Hotline Benchmark Statistical Snapshot

A Snapshot of Our Database

44M

Over 44 million employees

generated over 1 million reports in 2018 representing
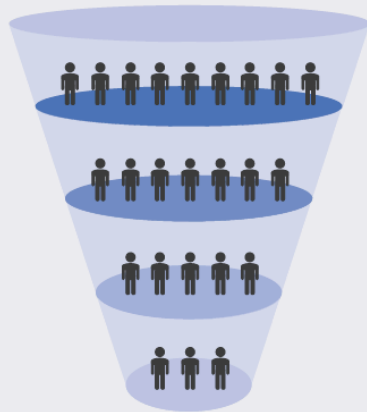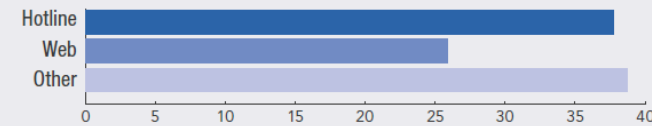
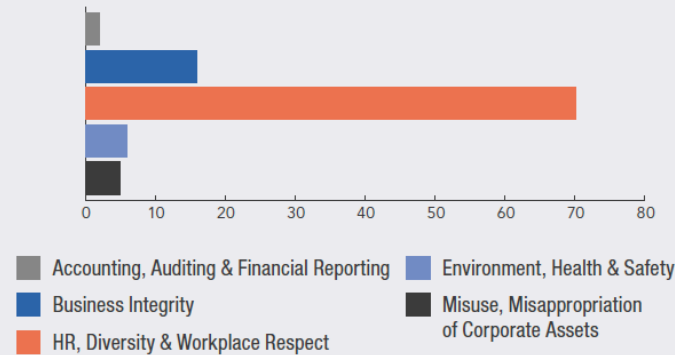### 2,738 customers

that received 10 or more reports in 2018

Methodology

Our report reflects all intake methods:

Hotline / Web / Other — scale 0 to 40

Our report reflects many issue types:

scale 0 to 80

- ▪ Accounting, Auditing & Financial Reporting
- ▪ Business Integrity
- ▪ HR, Diversity & Workplace Respect
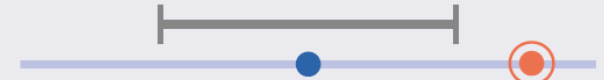- ▪ Environment, Health & Safety
- ▪ Misuse, Misappropriation of Corporate Assets

Industry Leading Approach

We use Medians or Midpoints rather than averages to reduce the impact of outliers

We calculate ranges to help identify extreme data points as potential areas of concern

Medians and ranges provide context for your individual benchmarks

Overall Reporting Rate Remains Consistent

How Does Your Report Volume Compare to Others?

Year	Range low	Median	Range high
2012	0.4	1.2	4.9
2013	0.5	1.2	4.0
2014	0.3	1.3	8.3
2015	0.3	1.3	10.3
2016	0.3	1.4	10.0
2017	0.3	1.4	11.0
2018	0.3	1.4	8.4

