who attended the Human Resources Forum. The survey was augmented with focus groups. Our purpose was to understand current practices, attitudes, and behaviors with respect to legal standards and professional and ethical codes. We also explored the roles of the CEO, HR leadership, and the HR function in minimizing ethical breaches that have diminished investor and public trust. We hope to shed light on the responsibilities, actions, and risks of the HR function and its leadership now and in the future.

Introduction

The HR function has recently taken a seat at the firm's strategic decision-making table, not simply as a partner, but, more importantly, as a player (Ulrich & Beatty, 2001). The objective is to impact the firm's success by influencing its strategy, culture, and strategic capabilities. Because HR's fundamental role is to influence behavior in organizations, it requires credible business acumen, as well as adherence to legal and professional/ethical standards (see Figure 1). Of course, other firm functions (e.g., the office of the general counsel and the chief financial officer) are also responsible for monitoring behavior. Yet we also have discovered from Enron and other recent scandals that these functions have "bent the rules" and occasionally participated in wrongdoing (Koniak, 2002). We believe the HR function must understand the issues and determine what the organization can do to reward positive behaviors and deter behaviors not in the firm's or customers' best interests.

Naturally, most HR professionals do not want to jeopardize their careers over disagreements with the ethical implications of

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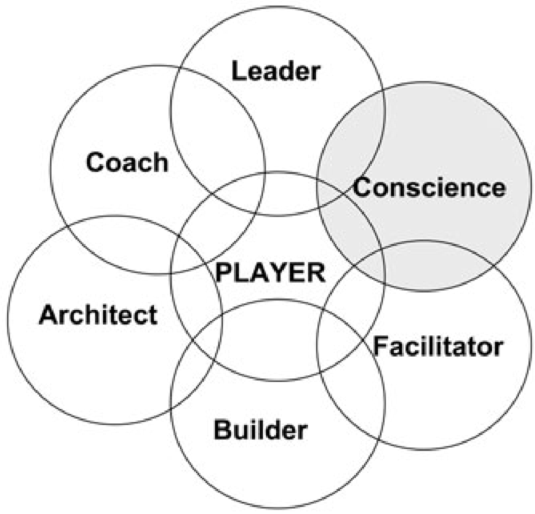

Figure 1. Partners to Players: Extending the HR Playing Field.

every issue or decision. Nevertheless, occasions arise when personal and professional integrity are at risk of being compromised, and HR is asked to "dance with the devil" (Ewing, 2002). HR professionals frequently face difficult decisions that favor one stakeholder over another. How can we encourage decisions based on professional judgment and courage to always move the organization in a direction that is in the best long-term interests of its most critical constituencies—customers and investors? To help resolve these difficult dilemmas, HR professionals must remind themselves that customer and investor interests come before the interests of top management (Cooper & Madigan, 2002). This is a difficult but necessary understanding for HR—that managers (their bosses) are not the primary customers of HR work!

In the case of Enron, WorldCom, and others, HR and non-HR employees have felt impelled to become whistleblowers. Such candor is rare, because few are willing to risk the consequences of informing the emperor that he or she is wardrobe-challenged. Confronting wrongdoing can lead to being shunned for disloyalty or being terminated. Issues of candor and openness go to the heart of an organization's culture. Without them, the level of trust seldom reaches the point where an organization can exercise its fiduciary responsibilities as expected by external stakeholders. When indicted executives deny knowledge of any wrongdoing within their corporation, is this merely an exercise in survival or a sign of the lack of internal organizational candor? In either case, the public's trust in such organizations suffers.

We believe that the senior HR executive's most fundamental organizational responsibility lies in creating a culture that encourages the candor and openness needed to gain customer and investor trust. The process begins by identifying and modeling the appropriate behavior for the firm and its workforce, as well as designing systems and practices that clarify behavioral standards, search out and deter behaviors that violate the public's trust, and reward those behaviors in the organization's best interest. This responsibility demands the ultimate focus, courage, and skill of HR professionals. The behaviors in question can be broken into three broad areas. The most straightforward is lawful behavior, where it is generally easier to determine what is "in bounds" and what is not. Violations of laws relating to environmental pollution, racial or sexual discrimination, or wages and hours are usually clear and must be brought to the attention of top management. HR has a fiduciary responsibility to ensure laws are followed. Failure to do so puts the firm in legal jeopardy.

