

Making the Grade: Developing and Implementing an Ethics & Compliance Scorecard for Executives

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Presented by:
Daniel R. Roach, JD
VP Compliance & Audit

Grace F. Renbarger, JD, CCEP
Principal, Grace Fisher Renbarger PLLC
former Chief Ethics & Compliance Officer for Dell Inc.



Overview

- The compliance and ethics challenge
- Roles and responsibilities: board, management and the ethics/compliance officer
- Aligning incentives

Ethics and Compliance Challenge

Ethics:

- Perception: Most people are ethical
- Realty
 - Cheating
 - High school
 - College
 - MBA
 - Resumes
 - Workplace

Ethics and Compliance Challenge

- Laws and rules can be complicated
- Not their area of expertise
- More than enough work already
- Intense pressure
 - One of our biggest challenges as ethics and compliance officers is to give management specific direction and tasks

What do they need to do? - Boards

- Define scope of the program
- Approve key policies & procedures
- Require periodic, substantive reporting by management/ethics & compliance officer
- Align incentives

Tip: Add expertise to board or appropriate committee

What do they need to do? - Management

- Actively support program
- Execute ethics & compliance program
- Insist on compliance
- Be a role model

Tip: It's management's job to implement the program and ensure compliance. The role of the compliance officer is to ensure management has the tools & resources.

Roles & Responsibility Compliance Officer

- Design (and redesign) program with input from management (operations), employees, peers and experts
- Develop policies and procedures
 - Structural → OSGs
 - Substantive → high risk areas
- Develop/acquire educational programs applicable to targeted job functions

Tip: Identify, address, measure and report your top 5 risks/metrics.

Roles & Responsibility Compliance Officer (Cont.)

- Give management clear direction, explicit targets
- Simplify complex, clarify ambiguous
- Monitor and report on execution
- Have the difficult conversations
- Ensure you are on the same page as CEO about the Compliance Program

Ethics and Compliance Challenge

- \$ Focused management
- Cognitive dissonance
- Unbalanced incentives
- Weak internal controls

How can we meaningfully impact management and other employee behavior?

Why Incentives?

- Don't have an effective program without incentives?
- Proven motivator
- Focus management's attention
- Emphasizes most important
- Rewards hard work & innovation

Incentives

Negatives

- Promote greed
- Promote “tunnel vision” or obsessive focus on target
- Encourage manipulation
- “We shouldn’t need to incentivize ethical behavior”

Trust is not an internal control!

Aligning Incentives

- Are ethical and compliant business practices fundamental to who we are?
- Prove it:
 - Specific, measurable objectives
 - Aligned incentives
 - Internal transparency
 - Climate monitoring

Incentives: Ethics & Compliance Metrics

- Specific
 - Structural – orientation, education screening, reporting, investigation, remediation
 - Substantive (high risk areas)
- Objectively measurable
- Fair, reasonable
- Meaningful impact

Tip: Target leaders of key business units.

Incentive Options

- Gate to incentive compensation
- Cash awards
- Recognition
- Eligibility for pay increase

Incentives: Transparency

- Transparency changes behavior
 - Taps competitiveness and self-preservation instinct
- Require “public” reporting to peers, management and board
- Must be objective, fair, reasonable and targeted to organization risks

See attached sample of ethics/compliance objectives

Incentives: Transparency

- Publicize the negatives / consequences...we have heard of this.
 - Ethics Bulletins
 - Best Buy Blog
- Equally as important to publicize the positives
 - Emails with CC to C-Suite, Business Presidents, etc.
 - “Ethical Leadership Bulletins”
 - Promotions – Ethics & Compliance track records, leadership, etc.

Roles

- Not being focused
- Setting the bar too high
- Board/Senior Management not committed
- Perception of unfairness/arbitrariness

Personal Effectiveness

- Leverage authority
- Practice difficult/crucial conversations
- Think before you speak
- Attack the problem, not the person
- Listen carefully

Admit mistakes – the two most disarming words in the English language are _____.

Sample Executive Ethics & Compliance Scorecard Process and Template

Grace F. Renbarger, JD, CCEP
Grace Fisher Renbarger, PLLC
Former Chief Ethics & Compliance Officer, Dell Inc.

Sample Executive E&C Scorecard - Process

- At beginning of fiscal year, Board sets performance objectives for CEO
- CEO sets performance objectives for his/her direct reports/senior leadership team and reviews them with the Board (or the Compensation Committee of the Board)
- Both should include ***specific and measurable objectives related to ethics and compliance*** along with the usual objectives for this level business executive (e.g., financial goals, progress on current company strategic initiatives, leadership, etc.)



