

Regulatory compliance: adapting to a pressurized environment

Executive summary

Even since early last year, the risk to companies from enhanced regulatory enforcement and new legislation continues to increase. Enforcement actions are up, and officials are becoming more zealous and more prescriptive about what they expect from companies' compliance programs. This activity is causing great concern among audit committee chairs. These days, audit chairs are asking, "What are the practical steps the company can take to demonstrate compliance with regulatory regimes? Where is the future of regulation headed? How do we do business in this changing regulatory environment?"

This edition of *InSights* looks at how company compliance functions are adapting to this new environment. It is based on conversations with audit committee chairs, compliance executives and a broad range of compliance advisors and subject-matter professionals.

1. **Make sure compliance risk is understood throughout the business** (*page 7*) Compliance risk needs to be understood, quantified and monitored. New tools and techniques can be leveraged more effectively, and internal and external advisors offer new ways to manage compliance.
2. **Strengthening the governance of compliance** (*page 8*) The design and governance of compliance functions is changing rapidly, prompting some hard questions regarding how well these activities are integrated across the company and the effectiveness of the board's oversight.
3. **Strengthening accountability throughout the company** (*page 10*) Leading organizations are proactively instilling a strong sense of accountability for managing and mitigating compliance risk across their companies.
4. **Cultivating an ethical culture** (*page 12*) Ultimately, every company depends heavily on its culture to protect against compliance breaches, and steps can be taken to build and foster stronger ethical cultures.

Taken together, these four steps both limit the amount of compliance risk companies will face and put companies in a better position with enforcement officials if, despite preventative measures, a compliance incident occurs.







A challenging regulatory compliance environment

An *InSights* report published in April 2010 noted that regulatory compliance risks were increasing for US companies and warned that “audit committees will need to remain vigilant on compliance programs and must confirm they are well prepared to assess the magnitude of these risks.”¹ Since then, regulators and enforcement agencies around the world have gained more powerful enforcement tools and are becoming more prescriptive in their evaluations of compliance programs. In addition, new legislation is being enacted that places burdensome new constraints and compliance requirements on companies across all industries.

Zealous compliance enforcement is becoming the norm

“The government is asking for so much information now, and we are spending so many resources to feed investigations,” said one compliance executive. Participants indicated compliance enforcement has increased in a number of areas:

- ▶ **The US is reinvigorating public health and safety enforcement.** A report administered by the nonprofit group OMB Watch found that President Barack Obama has taken an enforcement approach to public health and safety in his first term. The results have begun to show: the report noted, “At [the Occupational Safety and Health Administration (OSHA)], the number of health and safety violations cited by agency inspectors is increasing... . The [Food and Drug Administration (FDA)] has issued a greater number of warning letters to firms in violation of the agency’s rules... . The [Environmental Protection Agency (EPA)] is moving more quickly to address violations of environmental laws.”² In addition, on January 2, the EPA “enacted what are the first regulations of major stationary sources of greenhouse gases... . Eventually the EPA will be issuing regulations for nearly all sources of greenhouse gases – providing the only federal action to control U.S. carbon emissions.”³

- ▶ **The crackdown on financial institutions is intensifying.** In the wake of the financial crisis, the Obama Administration continues to crack down on financial fraud, including insider trading and mortgage fraud. In December, Attorney General Eric Holder announced “the largest federal crackdown against financial fraud in U.S. history.”⁴ Compliance experts note that regulators are asking for more information, and they want it delivered more quickly.⁵ One audit chair noted that “financial institutions must now also achieve the ‘spirit and intent’ of regulations, not just compliance with the rules. How do you know what that means?”
- ▶ **FCPA enforcement continues to intensify.** In fiscal year 2010, Foreign Corrupt Practices Act (FCPA) enforcement imposed “\$1 billion in penalties ... the largest in the history of FCPA enforcement.”⁶ “I’m proud to say that our FCPA enforcement is stronger than it’s ever been – and getting stronger,” reported Lanny Breuer, Assistant Attorney General for the Criminal Division of the Department of Justice (DOJ).⁷ Indeed, in a single week in April, the Securities and Exchange Commission (SEC) and DOJ levied almost \$300 million in FCPA-related fines against three companies.⁸

