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## Compliance program and ethics program: Does an organization need both?

Alexandra Bohinská

### ABSTRACT

The ambiguous use of terms 'compliance program' and 'ethics program' by legislators as well as in the literature can confuse organizations and slow down their efforts to build a compliant and ethical organizational culture. The aim of this article is to differentiate between a compliance program and an ethics program, and to explain their functions and their mutual relationship. Moreover, society expects from organizations to behave both legally and ethically. Thus, the article further clarifies on the theoretical level the need to implement the two programs.

### KEY WORDS

compliance program, ethical conduct, ethics program, legal conduct, organization

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## 1 INTRODUCTION

When the Federal Sentencing Guidelines for Organizations (FSGO) were enacted by the U.S. Congress in 1991, the formal program of an organization to fight organizational crime was referred to as a 'compliance program'. In 2004, the revised FSGO elevated the role of this program since a separate guideline was dedicated to it while the initial version of FSGO dealt with the definition of an effective program only in the commentary (Ethics Resource Center, 2012). In addition, the 2004 amendments appeared to move beyond expecting organizations to merely comply with laws since they recognized the importance of the ethical organizational culture in ensuring legal organizational behavior. The program was renamed to a 'compliance and ethics program' (Michaelson, 2006). Nevertheless, according to the American legislation, "compliance and ethics program means a program designed to prevent and detect criminal conduct" (United States Sentencing Commission, 2018).

Crane and Matten (2016) think that "business ethics can be said to begin where the law ends" (p. 6). So, law compliance is a minimum requirement for organizations, while ethics represents a higher standard (Michaelson, 2006). If an organization wants to behave ethically, it has to follow the law in all circumstances in the first place. On the one hand, the American legislators and regulators have acknowledged the idea that ethical and legal conduct of organizations are closely interconnected by shifting the language from 'compliance' to 'compliance and ethics'. On the other hand, it seems that they have focused mainly on reducing and eliminating criminal or illegal acts because they do not mention unethical conduct in their definition of a compliance and ethics program. As Michaelson (2006) notes, "sometimes, we speak of ethical progress in referring only to an increasing quantity of compliance standards imposed by legislation, regulation, and corporate policy on business conduct" (p. 244).

Formal ethics programs and compliance programs have their roots in the USA and many countries have replicated the American approach to dealing with unethical and illegal activities of organizations. Moreover, some US laws, for example the Foreign Corrupt Practices Act or Sarbanes-Oxley Act of 2002, apply to non-US

### CONTACT INFORMATION:

Alexandra Bohinská / Comenius University in Bratislava / Slovakia / alexandra.bohinska@fm.uniba.sk

organizations as well (Scherer & Palazzo, 2009). This means that many organizations outside the USA prefer or even have to follow American guidance and requirements for an effective compliance and ethics program if they want to be listed on the public equity markets or do business in the USA.

In the scientific literature, confusion arises regarding the terms ‘compliance program’ and ‘ethics program’ because different authors use one term or the other with different meanings or they use them interchangeably. Ambiguity is also apparent in the organizational world. Some companies have implemented ethics programs, other companies have adopted compliance programs. We can also come across compliance and ethics programs or ethics and compliance programs in practice. Therefore, it is crucial to make a clear distinction of the terms and what they mean for organizations if we want them to eliminate organizational misconduct.

## 2 DEFINING THE TERMS

Kaptein (2015) considers an ethics program and a compliance program being synonyms as he offers one definition for both programs: “An ethics or compliance program can be described as the formal organizational control system designed to impede unethical behavior” (p. 415). This suggests that he does not differentiate between ethical and legal, or unethical and illegal. He also identifies an ethics program or a compliance program with what other authors call an integrity, ethical compliance, business ethics and compliance, shared values, and responsible conduct programs. For Martineau, Johnson and Pauchant (2017), programs that “seek to improve the ethical behavior of employees and managers, in compliance with organizational rules and standards, and in line with corporate values” can be referred to as ‘corporate ethics programs’, ‘legal compliance programs’, or ‘integrity programs’ depending on their orientation (p. 791). Some scholars do not regard compliance programs and ethics programs as equivalents, but they combine managing ethics and managing legal compliance in an organization by means of one program. According to Weaver, Treviño and Cochran (1999), “formal ethics programs can be conceptualized as organizational control systems aimed at standardizing employee behavior within the domains of ethics and legal compliance” (p. 42). Majluf and Navarette (2011) see compliance and ethics programs as “the way companies make explicit their guidelines for ethical behavior in terms of basic principles and values, strategies, and company policies, as well as in terms of well-defined norms and rules such as the expectation that all employees should observe the law, honor contracts, and follow regulations” (p. 568). Hence, they do not have a separate definition for each program. Ethics and legal compliance in organizations are definitely closely linked together, but they are not identical. Therefore, if an organization wants to manage both ethics and legal compliance successfully, it needs to have a detailed plan on how to handle ethics and compliance by having an ethics program and a compliance program. This is possible only if an organization has a clear idea of what an ethics program and a compliance program stand for and what their functions are.