Sample Executive Ethics & Compliance Scorecard - Process

- At end of fiscal year, Board evaluates CEO's performance against all objectives
- CEO evaluates direct reports/senior leadership's performance against all objectives
- Board (or Compensation Committee) reviews CEO's evaluation of performance of his/her direct reports/senior leadership team
- Performance evaluation rating (e.g., red, yellow, green)—**including evaluation against ethics and compliance related objectives**—are factored in to decisions regarding compensation (salary increase, incentive/bonus, promotion, long term equity) for CEO and senior leadership

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Sample Ethics & Compliance Objectives

Strong Compliance & Control Environment – Factors Considered:

- Lawsuits, government enforcement actions
 - Cases with potential compliance implications identified as potentially material or otherwise significant
- Internal investigations
 - Substantiated cases (of certain type or significance level)
 - Trends in key categories
- Audit results and status of management action plans
 - number, type and significance of regulatory compliance audit findings (e.g., Exemplary, Satisfactory, Needs Improvement, Unsatisfactory)
 - Status of any resulting MAPs (closed, on track or delayed, and if delayed reason for delay)
- Internal controls
 - Compliance-related control deficiencies disclosed on internal management representation letters or identified by audits

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Sample Ethics & Compliance Objectives (continued)

Drive Culture of Integrity/Tone at the Top – Factors Considered:

- Direct or indirect role in any negative results in previous category
- Personal Ethics & Compliance leadership and commitment shown through communications, response to incidents and other indicia
- Ethics & Compliance objectives in executives' performance plans (i.e., leader should be cascading Ethics & Compliance objectives down to executives in his/her organization)
- Results of Ethics & Compliance related questions on annual employee survey
 - Establish minimum standard for executives
 - Review results for leader and direct reports
 - Determine whether follow up actions taken against those not meeting standard
- Ethics & Compliance Training
 - Percent employees in organization completing requirements by deadline
 - Determine whether managers imposing appropriate consequences for those who fail to meet deadline

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Sample Executive Scorecard - How Results Assessed

- Use both quantitative and qualitative (subjective) measures
- To bolster privilege argument, data and assessment should be conducted at direction of General Counsel or Outside Legal Counsel
- Data gathered by Ethics & Compliance Office, Legal Department, Human Resources or Internal Audit for CEO and each of his/her direct reports
 - Review lawsuits/gov't enforcement actions, substantiated internal investigations, audits, and control deficiencies reported to determine whether leader had personal role (direct or indirect) in the behaviors giving rise to the issue
 - Collect ethics and integrity-related oral and written communications personally delivered by leader during the year
 - Survey key internal stakeholders regarding leader's personal behavior and attitude relating to ethics and compliance, response to incidents, other indicia of leadership in ethics and compliance matters

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Sample Executive Scorecard - How Results Assessed (continued)

- Data gathered by Ethics & Compliance Office, Legal Department, Human Resources or Internal Audit for CEO and each of his/her direct reports
 - Review performance plans for executives in leader's organization to determine if E&C objectives included and taken into consideration in executives' performance evaluation/compensation decisions
 - Review results of E&C-related questions on annual survey for leader and for all executives in his/her organization to determine if minimum standard met and if follow up actions taken for those below standard
 - Review training status for all employees in leader's organization; consult with managers and HR to determine if appropriate consequences imposed for those who failed to complete training in a timely manner
 - Review leader's self-assessment



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Sample Executive Ethics & Compliance Scorecard

Goal	Highlights/Challenges	RYG
Strong Compliance and Control Environment		
Lawsuits/government actions potentially implicating ethics or compliance concerns	0 lawsuits; 0 enforcement actions	G
Significant substantiated internal investigations and trends; Appropriate discipline and other remediation from internal investigations on track	1 involving direct report; appropriate discipline and other corrective action taken No negative trends	G
Unsatisfactory or Needs Improvement findings relating to compliance/regulatory matters; Compliance-related Audit MAPs on track	1 unsatisfactory audit; MAP on track	Y
Regulatory compliance control deficiencies	0 regulatory compliance control deficiencies disclosed or identified	G
Drive Culture of Integrity		
Demonstrate leadership and personal commitment to ethics and compliance through communication, response to incidents, and other activities	E&C Communications: 4	G
	Response to Incidents: Took strong position on XYZ investigation to drive discipline and process improvements.	G
	Other: Engaged and supportive during E&C training at staff meeting	G
All executives in org have ethics and compliance objectives in performance plans	<95% level 1 executives; avg. 80% at other levels	R
All executives in org meet exec standard for E&C related questions in annual employee survey(remediation plans in place and on track for those who do not)	Leader met standard; 95% executives met standard and follow up taken for those who fell below	G
All employees in org timely complete required compliance training (appropriate disciplinary/compensation consequences imposed on those with unexcused failures)	90% by deadline and consequences imposed	Y