A more challenging and complex HR concern is the organization's financial measurement and reward systems. While these are intended to reward deserving leadership, poorly designed reward systems can lead executives to "cook the books." There have been several recent revelations that raise questions about a firm's integrity and leadership. In such instances, the HR professional may need to go outside the firm to further the best interests of customers and investors. The root cause of the problem may lie with the person to whom the HR professional reports or even with the parent company or board of directors.

A different HR challenge occurs when leaders turn to HR to bail out senior executives who are prima facie legal violators in order to "protect" the organization. This puts the senior HR professional in jeopardy, risks the sting of future litigation (as well as loss of the firm's public trust), and may encourage further violations and thus additional litigation. Such circumstances can put HR leaders in the position of choosing between the interests of customers and investors and the demands of executives. At this point, the HR professional may conclude that it is time to "bet their job." There are instances in which HR professionals may decide to put their jobs on the line to ensure legal compliance.

The second behavioral area concerns ethics, the complex mix of ideals, beliefs, and standards that characterizes or pervades a group (e.g., professional association) or community. These involve issues of right and wrong that may not rise to a legal breach, but that, at a minimum, have the potential for adverse publicity and therefore must be addressed. Issues often revolve around the workings and abrogation of the organization's internal governance systems or their consistency with established professional standards. The most telling examples in this area relate to "earnings management." Major firms, including Tyco, Lucent, Xerox, IBM, GE, ConAgra, Kmart WorldCom, and Qwest, among others, have been found wanting in this regard and have already had (or may have) to restate earnings.

This type of behavior is directly relevant to the HR function because it often involves the manipulation of reward systems, often in conjunction with revenue enhancements (e.g., revenue, earnings, earnings per share [EPS], or return on assets) that make the organization appear more successful, while simultaneously bestowing unmerited rewards (internal bonuses or external equity appreciation) for what is portrayed as organizational performance (Mount, 2002). Manipulating receivables and bad debt has become all too common. Depending on the egregiousness of the act, such behavior may step over the boundary into illegality as well. Senior HR professionals who work with executive incentive compensation systems (and with the board's compensation committee) must be alert to when "the fox is in the henhouse" and how the system can be abused to misrepresent the firm to its various constituencies for the benefit of the fox.

Within HR, ethical standards are often defined by groups and professional associations (e.g., Society for Human Resource Management, n.d.). HR professionals are often aware of these standards. They also understand the difficulties in applying them within U.S. organizations, and especially when dealing across countries and cultures. Behaviors considered acceptable by one society may be unacceptable in another. Thus, knowing and understanding cultural nuances can be essential for organizational success abroad.

The three domains of corporate conscience often overlap, as shown in Figure 2. Thus, it may be difficult to demarcate clearly where one area begins and another ends.

Some senior executives may not perceive the relevance of statements of professional standards and ethics. Nevertheless, such standards must be incorporated into the firm's governance protocol. Professional and ethical standards must be assessed for the potential to damage a firm's reputation if violated. On the other hand, because professional standards vary across cultures and regions of the world, the same standards may be seen as irrelevant in other cultures. For example, the financial scandals involving various forms of executive compensation and conflicts of interest that are of pressing concern in North America are dismissed as trivial by some executives (and their workforces) in Europe and Asia.

The third behavioral area, and perhaps the murkiest, is what we label "vocal constituencies." Whatever the issue, there may be deep-rooted, heartfelt feelings on various sides. What is critical for senior HR professionals is to be attuned to such issues and understand the underlying strategic unity necessary for the organization internally and externally. How a firm represents itself and the congruence of this representation with the external environment are important yet difficult to manage, such as instances of "political correctness," which may have several constituencies. The three domains of corporate conscience often overlap, as shown in Figure 2. Thus, it may be difficult to demarcate clearly where one area begins and another ends.