■ Range (reports per 100 employees)   ■ Median (reports per 100 employees)
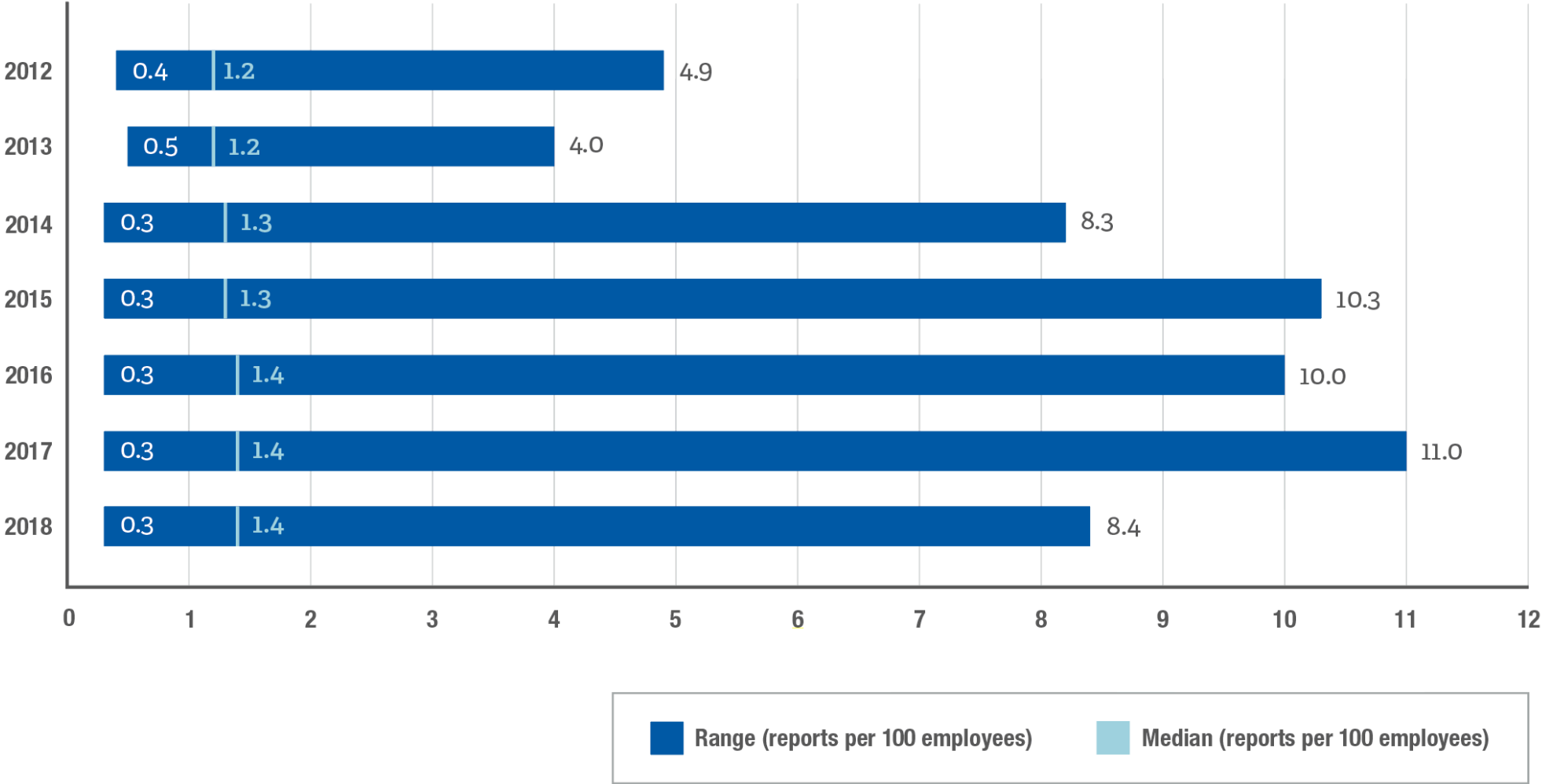
Impact of Collecting Reports from All Intake Sources Grows

Organizations Tracking Only Web & Hotline / All Sources

2018 — 0.3 | 1.1 | 5.0 (scale 0–12)

2018 — 0.4 | 2.1 | 11.6 (scale 0–16)

91% difference

Legend:
- ■ Range (reports per 100 employees)
- ■ Median (reports per 100 employees)