1. Ernst & Young and Tapestry Networks, “Regulatory Change Is Driving Audit Committee Agendas,” *InSights*, April 2010.
2. OMB Watch, *The Obama Approach to Public Protection: Enforcement* (Washington, DC: OMB Watch, 2010), 4.
3. Bryan Walsh, “Battle Brews over EPA’s Emissions Regulations,” *Time*, January 3, 2011.
4. Jourgen Wouters, “Feds Announce Largest Crackdown on Financial Fraud in U.S. History,” *WalletPop*, December 6, 2010.
5. Melissa Klein Aguilar, “Shop Talk: Can IT Save Compliance at Financial Firms?” *Compliance Week*, January 4, 2011.
6. U.S. Department of Justice, “Department of Justice Secures More Than \$2 Billion in Judgments and Settlements as a Result of Enforcement Actions Led by the Criminal Division,” news release, January 21, 2011.
7. Lanny Breuer, speech to the 24th National Conference on the Foreign Corrupt Practices Act., National Harbor, MD, November 16, 2010.
8. Mike Koehler, “Johnson & Johnson Enforcement Action Focuses on Health Care Providers as ‘Foreign Officials,’” *FCPA Professor*, April 11, 2011.

New anti-bribery laws

This spring, the UK's Serious Fraud Office released prosecutorial guidance, and the Ministry of Justice released adequate procedures guidance on the UK Bribery Act, which is effective July 1, 2011. While participants said "it is unclear how the Act will be enforced," a *Forbes* article noted, "[As the] guidance confirms, it is sheer folly for businesses to ignore what can justly be termed a new chapter in global anti-corruption enforcement. There's a reason it's being called 'the FCPA on steroids.'"⁹ According to an Ernst & Young brief, the Act "draws no distinction between public and private sector bribery" and makes "no exemption for facilitation or 'grease' payments."¹⁰ Furthermore, it "pays close attention to the role of individuals in bribery and in failing to prevent bribery: prison terms of up to 10 years can apply."¹¹

In addition, in late February the Chinese Government passed an anti-bribery law which criminalizes providing "property to a foreign official or an official of an international public organization for the purpose of seeking an improper commercial benefit."¹² Observers say that the law reflects a new anti-corruption "arms race" with "countries trying to out-FCPA each other."¹³

Participants also noted that signatories to the Organization for Economic Cooperation and Development Anti-Bribery Convention are "becoming more involved in anti-bribery efforts." Indeed, 38 countries are now members of the working group, having ratified the convention, which means their governments have agreed to adopt legislation necessary to criminalize bribery of foreign public officials in their countries.¹⁴

- ▶ **Deferred and non-prosecution agreements.** In 2010, the DOJ entered into 32 deferred and non-prosecution agreements with companies, a significant increase over 2009 and 2008, which had 21 and 19 agreements, respectively. The agreements, which require companies to pay a fine and institute governance reforms, netted the DOJ approximately \$2.3 billion.¹⁵ One compliance executive said, "These DOJ enforcement actions have become [a] ... disproportionate part of doing business in the US."
- ▶ **Actions against individuals.** In April, the Department of Health and Human Services informed Howard Solomon, the Chairman and chief executive officer (CEO) of Forest Laboratories, that it "intends to exclude him from doing business with the federal government," in effect banning him from participating in Medicare and Medicaid programs, as a result of its investigation into Forest Laboratories' drug marketing practices.¹⁶ The *Wall Street Journal* noted, "The campaign against drug-company CEOs is part of a larger Obama administration effort to pursue individual executives blamed for wrongdoing rather than simply punishing companies. The government has tried to prosecute *Wall Street* executives in connection with the 2008 financial crisis, but with limited success."¹⁷

Compliance program requirements are increasingly prescriptive

One aspect of the US Government's more zealous approach to compliance enforcement is increasing prescriptiveness regarding the contents of compliance programs. Enforcement agencies are using various mechanisms to highlight these expectations:

- ▶ **Prosecution agreements.** A recent study found that "over 90% of the deferred prosecution (DPA) and non-prosecution (NPA) agreements entered into in 2010 contained compliance features, an almost 40% increase since 2005."¹⁸ Features required typically include "training on a code of conduct, a hotline or e-mail system to report abuses, procedures to monitor and detect wrongdoing and a direct reporting line from a chief compliance officer (CCO) to the CEO or board of directors."¹⁹
- ▶ **Corporate Integrity Agreements (CIAs).** CIAs between a pharmaceutical company and the Office of the Inspector General of the Department of Health and Human Services lay out compliance obligations for the company as part of a settlement for company wrongdoing. Many CIAs require companies to overhaul their compliance programs.²⁰

9. Richard Levick, "Today's Guidance on UK Bribery Act Launches New Enforcement Era," *Forbes*, March 30, 2011.

10. Ernst & Young, *Business Briefing: The Bribery Act* (Ernst & Young Global Limited, 2010), 2.

11. Ernst & Young, *Impact of the New UK Bribery Act Extends beyond UK Operations* (Ernst & Young Global Limited, 2010), 1.

