Corporate Compliance

Crime, Convenience and Control

Petter Gottschalk
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Introduction

Compliance has long been identified by scholars of white-collar crime as a key strategic control device in the regulation of corporations and other complex organizations. Nevertheless, this essential process is largely ignored within criminology as a specific subject for close scrutiny. The current book seeks to address the anomaly. This initiating book applies the theory of convenience to provide criminological insight into the enduring self-regulatory phenomenon of corporate compliance. Convenience theory suggests that compliance is challenged when the corporation has a strong financial motive for illegitimate profits, ample organizational opportunities to commit and conceal wrongdoing, and executive willingness for deviant behavior (Asting & Gottschalk, 2022; Braaten & Vaughn, 2019; Dearden & Gottschalk, 2020; Desmond et al., 2022; Gottschalk & Hamerton, 2022; Stadler & Gottschalk, 2021; Qu, 2021). Focusing on white-collar deviance and crime within corporations (Benson & Simpson, 2018; Sutherland, 1939, 1983), the book argues that lack of compliance is recurrently a matter of deviant behavior by senior executives within organizations who abuse their privileged positions to commission, commit, and conceal financial crime.

Some deviant executives apply creative compliance (Nurse, 2022: 69):

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> Creative compliance involves the use of techniques which can be argued to be 'perfectly legal' despite the purpose and impact of such techniques being to undermine the whole purpose of reporting and regulation and in practical terms using the letter of the law to defeat its spirit, arguably 'with impunity'.

Rather than focusing on the regulatory formalities and staged procedures of compliance and audits, we emphasize the organizational challenges involved in compliance work when trusted corporate officials exhibit deviant behavior, refining and advancing knowledge in this field by reference to contemporary international case studies and associated original evaluative research. The themes and cases covered are carefully selected to provide the reader with an insight into professional conduct and procedural practice—the organization of corporate compliance success, failure, and corruption—with theoretical *convenience* placed at the fore. Crucially, compliance is often executively received as an *inconvenience,* a process capable of disturbing perceived *convenience* by increasing the subjective detection risk for potential offenders. Furthermore, with compliance officers habitually positioned at the very tip of the corporate governance spear, they emerge as uniquely able to communicate the terrible experience of executive fall from grace. We contend that learning from cases of conflict and failure of corporate compliance helps to identify the authentic challenges inherent to compliance functions within the contemporary workplace. As suggested by Antonsen and Madsen (2021: 7), compliance functions are typically established and strengthened in response to business scandals that expose "weaknesses related to regulatory risk management and internal control". Consequently, the lacking substance of compliance is evident whenever executives are caught in corporate wrongdoing—a fundamental premise explored and illustrated throughout this book.

Corporate compliance is concerned with the ability and practice at corporations to act without violating laws, the spirit of the laws, regulations, ethics, corporate culture, and other forms of rules and guidelines for the business. Corporate compliance is the ability to lead large groups of people toward achieving certain standards of conduct. Compliance refers to obeying the formal rules and regulations as well as the informal norms and attitudes in force at a given time and place (Desai, 2016; Durand et al., 2019).

Compliance is a challenge in situations where wrongdoing and misconduct have a potential of great benefits without significant perceived costs. In such situations, compliance functions within corporations are tested. For example, a small bribe in a corrupt country can result in a major profitable contract for a corporation. Refusing bribery might cause a competitor to obtain the profitable contract instead (Berghoff, 2018; Cuervo-Cazurra, 2016). Blokland et al. (2021) argued that corporate noncompliance is widespread in terms of corporate rule breaking, where drivers of corporate rule breaking include the extent of relative convenience of noncompliance versus compliance.

While there is no shortage of standard recommendations regarding formal compliance programs (e.g., Adreisova, 2016; Biegelman & Bartow, 2012; Desai, 2016; Graham, 2015; Haines & Macdonald, 2021; Kawasaki, 2020; Kurum, 2020; Lehman et al., 2020; Majluf & Navarrette, 2011; Marchetti, 2012; McKendall et al., 2002; Peterson, 2013; Roberts, 2008; Thottoli, 2021), there is no abundance of literature on why compliance functions fail and how to fix them (e.g., Chen & Soltes, 2018; Eberl et al., 2015; Rooij & Fine, 2020; Rorie, 2015). Some published works are concerned with specific industries, such as Braun (2019) who addressed compliance norms in financial institutions.