NAVEX GLOBAL®
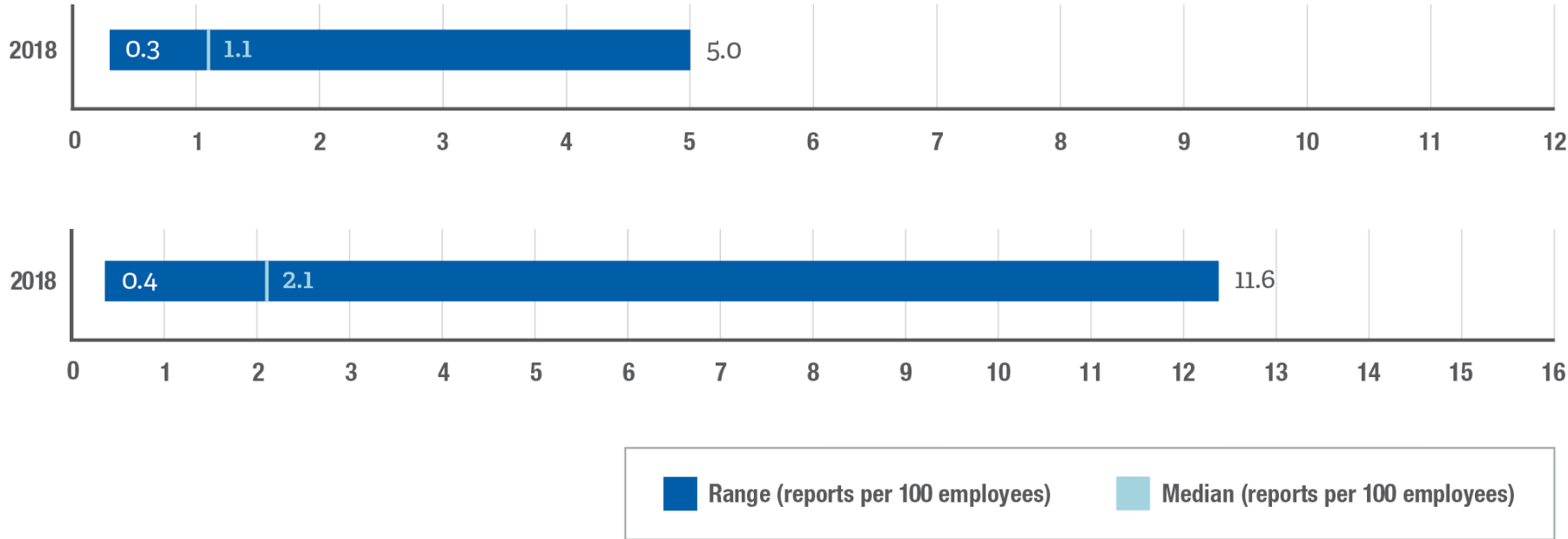
Ranges are Important

Of the customers who received 10 or more reports in 2018…

Overall 2018 Reporting Median = 1.4 Reports per 100 Employees

2018 Reporting Ranges of Reports per 100 employees	Percent of Customers in This Range
Less than 0.5	21%
0.51 to 0.99	18%
1 to 1.99	22%
2 to 4.99	22%
5 or more	17%

Question...

- So what about the 2,668 organizations that received less than 10 reports in total and those that received exactly 0 reports?

- Is is good news or bad news for them?

Efficacy of Internal (Hotline) Reporting Systems

Empirical Evidence of the Return on Investment in Compliance

Kyle Welch

George Washington University

Agenda

- Introduction

- Research Objectives & Methodology

- Key Findings

- Implications

Introduction

Prof. Kyle Welch, DBA

Assistant Professor at George Washington University

Previous Professional Experience:

- The Stanford Management Company – institutional investor for the Stanford University Endowment
- Standard & Poor's – valuation consultant

Education:

- Harvard Business School – Doctorate
- Brigham Young University – Undergraduate

Introduction

The inspiration behind, and approach to, this research:

- Human capital is the most important asset to companies
- All the existing research on how human capital is used to discover problems is based on externally reported debacles that make it into the court room or in the news (frequently both).
  - Research shows that when you have one bad event publicly, more debacles follow.
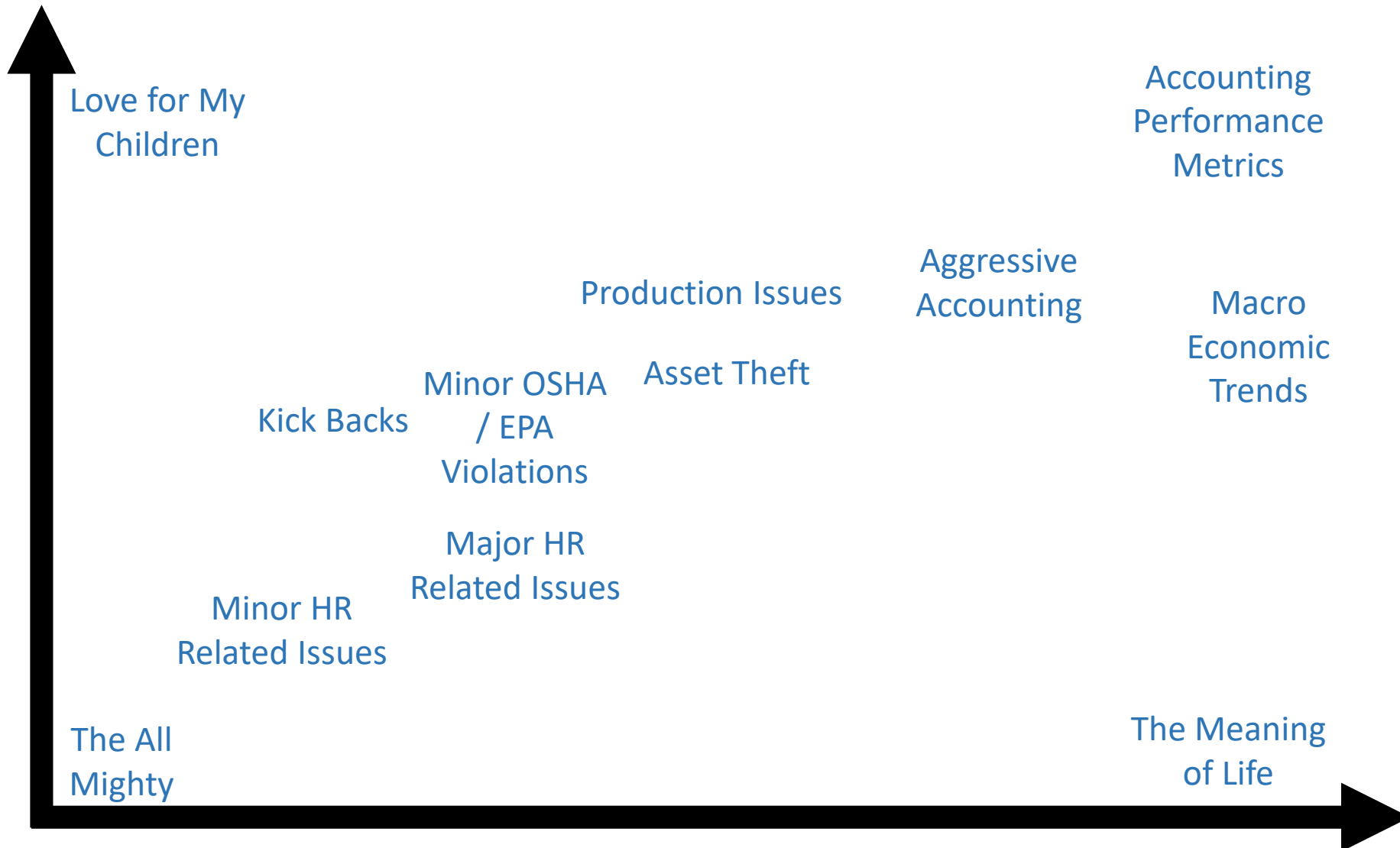- I wanted to see what was happening inside of firms.