12. Richard Meyer, "China Passes Anti-Bribery Law," *Compliance Week*, April 12, 2011.

13. *Ibid.*

14. OECD Directorate for Financial and Enterprise Affairs.

15. Gibson, Dunn & Crutcher, "2010 Year-end Update on Corporate Deferred Prosecution and Non-prosecution Agreements," January 4, 2011.

16. Alicia Mundy, "Government Aims to Oust Forest Labs CEO," *Wall Street Journal*, April 26, 2011.

17. *Ibid.*

18. Ryan McConnell and Charlotte Simon, "Remedial Compliance Programs: A Key Ingredient in the Enforcement Recipe," *FCPA Blog*, January 18, 2011.

19. Sue Reisinger, "Corporate Compliance and Criminal Cases: Plan Now or Pay Later," *Corporate Counsel*, January 13, 2011.

20. DPAs/NPAs, which are administered by the DOJ, frequently require a CIA, which is administered by the relevant federal government department. Companies can sign DPAs or NPAs without CIAs, and vice versa.

- ▶ **United States Sentencing Commission Guidelines (USSG).** Chapter 8 of the Federal Sentencing Guidelines outlines the features of an effective compliance program and serves as a benchmark for companies designing such programs. In the event a company is fined for a violation, a good compliance program potentially can reduce the fine by up to 30%.²¹ The recent revisions, which became effective in November 2010, state that a compliance program may be deemed effective even if high-level employees were involved in an offense, as long as certain conditions are met, one of which is that the head of compliance has “direct reporting obligations” to the governing authority, such as the audit committee.²²
- ▶ **New whistleblowing awards.** The Dodd-Frank Act requires the SEC to establish a new program to reward whistleblowers who provide original information to the SEC relating to all manner of securities law violations. SEC Commissioner Kathleen Casey has said, “Given the amount of money that will be at stake, whistleblowers will have extremely strong financial incentives to circumvent corporate compliance programs in favor of bringing information directly to the Commission.”²³ One compliance executive said, “I have to rely less and less on my employees to bring certain things to my attention. There’s no way we can compete with a \$50 or \$90 million reward.”

Participants said that regulators’ increased enforcement means that boards of directors and audit committees must engage much more deeply with their companies’ compliance programs. One advisor commented, “US institutions are going to be held to a higher standard, and board members are becoming much more actively involved in scrutinizing compliance programs.” Such engagement can greatly reduce their firm’s exposure to regulatory and reputational damage. More importantly, as one advisor noted, directors should seek to “understand the maturity of the compliance program and whether it fits with the complexity of the business and the business risks.”

Questions for the board and audit committee

- ▶ What are the company’s biggest compliance concerns regarding the current regulatory environment and how it might evolve?
- ▶ How are the company and board adapting to the new compliance environment?

21. Ryan McConnell and Charlotte Simon, “Remedial Compliance Programs: A Key Ingredient in the Enforcement Recipe.”
 22. Jay G. Martin and Ryan D. McConnell, “How Revised Sentencing Guidelines Impact CCOs,” *Compliance Week*, May 4, 2010.
 23. Kathleen Casey, “Proposed Rule for Implementing the Whistleblower Provisions,” speech at an SEC open meeting, November 3, 2010.