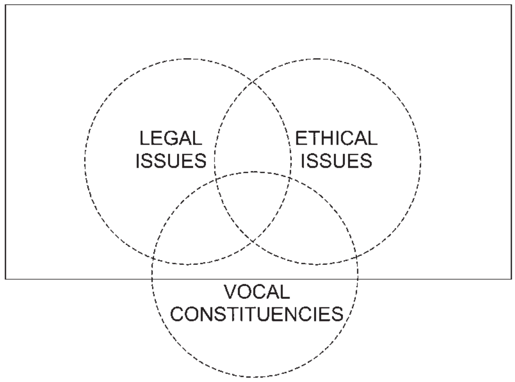

Figure 2. The Domain of HR's Corporate Conscience.

STUDY FINDINGS

We sent surveys to well over 300 experienced HR professionals; 112 responded (about 36%). Respondents' firms ranged in size from 275 to 140,000 employees across 19 industries. Most of the individuals (71%) came from corporate and 29% from business units. Roughly one-third of the respondents were senior HR vice presidents and a little more than a third were HR vice presidents. Their experience ranged from 3 to 40 years. Half reported to the CEO, and 17% reported to the president.

We found 79% of our HR sample would initiate action or "blow the whistle" if they discovered a legal violation, and 83% would do so if they observed a violation of professional or ethical standards. Only 64% would ensure action if they felt a vocal constituency required action (Table I). Respondents expected more adherence to legal standards by their senior HR professionals than by their CEOs (85% to 74%) (Table II). The same was basically true for professional and ethical standards. Respondents also perceived no difference in the willingness to enforce legal standards between their boss and the CEO. However, respondents' bosses were seen as being more willing to enforce professional/ethical standards than the firm's CEO.

The respondents were asked to rate their firm's level of legal-ethical concern with respect to four constituencies: investors, customers, employees, and the public at large. HR professionals were concerned about legal issues for investors, customers, and employees, all to about the same extent (about 80% of respondents indicated that they were "very strongly concerned"). Concern for professional and legal issues for these same constituents was about the same as legal issues, and vocal constituencies somewhat less, averaging 65%. The respondents perceived

TABLE I **HR's Role as Corporate Conscience**

	Ensure Action	*Blow Whistle*	*Combined*
LEGAL	34%	45%	79%
Professional/Ethical Standards	55%	28%	83%
Vocal Constituencies	64%	4%	68%

TABLE II **Boss's vs. CEO's Corporate Conscience Expectations**

	Boss Very Strong/Extremely Strong	*CEO Very Strong/Extremely Strong*
Legal		
Expectations	85%	74%
Willingness to Enforce	66%	68%
Professional/ Ethical Standards		
Expectations	84%	75%
Willingness to Enforce	77%	67

TABLE III **Firm Level of Legal-Ethical Concern**

	Legal Very Strong/ Extremely Strong	*Professional/Ethical Very Strong/ Extremely Strong*	*Vocal Constituencies Very Strong/ Extremely Strong*
Investors	80%	77%	73%
Customers	78%	74%	66%
Employees	81%	81%	69%
Public at Large	59%	52%	50%

TABLE IV **Level and Focus of Risk**

Organizational Risk		*Very Strong/Extremely Strong*
	Legal	40%
	Ethical/Professional	40%
Organizational		
	Candor	46%
	Trust	46%
Positions at Risk		
	CEO	29%
	CFO	36%
	Investor Relations	32%
	Public Relations	20%
	Advertising	13%

substantially less concern for the public at large than for investors, customers, and employees (Table III).

Seventy-seven percent of the firms had a code of ethics, yet 40% of the respondents indicated that their firm had a "moderate" to "very strong" risk of encountering a legal or ethical/professional violation within the next three years. The level of candor and trust in the organizations in the total sample was indicated as moderate to very strong (at 46%), and the positions greatest at risk were, not surprisingly, CFO and investor relations, as compared to the CEO (36% and 32% versus 29%) (Table IV).