Research Analogy: losing keys and looking under the lamppost

Big Problem With Big Data

We are interested in causal questions that lead to "if / then" statements

- *Big data analytics is sold as a panacea for firms.*

- *But only show relationships, causal answers are frequently missing.*

- ***The most important data*** *is difficult to capture and often critical observations of enlightenment come in the form of a single data point.*

- *This is what makes internal reporting systems valuable. They are intentionally designed to use a firm's **most precious resource— its people***.

Understanding (vertical axis)

Data Availability (horizontal axis)

- Love for My Children
- Accounting Performance Metrics
- Aggressive Accounting
- Production Issues
- Macro Economic Trends
- Asset Theft
- Minor OSHA / EPA Violations
- Kick Backs
- Major HR Related Issues
- Minor HR Related Issues
- The All Mighty
- The Meaning of Life

Epic Fails in Whistleblower History: Lehman Brothers Bankruptcy

- Matthew Lee, Lehman Brothers internal whistleblower reported unethical accounting (repo 105). Weeks later they fired Lee.

- Lehman Brothers omitted risky portfolio stress tests

- **Accepted commentary:** it was due to governance incompetence. **The truth:** it was a governance breakdown.

- Directors' primary role is to provide oversight, which is nearly impossible when management filters critical information.

THE TI

Max 18C, min 5C

Tuesday September 16 2008 timesonline.co.uk No 69430

Lehman collapse sends shockwave round world

ares and oil prices plunge, thousands lose jobs

Duncan Economics Editor

of a global financial meltdown yesterday as the world's biggest

Dow Jones industrial average was down 300 points, or 2.6 per cent. Sentiment was also bolstered

Epic Fails in Whistleblower History: Enron and World Com

- Sherron Watkins, an Enron executive who blew the whistle both to Enron and to Enron's external auditor, **was forced out** of the firm for doing so.

- Cynthia Cooper, an internal auditor at WorldCom, informed management and the external audit partner of WorldCom's accounting problems but her **concerns were ignored**.

- Employees at both companies were aware of fraud but failed to come forward for fear of retaliation.


December 2, 2002

Epic Fails in Internal Whistleblower History: Tuskegee experiment

- (1932-1972) U.S. Public Health Service and Tuskegee University syphilis experiment

- Peter Buxtun formally reported concerns **internally** in 1966, and again in 1968

- CDC and Tuskegee University ignored Mr. Bruxtun; experiment continued.

- In 1972, Peter Buxtun, leaked the story to the press
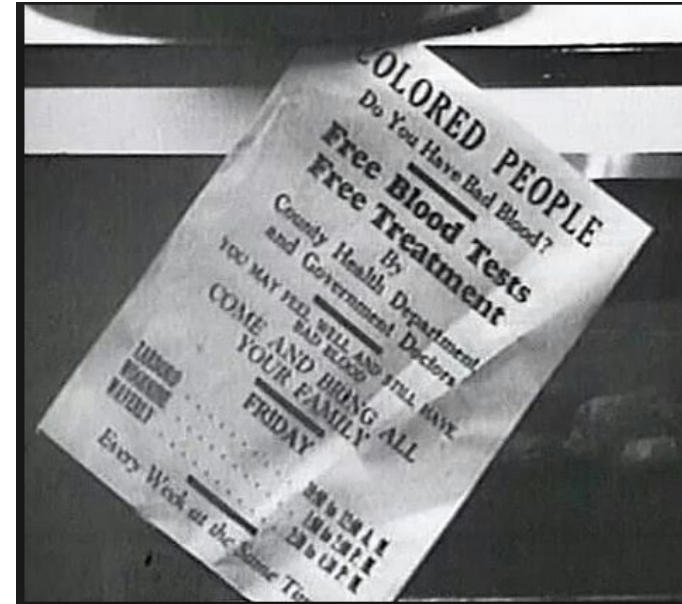
The good guy →

Employee Feedback Systems Matter!

1. These feedback systems enable firms to discover the data that is the most difficult to find.

2. How effective the firms are at engaging with the tool matters! What this tool does impacts hospitals, businesses, churches, government agencies, and even families.

Problem: no empirical evidence on how managers should engage with the systems.

