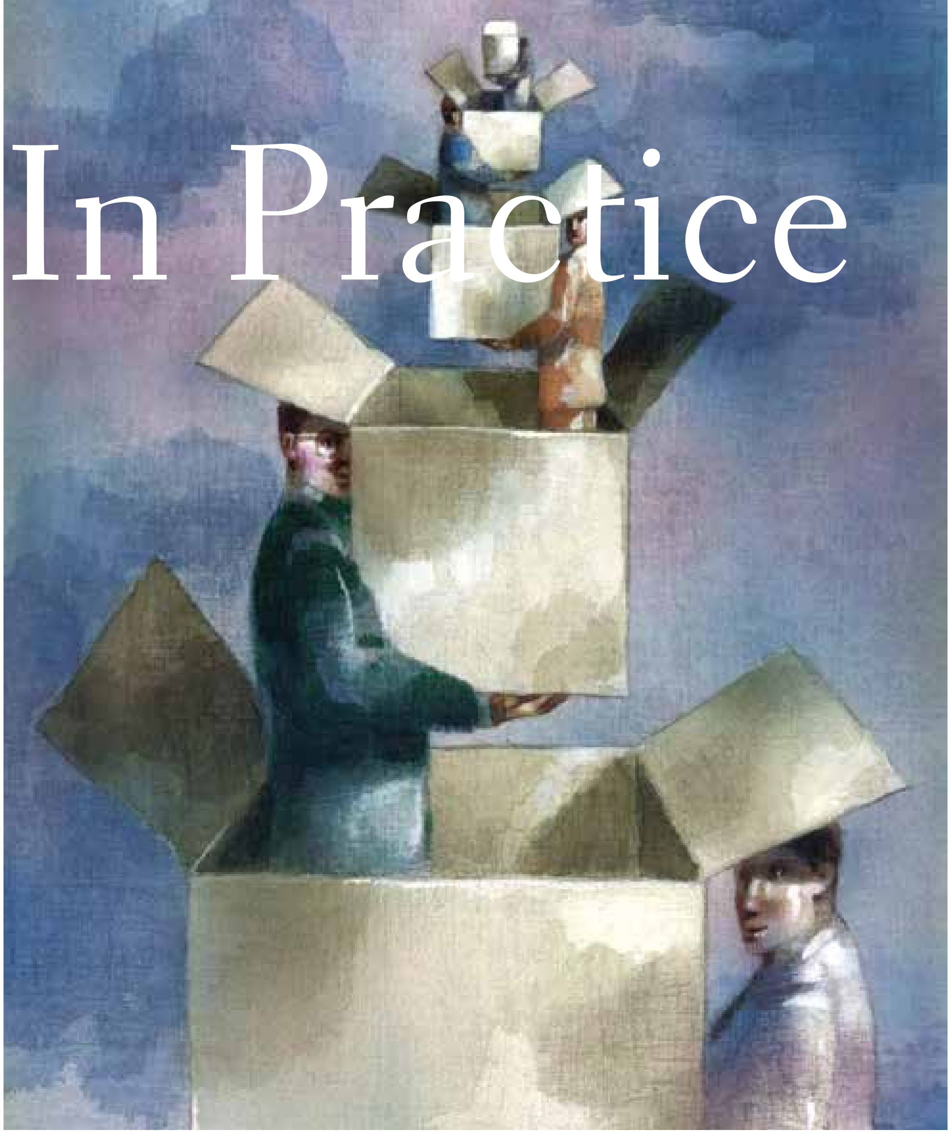
In Practice



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A Life-Cycle Guide to Ethics and Compliance Programs

By Andrea Bonime-Blanc and Martin Coyne II

Boards and executives often struggle with what constitutes an appropriate, cost-efficient, and effective ethics and compliance program for their companies. The issue gets even more complicated when one factors in the stage of development, type, sector, footprint, regulatory environment, and other complexities specific to the business in question.

What constitutes an effective ethics and compliance (E&C) management framework for companies at different stages of development? This article provides specific details of the key components of an effective ethics and compliance program corporate officers and directors should consider depending on their stage of development, i.e., the life-cycle point in which they find themselves at a given time.