An interesting finding is that the strategic unity (the accuracy and congruence of firm-generated internally and externally communicated information), although strong (indicating some transparency), was moderate to very strong for the CEO, CFO, and investor relations, yet fell off significantly in public relations and advertising. However, what is perhaps most surprising is that little or no strategic unity exists for 12% of the CEOs, 8% of the CFOs, 17% of investor relations, 17% of public relations, and 17% of advertising (Table V). The respondents also indicated that other areas in the organizations had little or no strategic unity, to the level of 27%. This surprising lack of congruence between internal and external information underscores the very real need for transparency continually demanded by constituencies such as the financial markets and investors.

As to our sample's perception of their firms on selected ethical dimensions, 89% indicated that HR would act upon legal and ethical issues within their organization more than other employees. However, they also indicated that employee understanding of legal and professional standards was "very strong" only among 15% of their workforce, and the strength of the firm's financial statements meeting professional and ethical standards was seen as very strong in only 22% of the firms (Table VI). In fact, our respondents believed that only 8% of the workforce was aware of the importance of professional/ethical standards and their relationship to firm success—and this was a sample of human re-

TABLE V **Strategic Unity of Information: Internal vs. External**

	Little	*Very Strong*
CEO	12%	72%
CFO	8%	69%
Investor Relations	17%	72%
Public Relations	17%	65%
Advertising	17%	58%
Others	27%	54%

TABLE VI **Perceptions of Firm Action on Selected Ethical Issues**

HR's Corporate Conscience Expectations Relative to Other Employees	89% Considerably More/Acting as Corporate Conscience	
Strength of Firm Statement about Professional/ Ethical Standards	22% Very Strong	
Employee Understanding of Professional/ Ethical Standards	15% Outstanding	
Workforce Awareness of Professional/ Ethical Standards for Firm Success	8% Very little/Some	28% Outstanding

HR Vulnerability to Legal and Professional/Ethical Standards Violation	*Very Little*	*Significant to Great*
Overall HR	15%	39%
Selection	15%	30%
Development	30%	23%
Rewards/Compensation	15%	33%
Performance Management	19%	29%
Communication	26%	26%

source professionals whose job is presumably to know and understand the workforce, its mind-set, and competencies.

In terms of HR's vulnerability to compromised legal, professional, and ethical standards (Table VI), the survey indicated that, overall, HR had a significant level of vulnerability, and that the rewards and compensation practitioners were most vulnerable (33%), followed by selection (30%), performance management (29%), and employee development (23%).

Perhaps one of the more interesting areas was related to organizational risk. With both legal and professional standards, the correlations between organizational candor and level of risk and trust and between organizational trust and level of risk were very low and insignificant. However, the respondents felt that employee understanding of legal issues had a significant relationship to reducing legal risk ($r = -0.41$; $p < .05$), as well as reducing professional and ethical risk ($r = -.36$; $p < .05$) (see Table VII). The sample also believed that ethical statements had a dramatic impact upon reducing legal vulnerability ($r = -.37$; $p < .05$), as well as in demonstrating the belief in the efficacy of the ethical statement impacting professional and ethical behavior ($r = -.34$; $p < .05$) (Table VII). Respondents believed that the only area where the firm was subject to sig-

TABLE VII Factors Related to Organizational Risk

Factor	*Legal*	*Professional/ Ethical*
Candor	–.04	. 11
Trust	.00	.15
Employee Understanding	–.41	–.36
Ethical Statement Strength	–.37	–.34

Factors Reducing Legal Vulnerability	
Strength of Ethical Statement and Organizational Risk	
Legal	–.37
Professional/Ethical	–.34
Advised of Ethical Statement and Organizational Risk	
Legal	–.18
Professional/Ethical	–.18

TABLE VIII Factors Related to HR's Vulnerability

	Candor	*Trust*	*Legal Risk*	*Professional/ Ethical Risk*
All HR	.45	.52	.61	.58
Selection	.73	.74	.35	.37
Development	.09	.04	.05	.04
Rewards/Compensation	.82	.82	.25	.28
Performance	.52	.54	.49	.47
Communication	.54	.44	.31	.30

nificant legal and professional vulnerability was if unity of information was not forthcoming in investor relations.