### A COMPLIANCE PROGRAM AND ITS FUNCTIONS

Although we find the term ‘compliance program’ in the literature and it is widely used in practice, there is no generally accepted definition of this program. In fact, there are a very few authors who have tried to come up with its definition. Among them, Walker (2006) defines a compliance program as “a formal system of policies and procedures adopted by an organisation with the purpose of preventing and detecting violations of law, regulation and organisational policy and fostering an ethical business environment” (p. 71). In our work, we understand compliance program as “a set of internal policies, procedures and instruments, which regulate the organization’s behavior, i.e. behavior of its owners, management and employees, so that the law is not violated during any activity undertaken by the organization” (Remišová & Bohinská, 2017:12). A compliance program represents a systematic management of all processes in the organization to ensure legal compliance (Remišová, 2015).

A compliance program has three main functions in an organization – detection of criminal conduct (Goldsmith & King, 1997; Laufer, 1999; Paine, 1994; Wellner, 2005), prevention of criminal conduct (Goldsmith & King, 1997; Paine, 1994; Wellner, 2005) and punishment of criminal conduct (Paine, 1994). It also helps improve legal knowledge of employees (Treviño, Weaver, Gibson & Toffler, 1999). The decision to implement a compliance program shows an organization’s strong commitment to acting in accordance with all applicable laws and regulations.

There has recently been an increase in a number of the legal regulations concerning organizations in the USA and they have become more complex (Peterson, 2013). This is certainly not the case of the USA only. For example, in Slovakia, businesses “often do not even have the time to realize new legislations or directives have become effective, not even mentioning their application” (Remišová, Lašáková & Bohinská, 2019:574). A compliance program can help an organization take control over the frequent changes in the national legislation as well as relevant international regulations or the law and implement them as necessary. If effective, it minimizes the legal risks, thus, it helps protect reputation of an organization. In case a legal problem emerges, an organization can react rapidly and be proactive

in investigations of illegal acts. No compliance program can assure that an employee or agent breaks the law, but if a court still finds the program effective, an organization can avoid severe penalties. In addition, it ensures compliance with internal policies and rules.

Regulators appreciate the fact that a compliance program helps identify legal problems before they become too serious, in which case they harm not only an organization itself but the whole society. In addition, with globalization, the problems can quickly spread beyond national markets and reach more economies.

## AN ETHICS PROGRAM AND ITS FUNCTIONS

Similarly to a compliance program, scholars often describe an ethics program using its different components. Brenner (1992) says “a corporate ethics program is made up of values, policies and activities which impact the propriety of organizational behaviors” (p. 393). In fact, each organization has an ethics program even if it is not formally put on paper as besides explicit components, such as codes of ethics, ethics seminar and training, internal control systems, it also consists of implicit parts, like corporate culture, valued and rewarded behaviors as well as management behavior (Brenner, 1992). Majluf and Navarette (2011) support the idea of explicit and implicit parts of an ethics program. Their empirical study confirms the influence of both types of components on employee behavior. Weaver, Treviño and Cochran (1999) distinguish six components of an ethics program: (1) formal ethics codes, (2) ethics committees, (3) ethics communication systems, (4) ethics officers or ombudspersons, (5) ethics training programs and (6) disciplinary processes. An ethics program, encompassing all or some of the above-mentioned components, is a form of an organizational control system (Weaver, Treviño & Cochran, 1999). The aim of these control systems is to predict employee behavior and create links between specific employee behavior and organizational goals (Weaver and Treviño, 1999).

In contrast with Brenner or Majluf and Navarette and similarly to Weaver, Treviño and Cochran, Kaptein (2015) thinks that an ethics program is comprised of only tangible components. He identifies nine of them: (1) a code of ethics, (2) an ethics office(r), (3) ethics training and communication, (4) ethics report line, (5) accountability policies, (6) investigation and correction policies, (7) incentive policies, (8) monitoring and auditing, and (9) pre-employment screening. Kaptein encourages organizations to adopt at least the first eight ones.

