

'Our Board of Directors Doesn't Need Training' And Other Myths

By Steve Priest

Earlier this year, the general counsel of one of the world's leading corporations removed ethics and compliance training from the agenda of a Board of Directors meeting with this explanation: "We don't need to train the full Board. As long as the Audit Committee has received a briefing about our program, we are okay."

Four years after the U.S. Sentencing Guidelines for Organizations were revised, there are still many misconceptions about the Board's appropriate role in ethics and compliance. This article lays out a practical, "pretty good" approach for Board oversight and engagement. It is based on the Sentencing Guidelines and observed effective practices at many of America's leading companies (and a few based outside the U.S.)

Board knowledge and oversight is required

There are only two paragraphs in the Guidelines that provide specific information about the oversight role of the Board—so it is worthwhile to consider them carefully. The first asserts that the Board of Directors *as a whole* is responsible for overseeing a corporation's ethics and compliance program.

"The organization's *governing authority* shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program." (Guideline 2a, emphasis added)

"Governing authority" is the Board of Directors in the case of a corporation. While the Board as a whole has responsibility for oversight, operationally, reporting may be delegated to a committee of the Board.

Specific individual(s) within the organization shall be delegated day-to-day operational responsibility for the compliance and ethics program. Individual(s) with operational responsibility shall *report periodically* to high-level personnel and, as appropriate, to the *governing authority, or an appropriate subgroup of the governing authority*, on the effectiveness of the compliance and ethics program. To carry out such operational responsibility, such individual(s) shall be given adequate resources, appropriate authority, and *direct access to the governing authority or an appropriate subgroup of the governing authority*.

The use of "pretty good" instead of "best practice" is intentional. "Best practice" implies that there is one best way to achieve a certain outcome. In most areas of ethics and compliance, empirical observation suggests a variety of approaches that will lead to a pretty good outcome, depending on an organization's culture, people, industry, etc. Use of "pretty good practice" also prevents the kind of "escalation" that service providers love and CFOs abhor.

Misconceptions about the Board's appropriate role in ethics and compliance still abound. Herewith, a practical approach for Board oversight and engagement.

Steve Priest founded Ethical Leadership Group, now a Global Compliance company, in 1993. Since then he has worked with the Boards of more than 10 percent of the *Fortune* 200 to foster cultures of integrity.

These paragraphs seem so simple. Yet I have worked with a number of boards who had members who had never heard of the Sentencing Guidelines. It is probably apocryphal, but a colleague of mine claims to have met a board member who thought the SEC was simply the best football conference in the U.S. Willy Loman's wife gets it right in one of the best plays to address business ethics, *Death of a Salesman*. "Attention must be paid."

Board knowledge and oversight applied

The first Board responsibility is knowledge. The Board must "be knowledgeable about the content and operation of the compliance and ethics program . . ." In practical terms, this is the easiest standard to live up to. The full board should receive a periodic briefing on the compliance and ethics program. This briefing—one to four times per year—may be in person or in the form of a written report included in the Board's binder of readings provided prior to the Board meeting.

An in-person briefing most typically comes from the chair of the committee engaged in operational oversight. In some cases the in-person briefing comes from the ethics/compliance officer. I advocate this approach, at least annually, as it provides the Board an opportunity to check their understanding of the program and to exercise "reasonable oversight," to which I now turn.

The second Board responsibility is to "exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program." Fulfilling this responsibility would be easy, except for the words "reasonable" and "effectiveness."

This article will not go into depth on what is and is not reasonable oversight for a Board of Directors. This is a topic about which thousands of articles have been written in the past seven years. As a narrower starting point, reasonable oversight of the compliance and ethics program requires, at a minimum, that the full Board:

- Understands what is required of it under the *U.S. Sentencing Guidelines* and relevant case law;
- Understands what the Guidelines (and other applicable law or guidance) defines as the elements of an effective program;
- Understands, at a high level, what steps the organization has taken to meet the defined elements of an effective program; and
- Delegates operational oversight of these organizational steps to a competent committee and commit-

Many board members of Fortune 500 firms would fail at least three of the four 'minimal' steps vis-à-vis 'reasonable oversight' of ethics and compliance programs.

tee chair.

Ethics and compliance professionals who spend their lives immersed in the Guidelines may find this list too minimal, or too elementary. If so, I applaud your effectiveness at informing your Board. Others may argue that only the committee to whom oversight responsibility is delegated needs to receive briefings to be informed of the above. It is an arguable point.

But it is our experience that many board members of Fortune 500 firms would fail at least three of the four steps. And given the scant time required to be more fully informed, this seems like inexpensive insurance indeed.

The role of the Audit Committee

The Sentencing Guidelines allow the full board to delegate *operational* oversight of the ethics and compliance program to a committee. This is most frequently the audit committee, although some companies have grown concerned with the workload assigned to the audit committee.

For this reason, and sometimes for others, companies may legitimately assign operational oversight to the governance committee, or to another specialized committee that may oversee a portfolio of activities including ethics, compliance, law and corporate responsibility. Each of these committees includes independent directors.