With that in mind, participants had the following recommendations for companies:

- ▶ Make sure compliance risk is understood throughout the business
- ▶ Strengthen the governance of compliance
- ▶ Strengthen accountability throughout the company
- ▶ Cultivate an ethical culture

Criteria	Leading compliance programs
Risk awareness	<ul style="list-style-type: none"> ▶ Audit committee focuses on the company’s key compliance risks ▶ Management prioritizes regulatory risk ▶ The program proactively deploys data analytics and forensic tools ▶ The program consistently engages outside advisors
Governance	<ul style="list-style-type: none"> ▶ Separate board committees oversee compliance ▶ The CCO has direct access to the CEO and appropriate board committees ▶ Compliance, risk management and audit committees share information and collaborate
Accountability	<ul style="list-style-type: none"> ▶ There is an effective compliance auditing and reporting process ▶ There is active engagement between the compliance function and the business units ▶ The compliance program builds employee accountability through online access to policies ▶ There is a process to retain records of training programs, including attendance ▶ There is thorough due diligence on employees and third-party consultants, distributors and joint venture partners
Culture	<ul style="list-style-type: none"> ▶ Compliance remains at the top of the CEO’s agenda ▶ The program continuously reinforces and adapts the code of business conduct ▶ Employees and business partners are trained on company compliance policies and tested on their awareness of those policies ▶ The program encourages self-reporting ▶ The compliance program encourages healthy relationships with regulators

Make sure compliance risk is understood throughout the business

One audit chair remarked, “The audit committee spends a lot of time trying to understand the regulatory environment that we are operating in now, and that we will be operating in the future. Regulatory compliance is an area that you really have to focus on. That is a bet-the-company risk.” An advisor said, “The main reason why most companies are struggling with compliance is that their compliance programs were implemented by lawyers and the operational side of the business never got to weigh in. What most companies have found is the people down in the trenches don’t understand the part of these legal-oriented compliance programs.” Participants said that understanding the company’s compliance risk profile from a business perspective is the first step toward building an effective compliance program and highlighted several ways to gain that understanding.

- ▶ **Focus on the company’s key compliance risks in audit committee meetings.** One audit chair said, “From the audit committee’s perspective, the most important issue is awareness of our laws and regulations. We’ve got people all over the world. It is one thing to have policies; it is another to make sure that people pay attention to those policies.” Another audit chair outlined how the audit committee’s review of compliance has changed as a result of enhanced enforcement: “We used to go through every [compliance issue] in the quarter with a slideshow. Now, we are asking management to tell us more specifically about the unusual items and the things that are unique to the industry. We have a tool to evaluate how well [our products] are performing against our requirements. We focus in on the things that are changing, and [that] gives us the opportunity to ask questions.”
- ▶ **Raise awareness of regulatory risk with management.** Of particular importance, participants said, is that management properly applies forthcoming regulations to the company’s businesses. One audit chair said, “My assessment of management’s ability to succeed in this area has so much to do with how inquiring they are with what requirements are all about. Where management is not curious about the implications, the issues are so sophisticated that you lose their significance.”
- ▶ **Proactively use data analytics, forensic tools and metrics.** An advisor remarked, “People say compliance is not quantifiable, but that’s nonsense. It’s very quantifiable. Audit committees should insist on seeing metrics on compliance risk. We benchmark the compliance risks of large companies and their vendors. Is my company above, on par or below compared to peer companies?” One compliance executive said, “Monitoring is the great new frontier of the compliance function, and the newest monitoring technique is very proactive data analysis. We use many different forensic tools, including transaction analysis, to look for certain patterns.”
- ▶ **Use advisors from inside and outside the company.** An audit chair remarked, “We are very proactive. We have our internal audit teams on the ground listening to rumors, and [we] use the external auditors and general counsel in every part of the world. You get a lot of information about where your biggest risks are. [You] have a good story to tell in the event of prosecutorial discretion.” Transparency International and the World Economic Forum Partnering Against Corruption Initiative (PACI) are leading an initiative to urge companies to adopt voluntary assurance of anti-bribery and corruption programs, raising the pressure on companies to benchmark their effectiveness of their compliance programs.²⁴ A compliance executive said, “We get a renowned firm to give us a conclusion that we either have or don’t have an effective program. We don’t want a mealy-mouthed answer. There can be too many caveats in these reviews. We pay a lot of money for these reviews, and they take a lot of time. I like to have a big name do it, too. They are not going to disparage their own name, and ... they have credibility with regulators.”

Questions for the board and audit committee

- ▶ How does the board assess the organization’s compliance risk profile?
- ▶ What metrics does the company use to quantify or monitor compliance risk?
- ▶ How do directors get a sufficient understanding of the company’s compliance risks? What tools and advisors do you rely on?

24. Transparency International. “Public consultation: TI Framework for Voluntary Independent Assurance of Corporate Anti-Bribery Programmes.”