Factors related to HR's vulnerability indicated some extremely interesting findings, as can be seen in Table VIII. Candor and trust seem to be very important to HR in reducing HR's overall vulnerability and in selection practices. However, it was not significant with respect to development practices, but most significant with respect to rewards and compensation, which seems to be the issue on which HR professionals and their firms may be most vulnerable to violations of legal or professional/ethical standards.

Rewards and compensation is certainly an area of major concern. While all HR practices are designed to influence behavior, this is especially true of rewards. HR must always recognize that rewards may have both functional and dysfunctional consequences and ask whether a given reward may have become too powerful, to the point where the dysfunctional consequences outweigh the functional consequences. Dysfunctional consequences certainly could be a partial explanation of recent financial scandals. In such cases, there is likely to be potential legal jeopardy not only for HR, but also for members of the board's compensation committee whose compliance, if not complicity, in executive incentive compensation plans make both potentially vulnerable.

Respondents identified improved performance management and communications systems as areas that could reduce HR's vulnerabilities in nearly all areas of the HR function. When these areas were associated with organizational-level risk, a high correlation between HR vulnerability and organizational-level risk was found. That is, the following were all associated with legal as well as professional and ethical risk: selection, rewards and compensation, performance management, and communication. Thus, higher HR risk was associated with higher organizational risk.

There was also an attempt to get much greater top management buy-in by having leaders express their statements of purpose and direction in more and more specific statements about legal and ethical behavior.

The boss's espoused expectations and enforcement as related to risk seem to have differential effects, as was shown in Table II. However, the boss's (or head of HR's) espoused expectations did not have a significant correlation with reducing legal and professional risk, but enforcement had a fairly powerful impact. That is, the boss's willingness to act on legal, professional, and ethical violations seemed to have a far greater efficacy than mere declarations. There was also a substantial correlation between the senior HR person's expectations and enforcement of the legal, professional, and ethical violations in influencing HR's role as corporate conscience. But espoused expectations did not seem to impact employee understanding, except through enforcement. The same was clearly true and perhaps more pronounced in the area of professional, as opposed to legal violations. Thus, the role of the HR community is profoundly influenced by the head of HR's stance in terms of both declared expectations and enforcement of legal and professional standards, as well as reinforcing employee understanding of legal and professional standards, with the exception that enforcement appears to be far more powerful in influencing employee understanding than the mere expectations as expressed by the HR function.

POTENTIAL REMEDIES

What might HR do in addressing these issues? The focus groups conducted concomitantly with the survey provide some insight. We found that some firms attempt to select for ethical behavior by a series of interviews, including specific situational examples to elicit candidate responses. Others seek cultural alignment by making explicit statements and admonishing applicants if they cannot easily and readily fulfill these, and constantly remind employees of the same and make overt efforts through enforcement to assure that the actual culture is in alignment with the desired culture.

There was also an attempt to get much greater top management buy-in by having leaders express their statements of purpose and direction in more and more specific statements about legal and ethical behavior. Some organizations have even attempted to develop an ethics pipeline by placing potential leaders in ethics-laden assignments, thus using ethics as a major determinant in the selection of their next generation of leadership.

Other efforts include training programs to initiate understanding of legal and ethical issues and discuss potential behaviors (as also cited by Master & Priest, 2002; Vogl, 2002; Kaplan-Leiserson, 2002). Some have even adopted "holy books" to teach ethical behavior (Seglin, 2002). Others have established a 1-800 hotline direct to the CEO, encouraging whistleblowers to identify issues that may be problematic for the firm. Others, such as the New York Stock Exchange, have identified chief ethics officers as well as statements of core values.