Defining Effectiveness

A lot of actual and virtual ink has been spilled on the topic of what constitutes an "effective ethics and compliance program" and it has taken about two decades for both the E&C community and the governmental (prosecutorial and regulatory) community to start to agree on what these components should be.

While guidance has been provided since 1991 under Chapter 8 of the U.S. Sentencing Guidelines, a breakthrough occurred in 2012 when the U.S. Department of Justice (DOJ) and Securities and Exchange Commission (SEC) coauthored and published the *FCPA Resource Guide*.

For the first time, the guide actually emphasizes the need for an "ethical culture" within organizations and the creation of an "effective" ethics and compliance program. *(see Table 1)*.

It's worth noting that these standards, while originally devised and developed within the U.S. for and by U.S.-based companies, have evolved in the past decade into global standards embraced, revised, and, in many cases, improved through key global efforts in both the governmental and private sectors. And, one result is that all boats have been forced to rise in terms of their E&C programs.

Stage 1: IPO Ready

The pre-IPO start-up—with a strong business plan, two to four years of good execution, and actively preparing to go public—needs several components of an E&C program, including a code of conduct and a system of basic policies covering its key risk areas. While these may not be highly evolved, they require a conscious effort by senior management to inform and communicate the code and policies to all employees and relevant third parties, including the board, outlining the expected behavioral standards of the organization.

The risks a company at this stage will experience are fairly fundamental: survival without breaking the law, insufficient knowledge of all risks and legal requirements applicable to the business, unsophisticated business processes with limited scalability, and undeveloped employee talent management. Minimal funding and resources for risk management and compliance exacerbate these risk factors.

For the IPO-ready company, there will be no dedicated chief ethics and compliance officer (CECO) but someone in senior management—certainly including the CEO—who will be thinking about E&C issues. Most likely this would include the general counsel or outside counsel, who will be proactive about informing senior management and the board of required legal and behavioral standards.

The E&C competency of the company at this stage will be pretty low and revolve largely around the tone from the top set by the CEO and the executive team. If this tone is one that sets clear ethical expectations coupled with the CEO and team "walking the talk" then the IPO-ready company will have created a reasonably good start to its E&C program. If not, the risks increase that ethical and compliance mishaps—or worse—might occur in the not-too-distant future.

It is incumbent on the board of the IPO-ready company to set and demand the proper tone from the CEO and senior management, despite resource constraints and growth pressures. If, however, the board is not composed of the right mix of savvy, independent, and experienced directors, and instead is a group of "friends and family" of the founder, dangers to the E&C resilience of the company will lurk and most likely surface before or not that far after the company files its IPO.

Stage 2: Fast-Growth, Small, Public

The rapidly growing public company—with 5-10 years of rapid growth nearing the $1 billion revenue mark—shares some of the traits of the IPO-ready company, except that it is older, has probably experienced some adverse E&C issues, and has additional serious external pressures to deal with because of the rapid pace of its growth.

At this point, the company should probably have some form of enterprise risk management (ERM), whether handled by the CFO or general counsel. Among the issues this nascent ERM system should capture are those that involve E&C risks—like fraud, corruption, discrimination, antitrust, insider trading, etc. Concomitantly, there should be more than a skeletal code of conduct that captures these risks, provides employees with behavioral guidelines, and where to go for help (through a helpline system). At this stage, the company should be revising its code and policies to include new issues or added nuances that didn't exist during the original pre-IPO period.

It is no longer an excuse to say that not enough resources are available to create a more formal and sophisticated E&C program. Most of the nine components described in Table 1 *(below)* should be present in one form or another even if not yet consciously organized into a formal E&C program. Fast-growth public companies are just as vulnerable (and perhaps even more so) than companies at Stages 3 and 4. They shouldn't assume that regulators won't come down hard on them for E&C infractions. This, of course, applies even more so for fast-growth companies in highly regulated industries (such as financial services and healthcare), or that are government contractors and/or have a global footprint, with all the attendant E&C risks that international business brings.