Strengthening the governance of compliance

An audit chair reflected, “In today’s environment, everybody has to think on their feet. We’re asking, ‘Do we have the right staff? Do we have the right structure? How should we drive [compliance] through the organization?’”

Features of leading compliance functions

Participants outlined a number of characteristics of leading compliance functions:

- ▶ **Strength and independence.** While heavily regulated industries such as health care have long counted the CCO as a key member of senior management, only recently have less-heavily regulated industries such as professional services or manufacturing recognized “the long-term strategic value of a chief compliance officer’s focus on risk, and sought the expertise.”²⁵ Currently, there is a debate around how the compliance function should be organized to tackle its responsibilities successfully. Which structure works best for a company depends on many factors, including industry, size and geographic scope, but in a recent article, Ben Heineman, the former general counsel (GC) of General Electric, laid out three possible approaches:²⁶

1. The CCO is independent of the GC and chief financial officer (CFO) and reports directly to the CEO and board
2. The GC is also the CCO
3. The CCO reports to the GC and the CFO

Heineman prefers the third approach because it supports a strong legal function and avoids “organizational overlap and confusion.”²⁷ However, some participants argued that the legal and compliance functions should be separated; one advisor said, “The general tendency for the GC is to defend the company. If you come at compliance with a defense or prosecutorial perspective, it will fail.” Several participants advocated the first approach outlined above, with one advisor commenting, “The [CCO] should report to the full board or a specific committee.” One compliance executive said, “Now that I am on the executive leadership team, the board looks at me differently, and I am in all the executive meetings, so I have a better vantage point about what the company is actually doing. And it gives the function a better stature overall.” Despite their differences of opinion, participants all agreed that the head of compliance must have unfettered access to the appropriate board or committee contact, when needed.

- ▶ **A centralized approach.** An audit chair said, “One big issue around the compliance function is getting your hands around all the regulations we are subject to – making sure we are not missing something. We have centralized the process, bringing all these compliance [areas] together. We have a way of keeping track and making sure someone is responsible.”
- ▶ **Integration with risk management and audit.** Participants said that more collaboration and information sharing between audit, risk management and compliance could lead to greater risk management efficiencies in the organization. One advisor recommended that companies “look at the totality of governance, risk management, audit, compliance and ethics as a single thing, of which there are many departments. If all these [elements] are integrated [or linked] with one another, you are able to deal with a lot of risk areas more efficiently.”

Echoing Ben Heineman, participants also noted that companies should avoid overlaps and gaps in oversight coverage. A compliance executive said, “We’ve created an integrated control infrastructure. Compliance is at one level, and audit is at another level. Audit comes in, shares their opinions, and then they get out. They talk to each other so everyone is aware of what everyone else is doing under a strategic leadership approach.”

A changing compliance oversight model

Banks are mandated under the Dodd-Frank Act to create separate risk committees of the board, and in the wake of the financial crisis, there was political pressure to mandate risk committees in all companies.²⁸ Some participants see a potential analogue with compliance: various CIAs have outlined the roles that boards and audit committees should play in overseeing the compliance function, including requiring a separate compliance committee of the board or requiring the audit committee to spend a certain amount of time overseeing the compliance function each quarter.

25. Chris DePippo, “The Evolving Role of the Chief Compliance Officer,” *Corporate Compliance Insights*, April 19, 2011.

26. Ben W. Heineman, Jr., “Don’t Divorce the GC and Compliance Officer,” *Harvard Law School Forum on Corporate Governance and Financial Regulation*, December 26, 2010.

27. *Ibid.*

28. Melissa Klein Aguilar, “Shareholder Bill of Rights Act Introduced,” *Compliance Week*, May 19, 2009.

Participants described two oversight models:

- 1. Separate board committee overseeing compliance.** The audit chair of a company in a heavily regulated industry recently remarked, "Risk and compliance are [paramount] in our industry. We have separate compliance committees and separate compliance leadership. It wouldn't surprise me if the model spreads." A compliance executive said, "I like the notion of a separate compliance committee... . If [we have a separate] committee, that gives me a lot more bandwidth to have qualitative risk discussions with the audit committee." However, most participants said few companies have separate regulatory compliance committees. One audit chair said, "I am uneasy about regulators prescribing oversight mechanisms for compliance in an arbitrary way. Some things, like a separate board committee for compliance, may make sense for a company in a heavily regulated industry, but it may be burdensome for other boards."
- 2. Audit committee oversight of compliance.** Many CIAs require the audit committee to spend a certain amount of time every quarter reviewing the company's compliance function. Several participants said audit committees are now devoting significant time to overseeing regulatory compliance. One audit committee chair said, "Compliance is on every agenda that we have. We force management to respond. Each quarter we get updates on training, [metrics] and policies; we force management to [think about] the issue in a consistent way."