The audit committee (or other committee assigned to oversee the program) is charged with several explicit duties beyond those delegated by the full Board. The primary duty specified in the Guidelines is to receive reports from, and provide direct access to, the "Specific individual(s) within the organization [to whom] shall be delegated day-to-day operational responsibility for the compliance and ethics program" or "SIDDOR" for short.² A related duty is to ensure that the SIDDOR receive "adequate resources" and

² I thank Dave Collins, formerly executive director of GM's Global Compliance Center, for this abbreviation (SIDDOR) stemming from work done in 2005. If someone else can claim credit, I apologize and will be quick to correct my error of attribution.

The Sentencing Guidelines state that large companies are expected to have more robust programs than smaller ones.

“appropriate authority.”

In my experience, many audit committees do not fulfill these responsibilities appropriately. Many SIDDORs are prevented from meeting with the Board or Board Committees at all. Sometimes this is simply a matter of logistics or lack of information, sometimes because a higher level, very part time ethics/compliance officer wants to own the Board relationship exclusively.

This exclusion does not appear to live up to the Guidelines or the spirit of the Advisory Panel debates. Some audit committees that do receive reports from the SIDDOR do so for fifteen minutes once a year. This may meet the letter of the Guidelines for “receiving reports” and providing “direct access,” but does not provide the reassurance of open channels of communications that the Sentencing Guidelines was aiming for.

Good audit committee chairs work on creating an open door relationship with the ethics/compliance officer as well as the SIDDOR when the two positions are separate. Good chairs may even hold meetings in executive session with the ethics/compliance officer and SIDDOR, using the successful model established with internal audit leadership, and for all the same reasons. And good chairs will review the resources and organizational structure of the ethics and compliance program to determine if they match the organization’s needs and risks.

Why do many companies do only fairly—or worse—at living up to these responsibilities? One reason may be training, or, more precisely, a lack thereof.

Training for the Board

Although the phrasing is a bit convoluted, the Sentencing Guidelines state that the full Board of Directors needs to receive “effective training . . . (and other) information appropriate to such individual’s respective roles and responsibilities.”

(4)(A) The organization shall take reasonable steps to communicate periodically and in a practical manner its standards and procedures, and other aspects of the

compliance and ethics program, to the individuals referred to in subdivision (B) by conducting effective training programs and otherwise disseminating information appropriate to such individuals’ respective roles and responsibilities.

(B) The individuals referred to in subdivision (A) are *the members of the governing authority*, high-level personnel, substantial authority personnel, the organization’s employees, and, as appropriate, the organization’s agents. (Guideline 4, emphasis added)

Companies that want to live up to the Sentencing Guidelines need to train their Boards in ethics and compliance. That much is clear. What is not clear—and is one of the features that makes the Guidelines, like the U.S. Constitution, wonderful documents—is what “effective training” means.

The Guidelines offer some clues. They state that programs should be based on risk. “In implementing [the aforementioned elements], the organization shall periodically assess the risk of criminal conduct and shall take appropriate steps to design, implement, or modify each requirement set forth [earlier] to reduce the risk of criminal conduct identified through this process.” They highlight that large companies are expected to have more robust programs than smaller ones. “A large organization generally shall devote more formal operations and greater resources in meeting the requirements of this guideline than shall a small organization.” And they emphasize a corporate version of keeping up with the Joneses: “An organization’s failure to incorporate and follow applicable industry practice . . . weighs against a finding of an effective compliance and ethics program.”

Translated into practice, this means that Fortune 500 companies, in the post-Enron, post-WorldCom, post-options-backdating world run a risk if they do not train their Boards. And so more and more do. There are no established best practices, but some pretty good practices are emerging.

- Training takes place for the full Board every two or three years.
- Sessions average 45 to 90 minutes in duration, although I know of some done in 30 minutes and some in four hours.
- Content is customized for the company, its culture, its industry, its risks, and the background of the Board.

- Content blends legal, regulatory and governance elements with case studies exploring board member risks, roles and responsibilities.

Would training that board members take on their own count? For example, what is the status of university programs on governance? We don't know the answer to this, but it seems plausible as long as you could document this as you would document training required of other employees. The company would also want to ensure that board members understood relevant company policy, which obviously could not be addressed in general training.

What about the general counsel quoted at the beginning of this article? Certainly a briefing solely for the audit committee would not live up to the Guidelines. What about a briefing to the full Board, summarizing case statistics, training accomplishments, code of conduct certifications and other similar easily reportable achievements? Would this constitute "effective training . . . appropriate to . . . roles and responsibilities"? The Guidelines do not duplicate points. Reporting to the Board is covered in item two. If reports were enough, then the training requirement of item four would be redundant. It also seems unlikely that a quick briefing of statistics passes the "smell test" of good faith, effective training.

Anecdotally, your Board may be more ready than some of your executives are. Earlier this year, the audit committee chair of a Fortune 50 company asked me if the company's training efforts satisfied best practices. I described some of what is in this article, and then he turned to the company's CEO and said, "See, we need to do some training."