Key Tension: What Does Whistleblowing Activity Indicate?

Conflicting perceptions internal Whistleblowing activity:

- Should management strive for fewer reports?   No reports?

- Should management strive for more reports?

- Is there such a thing as too many reports?

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Research Questions

1. What types of firms have an increased level of hotline usage?

2. How does increased (or decreased) level of use impact business outcomes??

   o Legal exposure

   o Regulatory exposure

   o Firm disclosure

Methodology – Data Collection

- Use NAVEX Global historical incident report database

  o Restricted, secure access

  o Visibility to meta details only; no details about report content

  o **<u>Anonymized findings; no individual reporter or organization identifiable</u>**

    o Similar to NAVEX Global benchmark report methodology and confidentiality protocols

- Merge this data with other public databases

  o Public financial statement data

  o FOIA request data

  o Material litigation, lawsuits filed

  o Regulatory agency reports (typically negative)

Methodology – Measuring Intensity of Hotline Use

Each proxy for usage is intended to capture the firm's engagement:

1. Number of submitted cases divided by the number of employees

2. Average number of times a report is accessed

3. Number of missing data points in reports

Key Findings – Part I

There is a significant difference between the types of firms that have a high level of usage of their hotline reporting system and a low level of usage.

1. **Power Users:** More profitable firms (ROA), large firms, and firms with higher quality governance

2. **Limited Users:** Less profitable, smaller firms, and firms with lower quality governance

Attributes of User Types – Power vs. Limited

Power Users

- Firms with quality governance
- Firms with higher quality earnings reports
- Large firms
- Older firms
- More profitable firms (ROA)
- Firms with more leverage
- Firms facing increased litigation risk

Limited Users

- Firms with poor governance
- Firms using more discretionary accruals
- Smaller firms
- New firms
- Less profitable firms (ROA)
- Firms facing extreme growth
- Firms with more employees (usage per employee)