The current turmoil has generated a whole new industry—"scoring" firms on corporate governance and related issues (Brown & Sidel, 2002; Resnick, 2002). The financial services industry has found this a new market opportunity, and firms such as Credit Lyonnais and Deutsche Bank have begun to market indices of legal/ethical compliance. Standard & Poor's has attempted to gauge transparency, both in Latin America and in Europe, and now in North America, with its ethics scoring. The International Corporate Governance Network (ICGN), which is pushing to limit options, demands shareholder review of executive pay and expensing options. There is Rails, a movement to accept the International Accounting Standards (versus GAAP) by international bodies, including the ICGN.

In the area of effective corporate governance (see Felton & Watson, 2002b), there have been efforts to identify good versus poor corporate governance practices (see McKinsey Global Investor Opinion Survey on Corporate Governance, 2002, summarized in Figure 3). Poor governance is indi-

Selected practices used by the investment community to evaluate governance

POOR GOVERNANCE

- Minority of outside directors
- Outside directors have financial ties with management
- Directors own little or no stock
- No formal director evaluation process
- Very unresponsive to investor requests for information on governance issues

GOOD GOVERNANCE

- Majority of outside directors
- Outside directors are truly independent with no ties with management
- Directors have significant shareholdings
- Material proportion of director's pay is stock-related
- Very responsive to investor requests for information on governance issues

Source: McKinsey Global Investor Opinion Survey on Corporate Governance, 2002

Figure 3. Corporate Conscience: Playing by the Rules.

cated by a minority of outside directors, directors with financial ties to management, directors who own little or no stock, directors compensated only with cash, no formal director evaluation process, and firms that are unresponsive to investor requests. Good governance is described as having (1) a majority of independent outside directors with no ties to management; (2) directors with significant shareholdings; (3) a material portion of each director's compensation stock-related; and (4) a formal director evaluation process in place and the firm and its board responsive to requests for information on governance issues.

Governance practices are clearly evolving such that more and more information (hopefully on rewards and compensation) will become available. This is comforting, as is the fact that less than 1% of the current $685 billion in corporate 2002 profits is subject to some restatement or potential litigation. Yet what remains troubling is that core earnings versus reported earnings are substantially different for firms such as DuPont, IBM, Microsoft, GE, Verizon, Motorola, Cisco, AOL Time Warner, SBC, and AT&T, as well as already troubled firms such as Adelphia, Xerox, Global Crossing, Kmart, Trump, Qwest, Lucent, and others. What these firms are actually earning from organic growth attributable to the efforts of their workforce is extremely important for effective design of organizational systems to produce a workforce that leads to success for customers and investors.

The obvious but often overlooked relationship between workforce success, customer success, and investor success must be the driving focus of HR in any role related to the firm's corporate conscience. Transgressive behaviors that may, in the short term, appear to contribute to workforce success clearly do not contribute to long-term organizational, customer, and investor success. Such behaviors are clearly beyond the pale of publicly traded companies (and, for that matter, all firms, no matter what their size) and thus a major concern for the HR function. Therefore, HR must make efforts to not only better understand its role, but also to develop means and methods of better assuring outcomes with integrity.

A PRESCRIPTION FOR HR

A prescription for HR would be to engage the workforce in the best interests of customers and investors—that is, as was mentioned earlier, providing a focus on investors and customers as the primary beneficiaries of HR work. Clearly, being subservient only to immediate management may place HR in a far more vulnerable position than it would like.

Communicating the business model and how the organization is to succeed will also be valuable in helping clarify why individuals joined the organization and what they need to do in order to see it succeed. This involves a series of causal steps that, if acted upon in the appropriate ethical framework, could help reduce a firm's vulnerability to legal and ethical violations.

Transparency, the objective of much of the financial community, should also be an organizational objective in order to help customers understand from whom they are buying and why they are buying from that particular concern.