Questions for the board and audit committee

- ▶ How is the CCO positioned in the organization? Who does the CCO report to?
- ▶ How does the compliance function work with the audit and risk management functions?
- ▶ What board committee(s) should oversee compliance? Should it be chiefly the audit committee, or should other committees or subcommittees play a role?
- ▶ What kinds of questions does the board ask about the compliance function?



Strengthening accountability throughout the company

Ryan McConnell, an attorney and former Federal Prosecutor, said, “If you don’t put boots to the ground and take adequate steps to make sure your compliance program is effective, you’re not going to get a lot of sympathy from the Justice Department.”²⁹ Participants suggested ways to embed accountability for compliance in the company:



- ▶ **Improve compliance auditing and reporting process.** One compliance executive outlined a new approach their company has taken to confirm it is looking at the right compliance risks: “Each business president, assisted by their business compliance officer, gives a report to the audit committee. The report lays out the business risks. This report is verified by a lead audit group. The final piece is a one-page subjective report from the vice president of risk management to the audit committee on how well the business unit is managed.”
- ▶ **Embed compliance in the business.** Many participants noted that although it is important to centralize compliance leadership, compliance must be carried out in the business units. An audit chair remarked, “The ultimate responsibility [for compliance] is with division heads and the CEO, not with the compliance organization.” Participants also said the CCO should be supported by a compliance team in each of the business units; one compliance executive said, “We have a chief compliance officer, and every business unit has a deputy compliance officer who reports into the head of that business.”

Questions for the board and audit committee

- ▶ How does the board measure the effectiveness of the company’s compliance program? What tools and resources are used to monitor compliance efforts?
- ▶ How does the company make sure that compliance is embedded in the business units? How does the company instill a sense of accountability in its employees?

29. Shannon Green, “Court Docs Show Role of Tyson In-House Lawyers in Foreign-Bribery Case,” *Corporate Counsel*, February 17, 2011.



Cultivating an ethical culture

Participants universally agreed that rules and procedures only get a company so far; ultimately, for compliance efforts to be effective, the company must have an ethical culture. As Richard Alderman, the Director of the UK's Serious Fraud Office, said recently, "The first question we ask, and the most important one for us, is, 'What is the top-level commitment from the board to an anti-corruption culture? Are the people at the top of the organization genuinely committed to an anti-corruption culture?' If not, the rest of it is just words."³⁰

Participants recommended several ways to build a strong compliance culture:

- ▶ **Keep compliance at the top of the CEO's agenda.** One compliance executive said, "It is easy to run around and talk about tone at the top, but if that is not reinforced throughout the organization, it is meaningless." One compliance executive defined tone at the top as "genuine support for the functions that carry out ethical compliance and the principles behind them." Another compliance executive remarked, "Once in awhile, [my CEO] will do something that will be supportive of compliance and will be way more valuable than any tone-at-the-top policy." Participants said the CEO and senior management create the tone at the top through their words and deeds, and the board and audit committee can reinforce senior management's efforts through discussions with them. An audit chair remarked, "Any time there are management meetings, we remind the CEO of the importance of this."
- ▶ **Disseminate, reinforce and adapt the code of business conduct.** Participants highlighted the importance of having a "crisp, clear" code of conduct that reinforces the ethical culture of the company. One audit chair ensures management continually adapts the code of conduct: "We are asking management to look at the marketing of our [code of conduct] ... what our policies are, and the ramifications of violating those policies. We are reviewing communications to all staff. We worry - are these messages old and forgotten? Do people need to be reintroduced to the company culture and what we stand for?" Some observers advocated policies that address specific regulatory risk, which would counter the current status quo in some areas - for example, one study of leading oil and gas companies found that "only five [of 40] companies had separate, stand-alone, publicly available FCPA policies."³¹ As one participant said, "You've got to clearly address your most important risks in your code of conduct." Participants encouraged companies to make employees accountable for learning company policies and partaking in training programs. One compliance executive described a mechanism for creating more accountability: "We have established an electronic library for our corporate policies which is available to all employees. Now everyone is accountable."
- ▶ **Champion compliance in the organization.** One advisor said, "CCOs sometimes don't have the resources to do effective auditing. If you are the CCO, convincing the business guys to spend money on something that's not a problem yet is hard. It's an especially tough choice when the economy is slowed down - how much do you devote to compliance? Selling that to the business is tough." One advisor said the audit committee could help champion the CCO: "Make sure the CCO has the right resources. Let them know that you are paying attention and asking tough questions. Is the compliance function working? We have an office in Nigeria - have we gone out there? Where is our product ending up? [Ask] the tough questions of your CCO and prepare him for his report to the board." A compliance executive said the audit committee's support allows him to strengthen compliance in the business units: "The relationship between the CCO and the audit committee is critical. It is a great thing for me to tell business folks, 'Compliance is something that the audit committee really cares about. I can help shepherd compliance through the business.'"
- ▶ **Train employees on company policies.** Most companies have formal training systems to help make sure employees are aware of company policies as well as local laws and regulations. One audit chair remarked, "[One company] has training for all ... employees and takes the board through a short mini-course on ethical behavior." Participants stressed the importance of training employees based in international locations. One audit chair said, "We had the general counsel on the road all the time, educating employees and ensuring they were aware of laws and regulations. This also protected us in case something bad happened and the SEC asked the question of what we were doing to prevent it."

30. Melissa Klein Aguilar, "A Conversation with Britain's Top Fraud Investigator" Compliance Week, January 19, 2011.

31. Ryan McConnell, Katharine Southard and Charlotte Simon, "What Does Effective FCPA Compliance Look Like?" Corporate Counsel, 2011.

- ▶ **Confirm that third-party business partners are covered.** An advisor said it is imperative that companies “make sure their anti-corruption policies extend to business partners.” Doug Tween, a partner at Baker & McKenzie who represented Panalpina in its recent FCPA enforcement case, said, “A majority of the [bribery] cases that the government prosecuted recently have involved payments made through intermediaries... . So there is an expectation that a substantial amount of third-party due diligence has to be done before a company can safely rely on any agent to do its business.”³²
- ▶ **Encourage healthy relationships with regulators.** Participants said that building relationships with their sector regulators (for example, the FDA or banking regulators) could help companies understand the direction in which the regulators are headed and would mean that a rapport was established before problems arose. One audit chair said, “In dealing with regulatory bodies, it pays to be over prepared and proactive. Get information in front of them; it can create good relations.”

One way to build healthy relationships with regulators is to encourage self-reporting to regulators. Indeed, in settling a recent deferred prosecution agreement with a company that violated the FCPA, the DOJ significantly reduced the fine, citing the company’s self-reporting.³³ As an observer noted, “This precise language makes clear that the DOJ places a real value on such self-disclosures and companies should take this as a clear sign that, at the end of the day, it will be better for them to self-disclose.”³⁴

32. Arielle Bikard, “Lessons from J&J’s \$70 Million FCPA Settlement,” *Compliance Week*, April 19, 2011.
 33. Ryan McConnell, Katharine Southard and Charlotte Simon, “What Does Effective FCPA Compliance Look Like?,” *Corporate Counsel*, 2011.
 34. Thomas Fox, “Johnson & Johnson DPA: Self-Disclosure Reduces Fine (Part I),” *Corporate Compliance Insights*, April 12, 2011.

However, participants affirmed that it is difficult to build relationships with regulators on the criminal enforcement side, such as the DOJ and SEC. Many of these regulators are focused on “getting a return on investment [in additional enforcement staff] from companies,” as one compliance executive said. The executive remarked, “The DOJ will not engage. It is a very political system where you have competing states’ attorneys general looking to get as much money out of companies as they can. The political current is against building relationships with the private sector.” An audit chair remarked, “There is a lack of trust in business now that is the worst I’ve ever seen. Regulators are all over us, and business doesn’t have a credible voice.”

Questions for board and audit committee

- ▶ How does the board define tone at the top? How can the board and the audit committee monitor whether tone at the top is maintained?
- ▶ How does the board see to it that senior management takes compliance seriously?
- ▶ How does the board confirm that the code of business conduct and company policies keep pace with new rules and laws and are communicated effectively to all employees and key business partners?
- ▶ How does the company engage with regulators?