Remišová believes implementing an ethics program represents an organization’s decision to encourage the development of employees’ moral orientation. “An ethics program of an organization is the system of connections and relations between ethical mechanisms. Ethical mechanisms mean materialization, e.g. ethics institutionalization” (Remišová, 2011:70). Each organization selects forms of ethics institutionalization based on their needs, considering different quality and quantity factors. The sector and field in which an organization operates, value orientation of owners, organizational culture, level of management ethical thinking, educational structure of employees or future perspectives of organization development are some of the quality factors to be considered. The quantitative factors include, for example, the size, structure and length of existence of an organization or the employee age structure (Remišová, 2011). In her later work, Remišová (2015) understands an ethics program as an integrated system of “beliefs and values, mechanisms, processes and ways of communication which the organization adopts for a long-term and continuous development of ethics in its organizational culture” (p. 80). In this sense, she classifies three main components in the program structure:

1. A group of ethical requirements (norms and rules of conduct in an organization);
2. An ethical infrastructure (different forms of institutionalization - written documents, information flow channels, subjects and bodies, forms of education, mechanisms of supervision);
3. Ways of communication (implementation and enforcement of an ethics program in an organization).

As for the functions of an ethics program, Kaptein (2015) suggests the following seven using his Corporate Ethical Virtues Model:

1. Offer clarity to employees regarding (un)ethical behavior;
2. Demonstrate role-model behavior by management;
3. Provide the necessary resources to employees to behave ethically;
4. Foster a commitment to ethical behavior among employees;
5. Enhance transparency surrounding (un)ethical behavior of employees;
6. Create openness in the discussion of ethical issues;
7. Reinforce ethical employee behavior.

In general, organizations implement an ethics program to regulate employee behavior in a desired way. An ethics program has two main functions - to promote ethical behavior and to suppress unethical behavior. Remišová, Lašáková and Kirchmayer (in press) mention that repressing unethical behavior is based on complying with the internal rules in an organization, while supporting ethical behavior emphasizes employee ethical development. Based on their empirical study, they come up with the third function besides two functions most described in the literature – counseling and resolving ethical issues.

As already mentioned, some authors use the terms ‘compliance program’ and ‘ethics program’ interchangeably claiming that the actual name of the program is linked to the orientation to ethics management in an organization. Paine distinguishes two strategies to ethics management in an organization: the first one is based on legal compliance, the second one on integrity. The compliance-based strategy is directed mainly towards the conformity with external standards, i.e. with criminal and regulatory law. The lawyers usually formulate and oversight such a strategy and it is enforced by education, reduced discretion, auditing, controls and penalties. Many organizations prefer to follow the compliance-based strategy since they want to ensure the penalty mitigation in case an unlawful conduct arises. This approach is often focused on avoiding severe penalties without covering issues that can be unethical. The integrity-based strategy, on the other hand, goes beyond legal requirements on organizations since besides acting in accordance with legislation, it also stands on taking responsibility for ethical conduct by owners and management. They develop the strategy with help of human resource, lawyers and other functions as applicable. Every organization with such an approach can self-govern itself following its values and principles. It creates an environment where an ethical conduct is enabled and rewarded, and consequently employees also become jointly accountable for the organizational activities (Paine, 1994).

Weaver, Treviño and Cochran (1999) distinguish between two types of ethics programs – a compliance-oriented ethics program and a values-oriented ethics program. The former focuses on legal compliance, leading to enforcement of legal rules, monitoring of employee behavior and punishing misconduct; the latter concentrates on creating commitment to organizational values among employees and supporting their ethical aspirations. Scholars agree that an ethics program can be aimed at ensuring legal compliance and at internalizing values at the same time (Paine, 1994; Weaver and Treviño, 1999). Qualitative (Paine, 1994) and quantitative (Weaver and Treviño, 1999) studies have proved that both orientations can eliminate unethical conduct. They have also shown that a values-oriented ethics program can positively influence employee behavior in more areas. Moreover, it has been confirmed that these two program orientations do not replace one another, but they complement each other.