Making financial and customer outcomes transparent and providing insight into them vis-à-vis the firm's objectives is another positive step that could be taken. Transparency, the objective of much of the financial community, should also be an organizational objective in order to help customers understand from whom they are buying and why they are buying from that particular concern. After all, this is the "brand" or image that firms aim to create to influence purchase decisions beyond the functionality of the product or service itself (Budd, 2002). The same concept of transparency is also applicable to those who are applying to a firm for a position, as firms attempt to create an "employer brand" to become the "employer of choice" in tight labor markets. Transparency into the organization enables a better understanding of whom one is working for and the ethical framework in which work is expected, helping an organization attract appropriate candidates and helping candidates better select organizations that fit their values.

Work also needs to be done to reengineer corporate boards (Felton & Watson, 2002a) to have an independent relationship with HR (Sonnenfeld, 2002; Lawler, Benson, Finegold, & Conger, 2002). This may mean establishing some sort of in-between relationship, which could prove very powerful. Senior finance, legal, and HR executives would have direct access to the board (especially to independent board members). This may be what is required to put in place the ethical "arm's length" relationship needed (Kinetz, 2002). Management may strenuously object because they often feel that the people who report to them are their employees and should respond in the best interests of the people to whom they report. However, as cited in far too many instances, without some recourse, this relationship is fraught with possibilities of conflict and failure on legal and ethical grounds ("Winnick to Pay Workers $25 Million," 2002). HR should encourage board participation in the design of measurement and reward systems.

HR should be providing input to the organization on such issues as financial reporting. Firms will likely need to experiment with alternative methods of financial reporting, perhaps by industry, so investors can have greater insight into firm success. It may seem easier to have standard processes and procedures to which all firms adhere. At the same time, considerable differences within industries may necessitate different reporting. One type of reporting that may be useful is to redefine earnings per share with the denominator for shares determined not only by outstanding shares but also by shares represented by options. This approach might also differ by industry. For example, in most industries, options might be an immediate deduction. However, other industries may need different reporting standards, especially where innovation is critical to attract not only a workforce, but capital from Wall Street in order to build the critical mass through mergers and acquisitions. That is, in industries such as pharmaceutical, biotech, and high-tech, we may need to have an additional industry financial metric that would provide the best indication of these firms' success.

We should also treat board members' appointments as a selection process. In many instances, boards are self-nominating and shareholders are merely rubber stamps for board membership (Gale, 2002). Actively involving the HR community in the board selection process, as with any other effective selection process, might yield substantial improvement in the quality, capability, and ethics of board members.

Finally, HR needs to ensure that the appropriate financial models for measuring business success are used and linked to executive compensation. This may be a truism, but it is rare to find it put into practice. Earnings generated through strategic operations (i.e., operating income generated through the intent of the organization) is what is necessary. Firms must "design to win and deserve to win" within the intended business model. Obviously all businesses cheerfully record profits from endeavors not connected to their core operations, but those should be explained clearly as extraordinary and not be used to mislead investors to expect that these recur. Clearly businesses use various pronouncements to explain away bad news created by the economic environment. The same should be done with positive influences upon a firm's earnings. Thus, earnings through intended operations appear to be the only economically viable measure that should be used to assess an organization and the success of an organization's business model and its executives. Pro forma financial results should not be used as the basis of executive compensation.

Obviously the import of this for HR professionals is to assure that the measurement component of the reward and measurement system focuses upon these same measures. That is, strategy should drive measurement and measurement should drive reward. Thus, if financial metrics have been enhanced by factors other than the strategic intent of the business, this should be reported as extraordinary income. In essence, regardless of what earnings return model is used, what we are really interested in is avoiding reporting EBBS—"everything but the bad stuff."

WHAT WILL IT TAKE TO REBUILD CORPORATE INTEGRITY?

Rebuilding corporate integrity is a complicated issue. As *The Kiplinger Letter* (2002) has recently reported, the level of corporate integrity has not reached such lows since the 1930s. Corporate oaths, signing of financial statements, and ethics statements are only a beginning. We must minimize the conflicts of interests between accounting and consulting, CFOs and financial reporting, and compensation committees and board membership.