While an independent CECO role is not likely at this stage, a conscious

TABLE 1

The Elements of an Effective Ethics and Compliance Program

E&C Risk Assessment	Conduct a periodic and targeted E&C risk assessment.
Code & Policies	Adopt a code of conduct and related system or framework of policies.
CECO Resources	Create an Office of the Chief Ethics and/or Compliance Officer (CECO) with sufficient resources and budget.
Board and C-Suite Access	Give the CECO access and report to highest levels of the organization including to management and the board.
Training and Communications	Provide appropriate E&C training and communications at all levels of the organization.
Internal Controls Alignment	Implement a system of internal controls and proper delegation of approval authority.
Helpline/Hotline System	Devise a system to solve concerns and problems including anonymous reporting options.
Consistent Discipline	Implement a consistent system of internal discipline.
Audit, Monitor, and Evaluate	Periodically audit, monitor and evaluate your E&C program.

acknowledgment of the importance of E&C by the CEO is critically important. Whether it is the general counsel or a member of the legal or finance team, a senior leader should begin to mind the E&C portfolio at least part time. While budgets and resources will be a constraint, it is necessary that a company at this stage of development have a well-formulated and effective reactive approach to the E&C issues that inevitably will come up.

Continued role modeling by the CEO and C-suite are critically important to creating a cohesive culture of business standards especially in a fast growing, still not fully developed company. Consistency of values and behaviors will be the single most important factor in determining how employees perceive the culture of the organization.

Several major barriers to E&C effectiveness at this stage revolve mainly around the fact that the company is single-mindedly focused on growth, has minimal cash and other resources to invest in non-growth activities, and the entrepreneurial spirit is very resistant to any sense of bureaucracy and process while shareholders are demanding positive earnings.

At this stage, the vigilance, savvy, independence, and knowledge of the board becomes critically important to creating and evolving a longer-term resilient and ethical business culture. The audit committee should start to receive a quarterly E&C report and proactively require at least an annual report on the state of E&C affairs at the company, and ask plenty of questions. The use of an external expert to advise the board on risk management generally but also including E&C risks is extremely important at this time, especially because of the lack of internal sophistication on these issues.

At the very least, the audit committee should know whether the nine elements of the program exist, including importantly what the tenor and quality of the helpline/hotline and its results are.

Stage 3: Mature, Mid-Size, Global

Two possibilities for the mid-size, mature company with a large global employee population (10,000-20,000), footprint (10+ countries), and \$2-10 billion in revenue will be considered: privately held versus publicly traded. No mature mid-size company has any excuse for not having an effective E&C program, customized to its industry, geographic footprint, regulatory status, and specific to its audit, legal, and other history. This would apply to both public and privately held companies.

While public companies will have additional requirements associated with listing on a stock exchange, in today's rapidly changing and homogenizing global business environment, privately held companies have to behave pretty much the same as publicly traded ones especially if they have sufficient size and visibility in the marketplace.

The general risk profile of a company at this stage will have become much more complex with a more extensive geographic/global footprint, more divisions and business units, possibly joint ventures and other partnering arrangements, more complex supply chains, the development and sale of products and services in more places, and much greater exposure to bad publicity (deserved or not) via social networks. In addition to this complexity, one of the greatest barriers to E&C success results from lack of knowledge about new regulatory or legal issues especially in new markets.

The code of conduct needs to be well honed and customized to this increased risk profile. The code and training program needs to focus on Q&A, storytelling, periodic and systematized education and communications with at least annual certifications and specific education for specialized employees (sales, e.g.). The hotline/helpline system needs to be well developed, publicized, ensconced, audited, and periodically tested for effectiveness.

At this stage, a company should have a CECO in charge of a formal E&C program with all the nine elements of an effective E&C program *(see Table 1)*. The CECO should have the visible support of, access to, and be a member of senior management. There will be a debate within the company as to whether the CECO should have an independent reporting line to the CEO or another top C-suite member, whether the role belongs within the legal department and whether it should have an independent reporting line to the audit committee. These are all valid and important discussions that should be resolved in favor of greater independence, higher stature, and twin reporting lines into both the

Key Questions at Each Stage of Development

WHAT are the principal components of an effective risk, ethics, and compliance program at this stage of development?

WHAT are the key generic E&C risks companies at this stage typically face?

WHO is in charge of this function, who should they report to, and what do the resources and budget look like?