Compliance and values orientations have been the most discussed in the literature, however, an ethics program can also be oriented towards protecting top management and owners, satisfying external stakeholders, and so on. Recently, Martineau, Johnson and Pauchant (2017) have identified six orientations of ethics programs, which are not in opposition, but create a synergetic effect. Their ‘six-orientation model’ is composed of the following orientations:

1. Structural orientation towards practices such as ethics offices, committees, programs and resource allocation;
2. Social-environmental orientation, or orientation towards social and environmental responsibility;
3. Consultation-participation orientation, encouraging dialogue with employees and stakeholders on ethical issues, conducting surveys, and employee involvement in the development of ethical initiatives;
4. Experiential development orientation, focusing on providing training programs using meditation, contemplation, arts, or spiritual practices;
5. Detection orientation, concentrating on revealing deviant behavior;
6. Normative orientation, aiming at regulating employee behavior through policies and standards.

From the above, it is clear that managing ethics is a very complex process, and it should not be approached simply by selecting one orientation, as no orientation can cover the wide range of organizational activities and ethical issues. Therefore, it is advisable for an organization to combine different orientations.

### 3 SHOULD AN ORGANIZATION ADOPT A COMPLIANCE PROGRAM, AN ETHICS PROGRAM OR THE TWO?

Both a compliance program and an ethics program are aimed at regulating employee behavior, as well as behavior of an organization as an entity. While **a compliance program concentrates on legal norms and regulations and internal rules, an ethics program focuses on ethical principles and norms**, which guide and influence conduct of individuals and groups, including organizations. It is impossible not to include ethics in a compliance program and vice versa; an ethics program should definitely cover a commitment to legal compliance. So, there are areas that will be covered by both programs. Nevertheless, those two programs have different goals and functions, and are in no way identical.

It is crucial to remember that there is a difference between legal and ethical conduct. The law is in fact an institutionalization or codification of ethics into specific social rules, regulations and restrictions. But the legislation regulating organizations cannot cover all their areas and activities. So, the standards given by legal acts are considered only minimal requirements for organizational conduct. If organizations were self-governing their behavior based on ethical principles, a big part of the legislation and international regulations would become redundant.

As Crane and Matten (2016) note, there is a so called ‘gray zone’ of issues that organizations encounter but are not regulated by law. In addition, some legal acts do not deal with ethical matters, still, organizations have to act in accordance with them. Besides, some processes and instruments can be legal, yet unethical. Last but not least, ethics

does not only try to determine what conduct is right or wrong, it also deals with ethical dilemmas with no obvious right solution.

The law as well as ethics have encountered dynamic changes recently. Globalization, the technological progress, the rapid transfer of information and other current business trends have led to the need of reconsidering some ethical concerns regarding organizational activities. New acts have been passed on the state levels and guidance or international regulations have been issued to standardize organizational conduct in sensitive areas. Kaptein (2017) remarks that new ethical norms have appeared as well in response to new theories, available information and phenomena.

In democracy, all subjects, individuals and organizations, are expected to comply with the law. Ignorance of the law does not exempt anyone from its consequences. Therefore, it is recommended for an organization to have a thorough plan on how to ensure compliance with the increasing number of new legal rules or changes in the law. A compliance program provides such a plan. It aims at guaranteeing that an organization satisfies the standard behavior required by the market and given by legal rules. **A compliance program is a set of policies, processes and instruments which determine the way an organization implements legal rules and internal regulations into its processes so that law, including internal law, is not breached.** It regulates behavior of owners, governing bodies, managers, employees and other agents of an organization. A compliance program focuses mainly on the observance of formally written, external or internal rules.

A compliance program represents an organization's commitment towards society to do its best to keep to the rules expressed in forms of laws. **Its function is to prevent, detect and repress illegal activities and actions that are not in accordance with internal rules.** In addition, its purpose is the promotion of legal conduct. An organization manifests internally and externally that the observance of the law and rules forms the basis of its ethical conduct. A thought through compliance program addresses legal risks that an organization faces and encourages adherence to the law. It leads to the state where owners, managers and employees start self-regulating themselves, legal behavior becomes part of their DNA. They realize that breaking the formal rules results in the unfair functioning of the market which is harmful for organizations, as well as for society. At this stage, a detection and repression of unlawful conduct become of a less importance and a compliance program is mainly a plan for incorporating a new law or changes in laws, for improving the level of lawfulness of processes and activities, and for enforcing legal behavior even outside the organization. A number of formal internal policies guiding employee and management behavior in an organization can start decreasing. If it has not done it yet, an organization can ask its business partners to behave legally as it cooperates only with those who either have their own compliance programs or adhere to the requirements for legal conduct of an organization. The number of organizations committed to behaving legally in all situations grows, and eventually the increase of legal norms regulating organizations gradually slows down.