Key Findings – Part II

Firms that have more active hotline reporting systems have…

1. Fewer material lawsuits filed against the organization

2. Lower amounts paid in litigation settlements

3. Fewer regulatory fines

4. Lower amount of regulatory fines

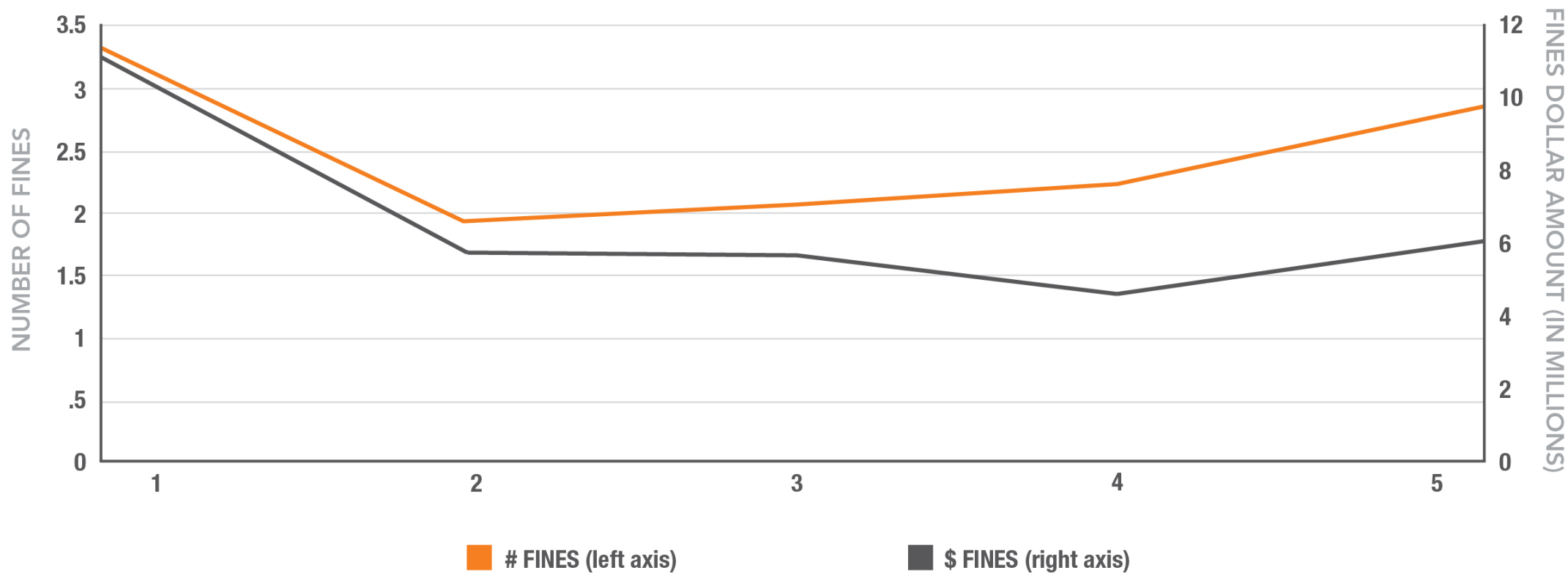5. Lower levels of news stories

6. Fewer negative news stories

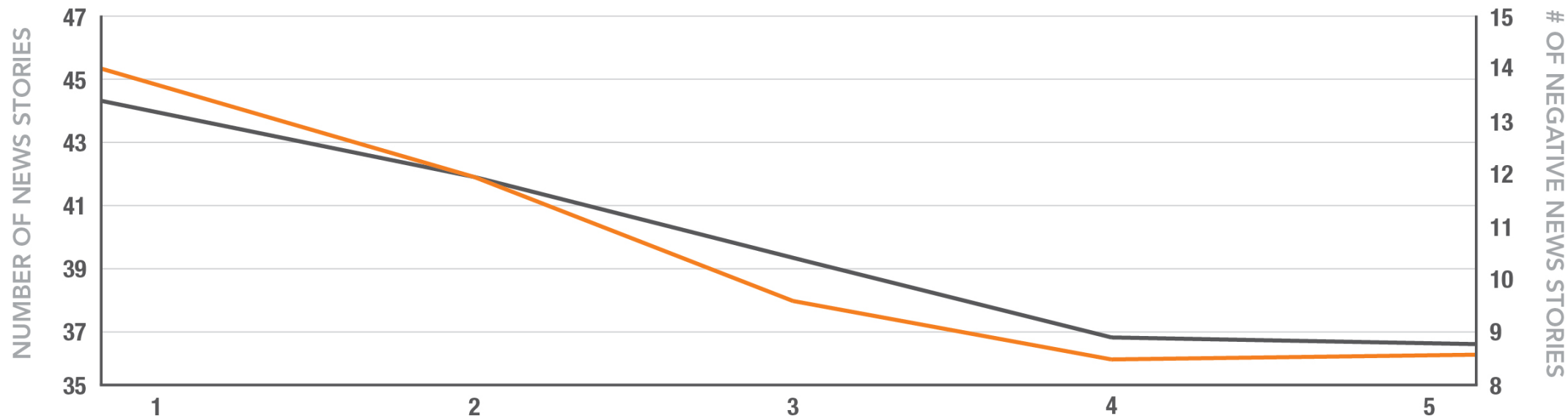# 2. Hotline Usage Associated with Fewer Material Lawsuits and Lower Settlement Costs

 # LEGAL (left axis)   **$ LEGAL (right axis)**
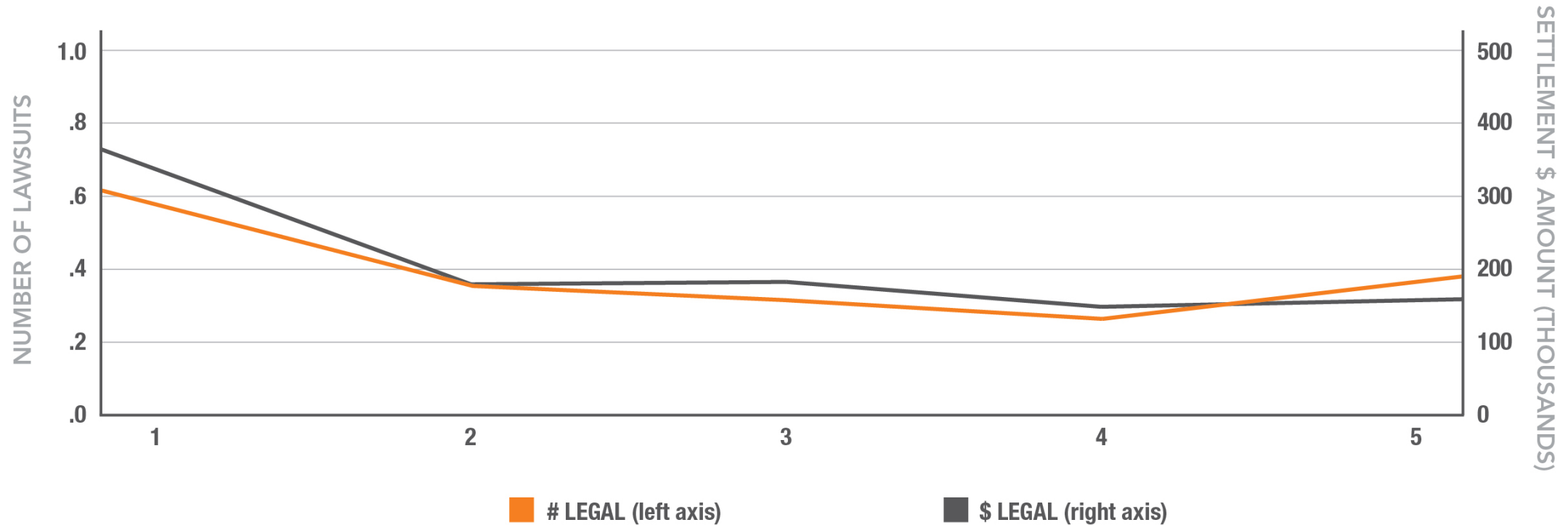
3. Hotline Usage Associated with Fewer Regulatory Agency Inquiries and Lower Fine Amounts