Rooij and Rorie (2022: 2) attempted to introduce some kind of measurement of compliance where they emphasized two core challenges in corporate compliance measurement:

> The first is to assess to what extent the organizations being studied (or the people in that organization) have been complying with or breaking the law. This is a highly difficult and sensitive question to answer, and also presents major ethical challenges. The second challenge is how to situate the interaction between the compliance behavior in the organization and potential influences on compliance in such a way that demonstrates a clear causal relationship. Establishing causality in a way that is both valid, yet also representative of a broader set of cases outside of those studied is extremely challenging. Any approach to compliance measurement must contend with both of these challenges.

Maybe the most challenging task for corporate compliance functions in practice is to prevent and detect white-collar crime. White-collar crime is financial crime committed by persons of respectability and high social status in the course of their occupation to benefit themselves or the organization (Sutherland, 1939, 1983). Corporate executives and board members belong to the class of elite members who can abuse their positions for illegal gain (Davidson et al., 2019; Ferrell & Ferrell, 2011; Gangloff et al., 2016; Schnatterly et al., 2018).

When there is suspicion of corporate white-collar crime, the governance branch typically involved should be the compliance function, potentially cooperating with internal and external auditors as well as various controllers. Internal or external fraud examiners have the task of investigating suspicions by reconstructing past events and sequences of events (Machen & Richards, 2004). If fraud examiners find sufficient evidence of law violation, then the case stops, moves internally, or moves externally to the national criminal justice system. If secrecy to protect corporate reputation is the main concern, then the case typically stops and remains internal (Gottschalk & Tcherni-Buzzeo, 2017). Corporations with inefficient or non-existing compliance functions or governance branch generally contribute to disorganized institutional deterioration (Crosina & Pratt, 2019; Rodriguez et al., 2005).

White-collar crime is a growing area of academic interest, partly due to the ongoing increase in the importance of compliance and partly because of the repeated, large-scale incidents of corporate misconduct that keep happening. Examples include Danske Bank in Denmark (Milne & Binham, 2018), Fuji Xerox in New Zealand (Deloitte, 2017), Siemens in Germany (Berghoff, 2018), Swedbank in Sweden (Milne, 2020), Telia in Sweden (Schoultz & Flyghed, 2021), Toshiba in Japan (Deloitte, 2015), VimpelCom in the Netherlands (Hovland & Gauthier-Villars, 2015), Wells Fargo in the United States (Shichor & Heeren, 2021), and Wirecard in Germany (Storbeck, 2020). The research interest in executive wrongdoing is growing given the high profile nature of white-collar crime as well as the growth of private policing, internal fraud examinations, and forensic accounting in recent years.

Lack of compliance is frequently demonstrated in fraud investigation reports. For example, Scandinavian banks Danske Bank and Swedbank were investigated by Bruun Hjejle (2018) and Clifford Chance (2020), respectively, resulting in the dismissal of the chief executives for lack of compliance related to anti-money laundering measures. Russian oligarchs and organized criminals could transfer proceeds from illegitimate business operations through the banks' East European branch offices. The non-resident clients were extremely profitable for the banks. Similarly, Scandinavian bank Nordea lacked compliance when helping clients in their wealth management to potentially avoid taxes in tax havens as revealed by the Panama Papers. In their internal investigation, Mannheimer Swartling (2016) revealed that bank executives had illegally backdated documents to benefit their rich clients.

Professional services firms such as law firms and audit firms can offer so much more than the police: risk assessments, regulatory compliance services, policy and program development, training, due diligence, review of suspicious transactions, and asset tracking and recovery (Schneider, 2006). Outside governments' criminal justice systems, private investigators can be found internally in organizations and externally (King, 2021; Meerts, 2020). An example of internal investigators is fraud examiners in insurance companies who investigate insurance customers' claims. Another example is internal investigators in banks who investigate suspicions of fraud and money laundering (Kurum, 2020). A final example is internal auditors and compliance officers who investigate suspicions of financial crime (Friedrich, 2021).