Beyond the Sentencing Guidelines

I have based the above analysis on the Sentencing Guidelines, and on corporate practices that have emerged in the wake of the revised Guidelines. However, this is not the only guidance for board engagement with ethics and compliance programs.

For example, the need for the Board to be engaged in compliance oversight was central to a 2006 Delaware Chancery Court decision, which was later embraced by the Delaware Supreme Court. In *Stone v. Ritter*, the directors of AmSouth Bank were sued following a money laundering problem that resulted in AmSouth paying a \$50 million fine. The complaint alleged that the directors "never took the necessary steps . . . to ensure that a reasonable BSA (Bank Secrecy Act) compliance and reporting system existed." Both courts rejected this argument, citing positive

Training sessions of 45 to 90 minutes should be conducted for the full Board every two or three years.

steps AmSouth's Board of Directors took to fulfill their compliance oversight role. These steps included:

- Receipt of annual reports from the company's BSA officer
- Quarterly oversight by the audit committee
- Annual Board training in BSA/AML (anti-money laundering) issues
- Adoption of a BSA/AML policy that required reporting of concerns

So the AmSouth Board was found to have discharged its duties of care and loyalty, in part because they received training in a high-risk area for the firm.

The December 2006 memo entitled *Principles of Federal Prosecution of Business Organizations*, from then-Deputy Attorney General Paul McNulty, provides guidelines for U.S. Attorneys to use when deciding whether to charge a corporation with a crime. The McNulty memo highlights the critical role of the Board of Directors in compliance.

In evaluating compliance programs, prosecutors may consider whether the corporation has established corporate governance mechanisms that can effectively detect and prevent misconduct. For example, do the corporation's directors exercise independent review over proposed corporate actions rather than unquestioningly ratifying officers' recommendations; are the directors provided with information sufficient to enable the exercise of independent judgment; are internal audit functions conducted at a level sufficient to ensure their independence and accuracy and have the directors established an information and reporting system in the organization reasonably designed to provide management and the board of directors with timely and accurate information sufficient to allow them to reach an informed decision regarding the organization's compliance with the law.

At least as important as these explicit roles for directors, McNulty cautions that "check the boxes" programs are not acceptable.

Prosecutors should therefore attempt to determine

It seems unlikely that a quick briefing of statistics passes the 'smell test' of good faith, effective board training.

whether a corporation's compliance program is merely a "paper program" or whether it was designed and implemented in an effective manner. . . . This will enable the prosecutor to make an informed decision as to whether the corporation has adopted and implemented a truly effective compliance program that, when consistent with other federal law enforcement policies, may result in a decision to charge only the corporation's employees and agents.

This reinforces the Board need to make sure the company has an effective program. And for one last bit of ammunition in an election year when business is sure to be a favorite target of politicians, recall what Congresswoman Diane DeGette said to Patricia Dunn, then Chair of the Hewlett-Packard Board, after the pretexting issues arose there: "You can't say, 'I'm just a board member, but I'm not responsible for things that happen because I am not in the chain of command.'"

The Board as ally

Except for a very few programs that benefit from a legal guillotine hovering over the neck of the corporation, no ethics and compliance function has as many resources—or as much clout—as they would like. This is not an indictment of corporations—very few functions have all the resources they would like to accomplish the many objectives they have.

For ethics and compliance functions, the Board can and should be an ally in implementing an effective program. Boards are paid to take a broad, longer-term view that incorporates reputational concerns as well as quarterly bottom line ones. Board leadership does not necessarily translate into higher budgets, but it does translate into management prioritization and more support for shaping a culture of integrity.

Good boards will embrace this role, once they understand it fully. Through their oversight and engagement, good Boards help set the tone of an organization, fostering a culture of integrity which is in the best interest of all stakeholders, including the shareholders they represent. □

Questions Board Members Should Ask Their Ethics/Compliance Officer

(These questions expose the main weaknesses in ethics and compliance programs in 2008. Several Boards are implementing periodic executive sessions with the Ethics/Compliance Officer to increase the odds these questions will be answered with full candor.)

Assessment

How do you know the program is effective?

Accountability and Human Resources processes

How are we at discipline? Are top performers and high-level people held accountable to the Code of Conduct? Has anyone ever been disciplined for failure to take reasonable steps to prevent and detect violations?

Culture

How does our culture support or undermine our commitment to integrity? Do we have a "make plan at all costs culture?" Is candor rewarded or punished? How much fear of retaliation is there?

Leadership

Do leaders—not just the CEO but line and functional leadership—set the right tone? How are they perceived by employees? Are they role models for accountability—or for entitlement?

Risk

What are the major compliance and reputational risks we face? Are there any risks that aren't being addressed as they should be? Are there risks that especially involve board members?

Resources & Empowerment

Do you have the resources you need to do your job appropriately? Do you feel you have access to the CEO and us whenever you need it? Are you in position to say "no" to the CEO, CFO or General Counsel if you feel that is necessary?

Training

Is your training targeted to an employee's roles and risks, and to address emerging risks, not just historic ones? What measurements do you have of effectiveness and employee perceptions of the training? □