FINES (left axis) $ FINES (right axis)

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4. Hotline Usage Associated with Fewer Negative News Stories in the Financial and Business Media

Big Takeaway

- Firms with higher levels of hotline reports are *not* lower quality firms with worse protocols and compliance. Instead…

- The number of reports received (normalized for company size) is a good proxy of compliance health

- Firms actively using internal whistleblowing systems are able to get ahead of problems before they become lawsuits

Implications for Employers and Managers

- The "tree falling in the woods…" approach does not work. If there is a problem at the firm and a manager does not know about it, it **still** matters

- Not knowing about inevitable problems means it will most likely get worse

- Firms that use reporting system have more opportunities to hear problems

- It's not enough just to have a hotline, firms must
    - Promote it to increase use (because use is a good thing)
    - Build processes to follow up and respond to issues the hotline reveals

For firms that do all of the above… **really good things start to happen culture-wise**

Implications for Directors

As the only unbiased report that reflects employee sentiment and workplace culture, internal hotline reports should be a focus for directors. And not just for the audit committee. All directors should be looking at this data on a regular basis

Implications for Directors (cont'd)

- The Hotline Reporting System is the only way we've found to gather some of the most valuable information an organization can ever have

- Audit committees should consider the monitoring of internal reporting systems as key performance measures

- Audit committees should be concerned if the reporting systems' data is not included in the board packet each quarter

- *Power Hotline Users* most likely also have more mature compliance programs overall: Strong internal policies, Employee training, Code of Conduct, etc.

Fear of Retaliation and the Impact on Employee Reporting

Why this Data Matters

- **EU Whistleblower Directive**

  - Includes a ban on all forms of retaliation **AND** shifts the ***burden of proof to the organization***, which must prove that it is not acting in a retaliatory way against the whistleblower

- **Australia – Changes to Corporations Act**

  - Increases in legal protections for whistleblowers, including improved access to compensation for those who suffer reprisal or retaliation following a disclosure
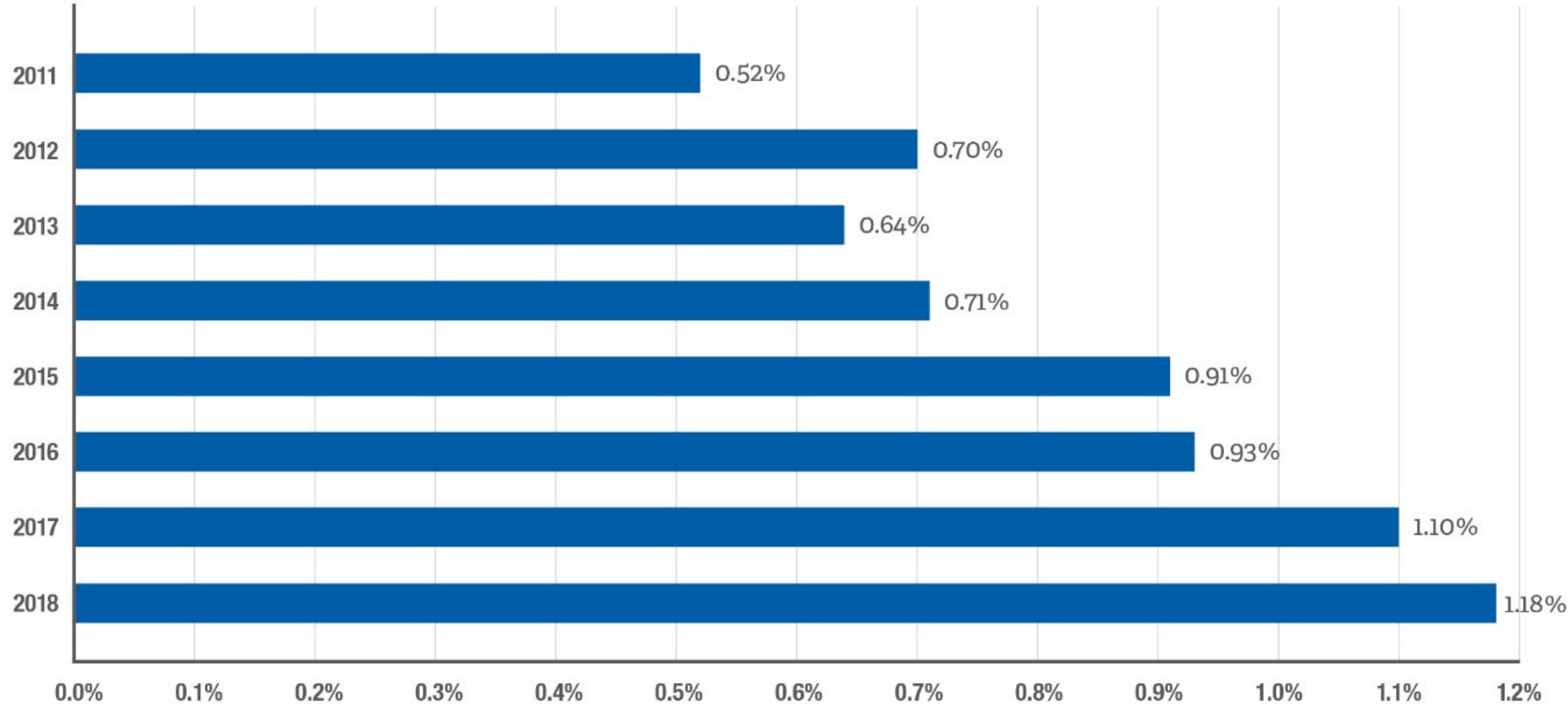
- **DOJ 2019 Guidance**