Norway is a small country with five million inhabitants. Some global companies have their headquarters in Norway. Examples include fertilizer company Yara and telecommunication company Telenor. Both companies operate in a number of countries worldwide. They are expected to respond to the globalization challenge by acknowledging a new political role of business that goes beyond mere compliance with legal standards and conformity with general ethics. As Dion (2019: 836) states, "ethics is not equivalent to laws". However, both companies have been caught in corruption scandals. The Norwegian National Authority for Investigation and Prosecution of Economic and Environmental Crime ("Økokrim") was prosecuting executives from both companies in Norwegian courts in 2015 and 2016. While Yara executives were prosecuted for corruption in Libya (Berglund, 2015; NTB, 2020), Telenor executives were investigated for corruption in Uzbekistan through the partly owned subsidiary Vimpelcom (Deloitte, 2016; Hovland & Gauthier-Villars, 2015; Klevstrand, 2020). VimpelCom paid $835 million to the U.S. Securities and Exchange Commission and to the public prosecution service of the Netherlands for corruption in Uzbekistan to obtain mobile frequencies in that country (Ekeberg, 2016).

When a sales manager was sent to prison in Norway, he claimed that his employer did not emphasize compliance or anti-corruption efforts at the company. Even when such topics received more attention, he claimed that his employer had no guidelines to help its sales force. He also claimed that all the payments to consultants and agents originated at company headquarters in Norway. "I had nothing to do with the payments", he testified in court. He felt that responsible executives attributed blame to him as a scapegoat. While the corruption amounted to a few million US dollars, the contract achieved for his employer, the Norwegian military communication systems provider Kongsberg, amounted to several hundred millions US dollars in Rumania (Berglund, 2017).

At Telia in Sweden, compliance failed and three former executives from the Swedish telecommunication company were brought to trial in 2018. The company had already paid $965 million to resolve charges relating to the violations of the Foreign Corrupt Practices Act in the United States and of Dutch law. The three former executives were charged with corruption when entering the Uzbekistan mobile phone market. Both the district court and the court of appeals in Sweden acquitted all three defendants in 2021 (Schoultz & Flyghed, 2021).

Both the sales manager at Kongsberg Defense in Norway, who was convicted, and the three executives at Telia Telecom in Sweden, who were acquitted, felt scapegoated by their former employers that were accused of lacking corporate compliance (Schoultz & Flyghed, 2021: 12):

> Scapegoating involves the corporation transferring the responsibility for an act or event from the corporation itself on one or a few symbolic figures. It reduces complexity and allows a corporation to avoid security.

In the Swedish trial against three executives, the company distanced itself from its former employees. Telia's lawyer asked himself during the court hearings: "Does it constitute a crime? The company Telia has no opinion on this; we leave that to the court to determine" (Schoultz & Flyghed, 2021: 12).

This book applies the theory of convenience to provide insights into the phenomenon of corporate compliance. Convenience theory suggests that compliance is challenged when the corporation has a strong financial motive for illegitimate profits, ample organizational opportunities to commit and conceal wrongdoing, and executive willingness for deviant behavior (Asting & Gottschalk, 2022; Braaten & Vaughn, 2019; Dearden & Gottschalk, 2020; Stadler & Gottschalk, 2021). Focusing on white-collar crime (Benson & Simpson, 2018; Sutherland, 1939, 1983), the lack of compliance is a matter of deviant behavior by executives in the organization who abuse their privileged positions to commit and conceal financial crime.

Rather than focusing on the formalities and procedures of compliance and audits, this book emphasizes the challenges involved in compliance work when trusted corporate officials exhibit deviant behavior. Learning from cases of failing corporate compliance helps identifying the real challenges for compliance functions. As suggested by Antonsen and Madsen (2021: 7), compliance functions are typically established and strengthened in response to business scandals that expose "weaknesses related to regulatory risk management and internal control". The lacking substance of compliance is evident whenever executives are caught in corporate wrongdoing.

The book identifies the problem of noncompliance within the global business practices as related to the matter of convenience. The book is not another title referring to compliance through the prism of regulatory requirements (e.g., McBarnet, 2004; Rooij & Sokol, 2021; Sergi & Teichmann, 2018). Rather, it refers to convenience in a number of case studies that illustrates the deviances from appropriate behaviors due to the negligence or even orchestrated actions that result in malpractices.