Firms must value honesty over results—very simply said, but very difficult to follow. Certainly businesses are moving in this direction, but more must be done. This requires creating cultures with an ethical foundation, so that people have a very clear idea of what is in bounds and out of bounds. Articulating clear boundaries is critical, so that people in their day-to-day decision making can know whether they are operating in the best ethical, long-term interest of the organization. Short-term maximization leading to long-term demise is not prudent business and is not ethical practice. As previously mentioned, the separating of core operating earnings from total profitability is essential. It must be mandated and those who mandate it must be willing to "walk the talk." At the end of the day, improved decision making will assure that the firm is accurately representing its performance as well as how the firm's performance is tied to the financial enhancement of its management.

This requires creating cultures with an ethical foundation, so that people have a very clear idea of what is in bounds and out of bounds.

Other suggestions include requiring business law courses in MBA programs (Prentice, 2002). At one time, almost all MBA courses required business law. However, business law has disappeared recently from most MBA programs. Perhaps it would be appropriate to have it return, while at the same time ensuring that an ethical component beyond merely meeting legal standards is included. This includes a belief in truth as opposed to "it's all relative" (Leo, 2002). It is important that clear and explicit rules in the interpretation of the law are included, especially rules with consequences.

It may also be very useful for the business media to take courses in finance and accounting, so that instead of simply swooning over business leaders as if they were rock stars, the Fourth Estate might instead play a significant role in bringing greater understanding of firm success or lack thereof (Quarrels, 2002). If this had been done earlier, the public, and especially shareholders, would have been much better off.

Finally, and probably consistent with the above, it is very important that those who have clearly violated the laws be punished …

including doing hard time ("Worthless Promises," 2002). The CEOs, CFOs, general counsels, or any others who have played a major role in a financial wrongdoing, must face the consequences of their behaviors (Freedman, 2002). If not, it will only encourage more crossing the line (Worthless Promises," 2002), driven by management greed, and not act in the best interests of investors, customers, and the society that licenses management to act.

CONCLUSION

There is a need for an expanded role for the HR function. Although many firms have ethics statements and many HR professionals seem to believe that ethics statements have some influence, they also clearly believe their organizations are vulnerable to legal and ethical violations, especially their CEOs, CFOs, and investor relations groups. This fact is reinforced by the number of respondents reporting an apparent lack of congruence between internally generated information and that disseminated to the public. This issue seemed to be of greatest concern with the investor relations community.

HR was perceived as being most vulnerable in rewards, performance management, and selection. Again, this appears to be fairly obvious in that most of the recent revelations provide insight into difficulties with the measurement/reward systems. Because of the power of incentives used, people in organizations have been willing to "cross the line."

The HR community appears to have higher expectations about adhering to ethical standards within HR, more so than they perceive at the top of the organization, and especially for the CEOs. They also believe that enforcement is far more powerful than declaring expectations in reducing ethical violations and that the HR community is much more willing to ensure action and "blow the whistle" than other organizational officers.

On the positive side, our sample of HR professionals clearly indicated that employee understanding of ethical statements may reduce risk. Strong statements by managers may reduce the risk of legal and ethical violations by their workforces, but enforcement of standards has the greatest impact.

This report is based on findings from a survey sent to the senior-level human resources professionals attending the Human Resources Forum, May 9–12, 2002. The survey was carried out by the Human Resources Forum in conjunction with Richard W. Beatty of the University of Michigan and Rutgers University.

Richard W. Beatty is professor of human resource management at Rutgers University and a core faculty member at the University of Michigan's Executive Education Center. He received his BA from Hanover College, his MBA from Emory University, and his PhD in human resources and organizational behavior from Washington University. He has written several books and more than 100 articles and is an associate editor of Human Resource Management. He was president of the Society for Human Resource Management Foundation and received the society's book award, and twice won the research award from the Human Resource Planning Society.

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