**A compliance program is mainly influenced by an external environment.** It deals primarily with the requirements coming from outside of an organization. Changes in the program result from the development of legislation and external demands on organizational conduct. An organization can find a law or regulation improper, unfair, or not in line with its values. Still, it has to find a way how to incorporate such a rule or regulation to its activities and processes. However, there are legal ways to change the situation, and an organization can take advantage of them. It cannot decide to ignore or break a rule or regulation.

Even if the observance of laws and rules falls under the area of ethics, it is not enough for an organization to commit to following the legal rules in an ethics program without clearly determining how it will achieve legal compliance. Organizations often focus on keeping those standards for which sanctions are known. In other words, they try to avoid penalties and punishments, so they center their attention on legal conduct. For these organizations, ethics in business restricts to legal compliance. Enderle (1997) mentions that human action takes place on three levels - micro-level (individual level), meso-level (organizational level) and macro-level (the economic system). Activities at these levels are not separated, there are multiple relations between them, one level cannot determine the other completely. Organizations as part of the social system contribute to the quality of morality of the society in which they operate. Consequently, they also influence the quality of life in that society. For this reason, organizations should not only commit to legal conduct, but expand the requirements and commit to ethical behavior based on ethical norms and principles. This can be achieved through an ethics program. While the objective of a compliance program is to assure the standard behavior required by the market, an ethics program is an organization's manifestation that it wants to exceed this standard.

**An ethics program defines fundamental values and ethical principles that are essential to an organization. It describes a desired behavior and conduct.** It explains what behavior is required and supported in an organization. An ethics program also determines processes and tools to achieve ethical behavior, conduct and decision-making. It motivates representatives and employees to behave ethically not only because it is expected from the external environment but because it is the right thing to do. **An ethics program's aspiration is for owners, managers and employees to internalize values and ethical principles that an organization follows.** Moreover, an ethics program provides instructions on how to act in situations that are unethical and helps managers and

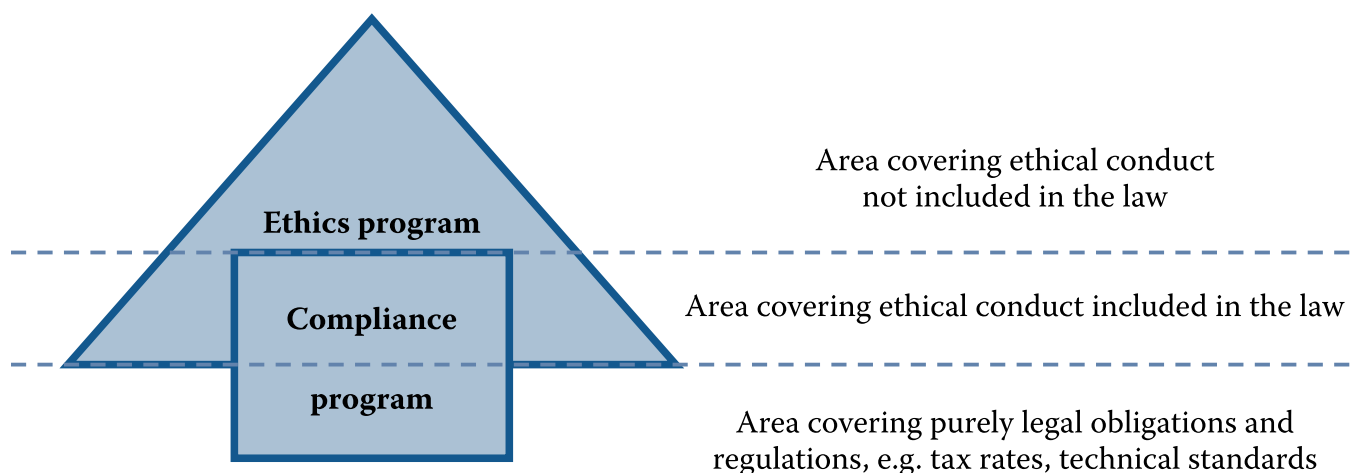
employees decide in case an ethical dilemma occurs. So, it also covers those areas that are not included in the legislation. It evolves together with an organizational culture, which means that impulses for changes come mainly from inside of an organization with the objective to constantly improve conduct of an organization and its representatives.