The book attempts to guide the reader in better comprehending corporate white-collar crime by means of an analysis of the functioning of corporate compliance. Convenience theory is used as the principal theoretical framework for interpreting the enduring self-regulatory phenomenon of corporate compliance. The book refers to contemporary cases of corporate crime to exemplify the theoretical reasoning and to support it with empirical evidence. Overall, the book provides a criminological perspective on the role of compliance in corporate white-collar crime.

Chapter 2 provides a review of the research literature on corporate compliance. Chapter 3 introduces the theory and concept of convenience, applied throughout this book, to gain insight into compliance challenges. Chapter 4 presents a number of international case studies where corporate compliance can be seen to have failed. Chapter 5 discusses individual and organizational barriers to corporate compliance. Chapter 6 describes and evaluates the pivotal role of corporate compliance officers as a specialized bulwark against white-collar offending. Chapter 7 discusses how corporate compliance, when lost, might be restored. Chapter 8 introduces and explores crime signal detection in terms of its relevance for compliance functions. Lack of compliance requires change management and change measures as presented in Chapters 9 and 10. Finally, Chapter 11 presents an approach to wrongdoing investigation for compliance officers, while Chapter 12 provides compliance officers with a structural model for profiling of potential offenders.

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2

Corporation Conformity and Compliance

This chapter seeks to define the concept of compliance and examine enduring models of corporate conformity. Research perspectives on compliance are evaluated, highlighting the distinction between external and internal compliance processes, allied to the social control goal of organizational conformance (Abadinsky, 2007; Ahrne & Brunsson, 2011; Eberl et al., 2015; Kawasaki, 2020). Existing perspectives have established a close connection between compliance and corporate social responsibility, an adaption which confers dominant norms toward globalization (Scherer & Palazzo, 2011; Zhang, 2021), and the pivotal positioning of the chief executive officer (CEO) within such processes (Davidson et al., 2019; Plesner, 2020; Sands, 2019). The chapter develops to evaluate the efficacy of legalistic and formalistic approaches in delivering perceptions of integrity and trust—a significant challenge when set within a multilayered global landscape of differing individual and cultural values (Alon et al., 2019; Chen & Soltes, 2018; Eberl et al., 2015). Prevailing regulatory tools are then considered, in terms of compliance audit, risk assessment, and fraud examinations of compliance failures, to gauge organizational response to legislative and regulatory measures (Boateng et al., 2021; Gottschalk, 2012; Shichor & Heeren,

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2021; Thottoli, 2021). Here, an analysis of fraud examination processes is illustrated by a series of contemporary cases, to include the Community Bank at Wells Fargo, British Petroleum and General Motors in the United States, Wirecard in Germany, Samherji in Iceland, and Oceanteam in the Netherlands. The chapter concludes with the provision of a maturity model for corporate compliance, such modeling having been previously used to assess and evaluate a variety of multifarious phenomena in terms of 4 developmental staging within complex organizations (Chen et al., 2021; Mondani & Rostami, 2021; Masood, 2020; Röglinger et al., 2012; Solli-Sæther & Gottschalk, 2015).

Research Perspectives on Compliance

The word compliance can be defined as the act of adhering to or conforming to a law, rule, guideline, code, demand, or request. In a business environment, conforming is referred to as corporate compliance. Corporate compliance involves keeping a watchful eye on an ever-changing legal, regulatory, and moral climate, and making the changes necessary for the business to continue operating in good standing within its industry, community, and customer base to the satisfaction of all stakeholders. Compliance can be defined as "the internal programs that organizations adopt in order to educate employees, improve ethical norms, and detect and prevent violations of law" (Baer, 2009: 949).

Corporate compliance is a matter of organizational ability to carry out business activities without violating formal laws, the spirit of the laws, regulations and rules, ethics within and outside the organization, corporate culture in terms of norms and values, and other forms of guiding principles for the business. Corporate compliance is the ability to lead large groups of people toward achieving certain standards of conduct when performing their activities. Compliance refers to obeying the formal rules and regulations as well as the informal norms and attitudes in force in a given situation (Desai, 2016; Durand et al., 2019).