WHAT is the role of the CEO, C-suite, and executive management on risk, ethics, and compliance issues?

WHAT is the role of the board? How can the board be sure that it is providing the stage-appropriate degree of oversight and guidance on risk, ethics, and compliance issues?

C-suite and the board. At this stage, there can be no compromise on whether the CEO and leadership team actually walk the talk and continuously communicate values and expected behavior.

The board must have a formal and proactive approach to oversight and review of the company's E&C program, and should require at least quarterly reports from the CECO. One independent director, either the audit committee chair or lead independent director, should always be available to the CECO and other members of senior management who may need to discuss an urgent or emerging E&C issue.

The board should also receive periodic education from an outside E&C expert and retain one immediately if the company undergoes an E&C-related crisis. Senior management and/or the board should ask expert third parties to regularly conduct an effectiveness evaluation of the E&C program.

Stage 4: Mature, Large, and Global

The mature, large, diversified company with revenues of $10-billion plus, a large farflung employee base (50,000+), and a wide global footprint must have a gold-plated E&C program. That program will contain all nine elements of an effective E&C program with all the attendant nuances and details that this would entail including most importantly:

- CEO and leadership who walk the talk and continually articulating requirements for E&C, with a culture that is clear and supported with a consistent message, and a performance management system that lives up to the talk
- A sophisticated, customized, and adaptable global code of conduct in necessary languages to reach all employees, available in all forms (hard, soft) to reach them wherever they are, tested and retested—not only once in a while—but annually.
- Annual training and tracking certification, including extensive training for all new hires during orientation. All exit interviews must include E&C questions.
- Regular communications, reminders, and interactive features such as a company intranet with well-devised information to help employees with questions, resources, and concerns.
- A sophisticated helpline/hotline system in place and periodically tested. A "safe-to-speak-up culture" that encourages employees and third parties to raise concerns before they become E&C mishaps or worse.
- A performance management system that specifically includes living up to elements of the E&C program.
- A cultural survey that is periodically undertaken to measure a wide variety of company cultural issues including specific E&C-related questions that can gauge the E&C temperature of the organization.
- A comprehensive and sophisticated due diligence and post M&A onboarding program for all acquisitions and for all third-party business partners and suppliers to ensure E&C consistency.

Some of the risks large-scale mature companies face include the vastness of their footprint making it challenging to ensure consistency of leadership around the world on E&C issues and local cultural barriers to success relating to country-specific or local leadership-specific issues.

At this ultimate stage of development and sophistication, there needs to be an independent, well-resourced CECO who should probably report to the CEO, is a member of the global executive team, and has a clear and unobstructed reporting line to the board. Indeed, this CECO should be accountable mainly to the board and the board should have a leading role in the hiring, review, and termination of the CECO.

The role of the board at this ultimate level of sophistication is much more involved and includes maintaining a degree of familiarity with the state of the art in E&C and how these issues connect back to other functions such as ERM, corporate social responsibility (CSR), supply chain, etc.

Indeed, at this stage, boards should consider a separate committee for E&C and related issues—perhaps a risk and compliance or a risk, compliance, and CSR committee that specifically oversees these programs in a holistic way. The board itself should not only be educated periodically on these issues, but also should seriously consider having a board member, perhaps as chair of this additional (non-audit) committee, who has extensive leadership experience in E&C, risk, CSR, and related areas.

A Framework for Discussion

These thumbnail descriptions of the various components of an effective E&C program for companies at four different stages of development may be limited. It does provide, however, a useful framework and parameters for the C-suite and the board to think about when looking at their company. D

Dr. Andrea Bonime-Blanc is CEO and founder of GEC Risk Advisory, a global governance, risk, ethics, compliance, and corporate responsibility advisory firm (www.GECRisk.com), the chair and audit chair of two non-profits, and the author of the newly published *The Reputation Risk Handbook: Surviving and Thriving in the Age of Hyper Transparency* (DoShorts, 2014). Martin M. Coyne II is a director of Akamai, RainDance Technology, and RockTech. He is president and CEO of the NACD New Jersey Chapter and author of *How to Manage Your Board While Your Board Manages You.*