**Similarly to a compliance program, an ethics program has three main functions – prevention, detection and repression, but it concentrates on the undesired and harmful conduct that is not covered by the law, i.e. on unethical conduct.** In addition, it strengthens an ethical alignment of owners, management and employees. It is a program of the ethical development of an organization, its ambition is to reach a point of self-governance of everyone in an organization, at all levels. This means that representatives of an organization behave ethically in all circumstances. As Remišová and Lašáková (2017b) emphasize, ethical conduct integrates ethical motives and ethical consequences. This means that reasons behind owners, managers and employees' decisions and actions are ethical and at the same time, they consider the consequences of their decisions and actions on different stakeholders and the environment. If one or the other is missing, conduct is considered as unethical.

Taken the above into the consideration, I believe that it is not enough for an organization to only implement a compliance program to assure the requirements given by the law and internal rules are met or to only include a commitment to legal compliance in an ethics program. It is highly advisable for every organization to have a plan on how to deal with legal compliance. At the same time, an organization also has to have a formal description of what behavior is desired and restricted and how that particular organization can make a difference in the society it is part of. Consequently, I think an organization needs to adopt the two programs – a compliance program and an ethics program, the latter should be an umbrella program for the former as respecting the law and internal rules creates the base for the ethical conduct. Picture 1 represents the relationship between the two.

Building a compliant and ethical organizational culture is similar to building a house. An organization needs to lay the foundations first. Otherwise, without the strong foundations, it builds on a shaky ground and no matter how high up it will go, the lack of stability will always threaten the organization. A compliance program can be seen as the foundations. It ensures that the basic requirements of society are satisfied and that the internal rules are followed. Although the foundations are an essential element, an ethics program can be considered a roof that covers and protects the foundations. If an organization limits itself to following laws, in other words just meeting the basic demands, it does not offer much to society and cannot be successful in the long run.

Picture 1: Relationship between a compliance program and an ethics program



Source: Own representation

## 4 CONCLUSION

States have started to have stricter requirements on organizations when it comes to their conduct because of many organizational scandals and frauds that led to the instability on the financial markets, loss of trust of investors as well as customers and broader society. For example, corruption, a widespread problem globally, can have many economic as well as non-economic implications for any democratic state, including non-optimal allocation of resources, deformation of competition environment, negative impact on the economic growth and investments, and even citizens' distrust of the rule of the law, equality before the law and liberal democracy as such (Zemanovičová & Vašáková, 2017). The work of many NGOs has also pressed organizations to fight against illegal and unethical

conduct (Remišová & Lašáková, 2018). Criminal liability of organizations together with a punishment mitigation in case of an effective program to fight organizational misconduct have been introduced in many countries. As a result, organizations have begun to adopt compliance programs to satisfy the law and to avoid severe penalties. A compliance program is a set of written guidelines, processes and instruments to control behavior in an organization so that the law and internal rules are not breached during any activity undertaken by the organization. In today's complex environment, including legal environment, such a program is a great tool to deal with legal risks as its goal is to prevent, repress, detect and punish illegal activities in the organization.

Moreover, as Remišová & Lašáková (2017a) conclude, the quality of our lives is directly affected by the morality in the economic sphere. Organizations have acquired more power in the globalized world, they can influence the business standards and contribute to the better functioning of the market, and consequently improve the quality of life in society in which they operate. This is possible only if their decisions and activities follow high ethical norms and principles. Ethical behavior can be achieved thanks to a series of ethical mechanisms that support each other and lead to a self-regulation of organization's representatives, in other words by an ethics program. The aim of an ethics program is to detect, prevent and repress unethical behaviour, but what is even more important, its function is to support and develop ethical behavior of owners, managers and employees.

Legal and ethical conduct is a presupposition of the long-term success of an organization. In order to achieve such a conduct, it is not enough for an organization to randomly institutionalize a few forms of ethics. It needs to have systematic plans, or entire programs in other words, on how to ensure legal and internal rules as well as ethical norms and principles are always followed in an organization (Bohinská, 2018). A compliance program helps an organization to incorporate laws and internal rules in the daily operations. An ethics program leads to behavior based on ethical norms and principles that does not harm anyone, on the contrary, it adds value to society and the organization itself. Therefore, an organization should definitely adopt both programs. A compliance program creates the solid foundations of a compliant and ethical organizational culture, while an ethics program further develops ethical aspirations of leaders and employees.

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