Corporate compliance extends beyond mere legal and regulatory conformity into the realm of promoting organizational ethics and corporate integrity (Dion, 2019). Corporate compliance programs require monitoring, auditing, corrective actions, and system modifications or redesign to prevent future problem behavior (Andreisova, 2016; Majluf & Navarrete, 2011; Peterson, 2013; Remisova et al., 2019). A company's intolerance for wrongdoing is evidenced by corporate action taken consistent with its corporate compliance effort. Corporate compliance functions need internal and external intelligence to collect information on a continuous basis to prevent and detect deviant behaviors. If a corporate compliance function never prevents or detects actual incidents of wrongdoing, then it is likely that incidents escape under the radar (Desai, 2016; Williams et al., 2019), rather than it is a situation characterized by the absence of wrongdoing.

A distinction can be made between external and internal compliance (Kawasaki, 2020). External compliance is concerned with the laws, rules, and other regulations from a government that spell out how an organization should conduct itself. External compliance is also concerned with the local norms and values in the organizational environment. Internal compliance is concerned with internal policies and procedures that are implemented in the organizational structure as well as the organizational culture, where structure refers to the division of labor to complete tasks, while culture refers to the norms and values among organizational members when completing tasks. It is a matter of external and internal restraints from social control that influences organizational members toward conformance (Abadinsky, 2007).

When reviewing the corruption scandal at Siemens in Germany, Eberl et al. (2015) emphasized organizational rule adjustments such as strengthening of internal guidelines in order to close potential gaps, extension, and specification of compliance rules for all employees and suppliers, general interdiction of consultancy contracts in sales and distribution, and guidelines on presents and invitations.

Ahrne and Brunsson (2011) described the characteristics of an organization as membership, hierarchy, monitor, and sanctions. Organizations decide about membership and thus who will be allowed to join the organization as employees. Membership brings a certain identity with it, where the identity differs from that of non-members. Organizations include a hierarchy where there is a duty to oblige others to comply with decisions. Hierarchy entails a form of organized power. Organizations can issue commands, and they can decide upon rules that their members are expected to follow in their actions. An organization has the right to monitor compliance with its commands and rules (Kawasaki, 2020; Rooij & Fine, 2020). Organizations have the right to decide about sanctions, both positive and negative. They can decide to change a member's status by using promotions, grading systems, awards, diplomas, and medals. In this hierarchical perspective, compliance at the top is far more difficult to monitor than compliance further down in the organization.

Compliance is linked to corporate social responsibility. To take on corporate social responsibility (CSR) means to pay back to society. Payback is the opposite of causing costs to society. CSR is supposed to be a self-regulatory mechanism whereby a business monitors and ensures its active compliance with the spirit of the law, ethical standards, and national and international norms (Zhang, 2021). CSR is a concept whereby companies integrate social and environmental concerns in their business operations and in the interaction with their stakeholders on a voluntary basis (Ditlev-Simonsen, 2014).

While research perspectives on compliance are still very limited, CSR is receiving increased attention, sometimes linked to the concept of governance. Corporate social responsibility, governance, and compliance with laws and regulations are three approaches often suggested to combat fraud and corruption in organizations. CSR is defined as discretionary corporate initiatives and activities intended to further social welfare (Carnahan et al., 2017). Today, companies are expected to take on responsibilities beyond regulatory compliance and posting profits (Ditlev-Simonsen, 2014: 117):

> How companies engage the environment, human rights, ethics, corruption, employee rights, donations, volunteer work, contributions to the community and relationships with suppliers are typically viewed as components of CSR.

Scherer and Palazzo (2011: 906) claimed that globalization is a given and not something we can opt out from and that this makes a new perspective on CSR necessary and unavoidable:

> In order to respond to the globalization phenomenon and the emerging post-national constellation, it is necessary to acknowledge a new political role of business that goes beyond mere compliance with legal standards and conformity with moral rules.

Corporate social responsibility is described as a leadership task. Board members and chief executives in an organization have a particular responsibility to make sure that the organization is in compliance with laws and regulations, and that the organization makes contributions to society wherever relevant. Chief executives should make the organization accountable, compensate for negative impacts, contribute to societal welfare, operate business ethically, take responsibility for society, and manage in relation with society.