Conclusion

“Compliance risk is exponentially more complex today. Everyone is trying to figure out heightened standards of compliance, when they go into effect and how they will impact and interrupt businesses.”

Regulators and enforcement officials continue to develop more powerful enforcement tools. With the Dodd-Frank Act, they stand to gain new powers to target companies for non-compliance with myriad regulations.

Audit committee chairs interviewed for this report said the new regulatory mandates have triggered re-examination of how best to oversee compliance. One said, “There should be tangible things you can point to at every company that demonstrate the importance of an ethical company. The board needs to think about that. That [thinking] has been a by-product of these regulations; I would rather people take away those lessons than belittle a mandate.”

Not surprisingly, there are no silver bullets. It comes down to focusing more attention on the increasing scale of compliance risk, building a strong compliance governance model that has a larger footprint on board-committee agendas, making sure that all employees feel accountable for limiting the company's compliance risk and sustaining an overall compliance culture. These actions will limit companies' compliance failures and arm them for the difficult conversations they must have with zealous enforcement officials when, goodwill notwithstanding, compliance processes fail.

About Tapestry Networks

Tapestry Networks is a privately held professional services firm that brings leaders together to solve complex problems. Since 2002, networks convened by Tapestry Networks have tackled some of the most significant strategic challenges facing institutions and society, through public-private collaboration, including raising standards in corporate governance in the United States, Canada and Europe and developing strategies for a more sustainable healthcare environment in Europe. Tapestry Networks convenes seven audit committee networks sponsored by Ernst & Young that collectively consist of nearly 150 individuals, who chair more than 200 audit committees and sit on over 300 boards at some of the world's most admired companies. For more information, please visit www.tapestrynetworks.com.

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The views expressed in this document represent those of the individuals who participated in the research. They do not reflect the views nor constitute the advice of network members, their companies, any Ernst & Young member firm or Tapestry Networks.



Appendix: Research participants

For this report, Tapestry Networks drew upon interviews with approximately 15 audit committee chairs in the Audit Committee Leadership Network, as well as several other audit committee chairs who participate in Tapestry Networks' regional audit committee networks. For more on these networks, see http://www.tapestrynetworks.com/networks/net_audit.html.

In addition, Tapestry Networks interviewed a range of leading subject-matter professionals including:

- ▶ **Jim Berg**, Vice President, Ethics and Compliance, Apollo Group
- ▶ **Simon Bicknell**, Senior Vice President, Governance, Ethics, and Assurance, GlaxoSmithKline
- ▶ **Richard Cellini**, Chief Executive Officer, Briefcase Analytics
- ▶ **Rich Corgel**, Executive Director, Fraud Investigation & Dispute Services, Ernst & Young LLP
- ▶ **Christine Edwards**, Corporate Partner, Winston & Strawn, and Director, BMO Financial Group
- ▶ **Andy Hinton**, Global Ethics and Compliance Officer, Google
- ▶ **Dean Krehmeyer**, Executive Director, Business Roundtable Institute for Corporate Ethics
- ▶ **Steve Kuzma**, Corporate Compliance Leader, Americas Fraud Investigation & Dispute Services, Ernst & Young LLP
- ▶ **Dave Landsittel**, Audit Committee Chair, Molex, and Chairman, Committee of Sponsoring Organizations of the Treadway Commission
- ▶ **Douglas Lankler**, Senior Vice President and Chief Compliance Officer, Pfizer
- ▶ **Brian Loughman**, Americas Leader, Fraud Investigation & Dispute Services, Ernst & Young LLP
- ▶ **Amanda Massucci**, Partner, Fraud Investigation & Dispute Services, Ernst & Young LLP
- ▶ **Ryan McConnell**, Partner, Haynes and Boone
- ▶ **Scott Mitchell**, Chairman and CEO, Open Compliance and Ethics Group
- ▶ **Brian Moriarty**, Director, Business Roundtable Institute for Corporate Ethics
- ▶ **Amy Riella**, Partner, Vinson & Elkins LLP
- ▶ **Dan Roach**, Vice President, Compliance and Audit, Catholic Healthcare West
- ▶ **Roy Snell**, Chief Executive Officer, Health Care Compliance Association

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