  - Prosecutors should assess the ***pro-active measures*** to create a workplace atmosphere without fear of retaliation,

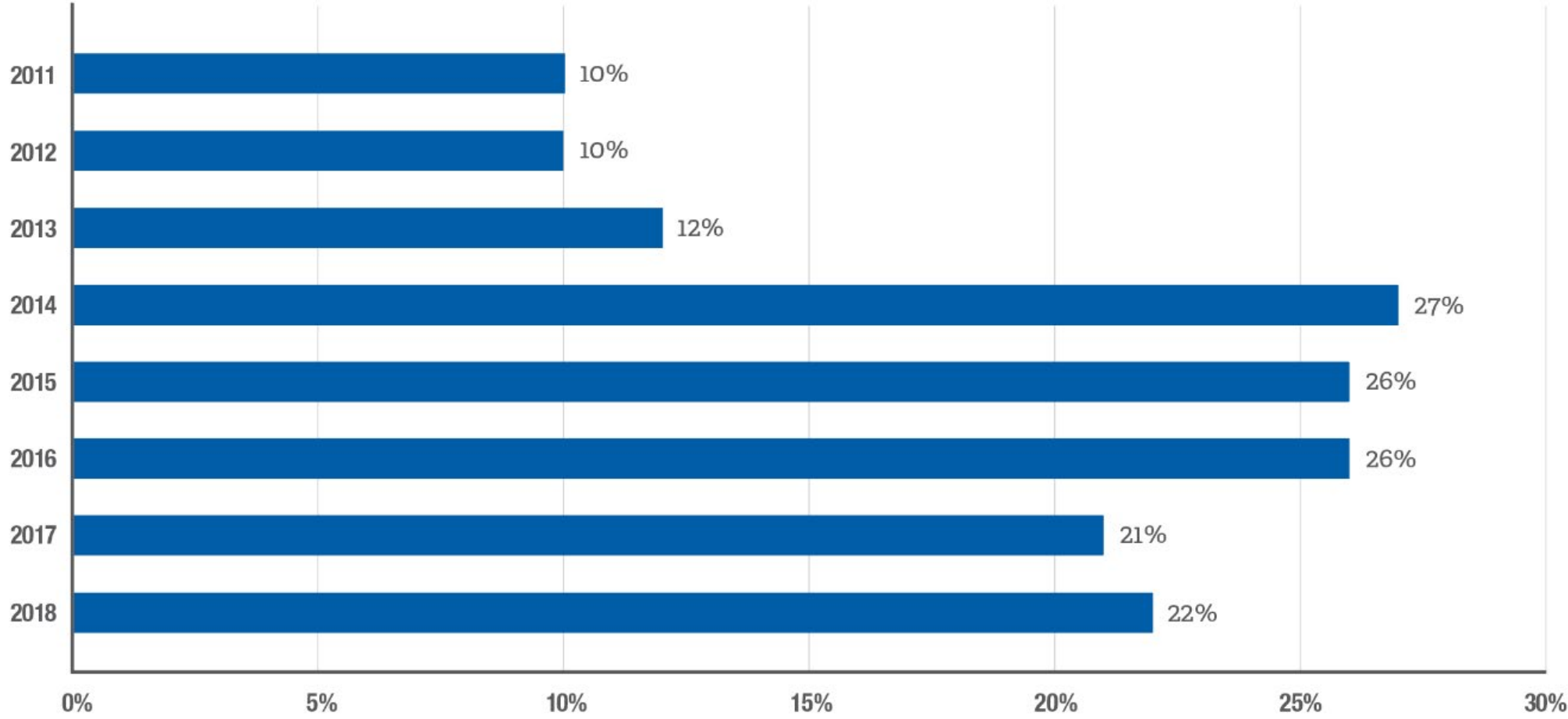- **ISO 37002**

  - TBD

Retaliation Reports

Percentage of Retaliation Reports

Retaliation Reports

Substantiation Rate of Retaliation Reports

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