Engdahl (2013: 332) found that duality in terms of segregation of duties might ensure regulatory compliance in banking and finance:

> Today the segregation of duties is commonly used to ensure regulatory compliance in various industries. (…) The argument is made that an effective duality-based segregation-of-duties type control system presupposes social relations characterized by relative autonomy and third-party dependence, along with work task interdependence.

The chief executive officer (CEO) is the only executive at level 1 in the hierarchy of an organization (Davidson et al., 2019). All other executives are at lower levels. Above the CEO, a number of board members who have major positions elsewhere, show up from time to time. Hambrick et al. (2015) found that boards often fail in their monitoring responsibilities. One reason is that many board members are missing some of the following attributes: independence, expertise in the domain, bandwidth, and motivation. Hambrick et al. (2015: 324) expressed surprise that investigative journalists succeed while board members fail:

> On the face of it, this study applauds the role of the press as governance watchdog, but it also raises deeper questions: If journalists could spot these frauds using public sources, why couldn't the companies' boards have detected them? For that matter, why couldn't the boards have spotted the frauds when they were first being perpetrated? And what kind of tone

> did these boards set that would prompt their companies' CEOs and other executives to engage in such acts and think they could get away with it?

CEOs typically enjoy substantial individual freedom in their professions with little or no control (Khanna et al., 2004). Fraud examiners recommend more control of CEOs because of failing compliance (e.g., Bruun Hjejle, 2018; Clifford Chance, 2020; KPMG, 2020a, 2020b; Plesner, 2020; Sands, 2019). It starts already with travel expenses by CEOs that typically find approval from a subordinate—the chief financial officer (CFO). Control of the CEO is less likely to succeed by a group of people—the board. Rather, the chairperson of the board should control and approve all financial activities of the CEO. Furthermore, the CEO should never be able to act alone in major business activities. The chief compliance officer in the organization should have a special assignment of monitoring CEO activities and reporting findings to the chairperson. Cowen et al. (2016: 152) suggested that employment contracts for CEOs should have a clause related to misconduct and crime:

> For example, a claw back could be triggered by a financial restatement that happens after an executive's dismissal or by new evidence that surfaces indicating he or she engaged in misconduct while serving as CEO. Claw backs can also force terminated executives to repay benefits if there is evidence their actions have violated restrictive covenants.

As suggested in agency theory, CEOs have a tendency to become opportunistic agents (Shen, 2003). Based on their charisma, external stakeholders and board members lose control over CEO activities (Fanelli & Misangyi, 2006). Therefore, Cowen's (2016) proposal of employment contracts with repayment option may cause a decline in white-collar crime by CEOs.

In the perspective of preventing and prosecuting corporate crime, Haines and Macdonald (2021: 299) argued that addressing corporate crime and harm is not simply an issue of enforcement and compliance:

> Neither is it one of digging deeper to find the ultimate root of the problem – the reproduction of power relations is nothing new to criminology. Understanding the direction of prevailing winds that shape business activity is important though in understanding where change is possible. Grappling with injustice is just that – looking for sources of influence ultimately requires going beyond blanket classifications of law – in all its forms – as either helpful or unhelpful, and understanding which law, from which place and used in which way within a field of struggle is important.

Lehman et al. (2020) introduced rule complexity as a research perspective on compliance. The perspective claims that it sometimes is impossible to understand what is right and what is wrong. Some laws, rules, and regulations are so complex that compliance becomes random. Some rules are more complex to the extent that they have more connections to or functional dependencies upon other rules in the same system.

Legalistic and Formalistic Approaches

The popular choice of strengthening the formalistic compliance function in organizations is no substantive action (Eberl et al., 2015: 1207):

> Internal rule adjustments have the potential to signal a voluntary willingness to change the moral standards of an organization, whereas simple compliance with external legal requirements may prove less effective.

Legalistic remedies do generally have little effect on integrity when they are inconsistent with individual and cultural values. Trust cannot be re-established by formal, legalistic measures. Instead, the value inconsistencies have to be addressed directly. However, in a short-term perspective, the approach of window dressing by a strengthened compliance function might temporarily contribute to trust repair. Window dressing is the act or the instance of making something appear better than it actually is. Formal control mechanisms are a window dressing approach that might reduce trust (Eberl et al., 2015: 1207):