

EVALUATING A COMPANY'S COMPLIANCE AND ETHICS PROGRAM: WHERE TO BEGIN?

Carole Stern Switzer, Esq.
Senior Vice President and General Counsel
Open Compliance & Ethics Group

- You are general counsel at a company with a new Chairman of the Board, who has asked you to report on the state of compliance and risk management and recommend any changes you think are necessary.
- You work for an insurance carrier and provide legal support to the underwriters of D & O and other business risk policies.
- You advise an institutional investor and part of your job is to help evaluate the likelihood of material risks coming to pass at investment targets.
- Your company or client has been criminally charged with compliance failures and you need to demonstrate that the company has an effective compliance program to mitigate penalties.
- You are in-house or outside counsel to a corporate client, and you are conducting due diligence on a possible acquisition target.

In each case, your task is to find out if your client (or the target company) has the systems that are needed to establish and maintain effective governance, control risks, manage compliance and encourage ethical conduct. If you perform this task well, you will be able to determine if a company has processes and a culture in place to control, and even mitigate or avoid, enterprise risks.

The question is: what do you look for and what do you need to ask?

The Open Compliance and Ethics Group (OCEG), a not for profit organization formed by a multi-industry cross-section of business thought leaders, has developed a framework of guidelines for effective compliance and ethics management. The OCEG Framework sets out both legally required and recommended practices for establishing an organization's ethical culture, assessing and prioritizing risks it must address, and implementing necessary policies and procedures to achieve its compliance goals. This Framework forms the basis of *TWENTY QUESTIONS* that OCEG makes available for investors, insurers, and company executives to use in evaluating an entity's compliance and ethics systems. Like the children's game, as you gain answers to the *TWENTY QUESTIONS*, you develop an evolving and more detailed picture of the item that must be defined. A full copy of the *TWENTY QUESTIONS* is available for download, and more information on OCEG is available, at www.oceg.org. To download the document, register at the site and, download this and other documents through the "My Documents" link.

The OCEG Framework and the *TWENTY QUESTIONS* address these key aspects of an effective program:

What is the Company's Culture?

Begin to analyze the effectiveness of a company's compliance and ethics management by looking at the organizational culture. At the threshold, determine whether the company is taking the formal steps necessary to establish a code of conduct and working to establish that code as part of the fabric of the company. Then, evaluate whether the Board, management and the employees really believe that compliance and ethics are an integral part of the company's culture and that the company's policies are the "law of the land."

How is the Compliance Program Embedded in the Business?

It is not enough to find that the company has compliance policies or even a compliance staff. A true inquiry probes into the comprehensiveness of the compliance and ethics program and its effectiveness in supporting enterprise goals. Determine whether the established policies and procedures are effectively communicated and enforced throughout the entity. Consider how well decisions about operation of the program take into account the company's assessment of enterprise risk and business goals.

Is the Program Well Structured with Adequate Resources?

For a compliance and ethics program to be effective, it must have a structure that works with, not against, the internal environment of the company. To assess the structure, determine if it is centralized or decentralized, where lines of authority and reporting are established, and how various skills within the company are drawn upon to support the program. Assess whether the program has sufficient resources to fulfill its mission, by asking about the funding and personnel that are devoted to the program and evaluating their adequacy to address the identified risks. Evaluate the degree of independence and objectivity in the senior level staff of the program.

How are Policies and Procedures Implemented and Enforced?

A Code of Conduct and a well drafted set of policies do not, in and of themselves, make an effective compliance program. Questions must be asked about the distribution and training for the Code and policies. Ask how often and by what methods the values, mission and vision of the program, as well as specific policies, are communicated. Evaluate how understanding of policies and procedures is confirmed.

Are Issues Managed Effectively?

Determine what the procedures are for employee reporting of problems and for addressing issues that arise. Ask how often, and in what way, action has been taken against identified "bad actors." Identify the decision tree used for informing the Board

about issues that arise and how they are resolved, and for escalating certain issues to the Board or most senior executives for ultimate resolution.

Is the Program Monitored, Evaluated and Continually Improved?

A management system is only as effective as the attention that is paid to it. Without continual monitoring of issues that arise and their relationship to program flaws, the system will continue to operate ineffectively or inefficiently. Ask how the program systems are measured and monitored for effectiveness. Determine how changes in laws, regulations and internal/external events are identified and evaluated to ensure program responsiveness. Ask whether internal or external periodic assessments of program operation are performed, and evaluate the responses taken to recommendations from past assessments.

Next steps in the inquiry: what do you do with the answers?

Just getting answers, or learning that a company can't answer certain questions, is a valuable start. But there are certain responses that should raise a *red flag* and warn of fatal flaws in the systems or culture of the company. The ***TWENTY QUESTIONS*** identify typical answers that you may receive and highlight those that present warning signs.

To go further, and compare a company's performance against its peers or competitors, use OCEG benchmarking study data and tools now under development and soon to be available at www.oceg.org. As more companies participate in OCEG benchmarking studies, data specific to different sizes of companies and different industries will become available, allowing for detailed comparisons that companies can use to assess and improve their programs.

Now, more than ever, stakeholders are going 'beyond the numbers' as they evaluate potential vendors, clients, partners and investment opportunities. The ***TWENTY QUESTIONS*** tool tests a target's compliance and ethics foundation – and provides valuable insights as to how that company conducts business.