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OVERALL: Y



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Sample Executive Ethics & Compliance Scorecard

Key to Color Coding – Quantitative Measures

- **Lawsuits, Gov't Enforcement Actions (material and with compliance implications)**
 - Green = no lawsuits or government actions
 - Yellow = 1-2 lawsuits or government actions
 - Red = 2+ lawsuits or government actions

- **Substantiated Internal Investigations/trends**
 - Green = no significant substantiated cases; trends positive
 - Yellow = 1-2 significant substantiated cases, or slightly negative trends in key categories
 - Red = 3+ significant substantiated cases, or significantly negative trends in key categories

- **Audit Results and Status of Management Action (compliance related)**
 - Green = "Exemplary" or "satisfactory" audit findings; no "unsatisfactory" or "needs improvement" audit findings
 - Yellow = 1-2 "unsatisfactory" or "needs improvement" audit findings and MAPs on track
 - Red = >2 "unsatisfactory" or "needs improvement" audit findings, or if less, MAPs delayed

- **Control deficiencies (compliance-related)**
 - Green = None disclosed or identified by audits
 - Yellow = 1-2 disclosed; no others identified by audits; remedial actions in process
 - Red = 1+ not disclosed but identified by audits

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Sample Executive Ethics & Compliance Scorecard

Key to Color Coding – Quantitative Measures

- **Communications (from leader directly)**
 - Green = 4+; yellow = 2-3; red = <2

- **E&C objectives in executives' performance plans (i.e., leader should be cascading E&C objectives down to the executives in his/her organization)**
 - Green = 100% all levels
 - Yellow = 100% level 1, average 70 - 90% other levels
 - Red = <100% level 1 regardless of other levels, or any level below 70% even if 100% level 1

- **Annual employee survey**
 - Green = Leader met standard, and 100% execs met standard or if less, follow up complete
 - Yellow = Leader met standard, and <100% execs met standard and follow up complete or in process
 - Red = Leader did not meet standard; or <100% execs and no follow up

- **Training – rate of completion and consequences imposed for those failing to meet deadline**
 - Green = >95% by deadline and consequences imposed
 - Yellow = >95% by deadline and consequences not imposed, or 90 – 95% by deadline and consequences imposed;
 - Red = <90% regardless of consequences imposed

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Sample Executive Ethics & Compliance Scorecard

Examples of Color Coding for Qualitative (Subjective) Measures

- **Direct or indirect role in negative indicator relating to compliance and control environment**
 - Green = leader had no direct or indirect role
 - Yellow = incident attributable to lack of adequate process/controls in leader's organization
 - Red = substantiated internal investigation involving misconduct by leader (if not already terminated!)
- **Response to incidents**
 - Green = leader supportive of internal investigation and took prompt disciplinary action and instituted process improvements
 - Yellow = leader reluctantly supported investigation and disputed need for discipline or corrective action
 - Red = leader objected to or interfered with investigation or failed to impose adequate discipline (if not already terminated!)
- **Other indicia (from surveys of peers and stakeholders)**
 - Green = leader completes own training early and consistently supportive of E&C efforts, concerned about even the appearance of impropriety and insists on highest standards of integrity
 - Yellow = leader "talks the talk" but doesn't seem sincere (e.g., makes jokes about compliance training)
 - Red = leader cynical about E&C, views it as waste of time, appears to operate close to the "line"

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Sample Executive Ethics & Compliance Scorecard

- Compiling quantitatively measured data into a single report provides consolidated picture of overall compliance and control environment in leader's organization
- Ideally quantitatively measured results compiled quarterly and results reviewed with leader personally so he/she can identify problem areas and determine if corrective action needed
- Periodic reports of quantitatively measured results should also be shown at leadership meetings (e.g., CEO's quarterly staff meeting) to generate accountability and positive peer pressure (competition) among leaders
- Develop and institute processes for reporting and collecting data on an ongoing basis to reduce burden at end of evaluation period

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Resources

2010 Federal Sentencing Guidelines, Organizations. Chapter 8 – Part B. Remediating Harm from Criminal Conduct, and Effective Compliance And Ethics Programs.

<http://www.ussc.gov/orguide.htm>

The Seven Signs of Ethical Collapse: How to Spot Moral Meltdowns in Companies . . . Before It's Too Late, Marianne M. Jennings, J.D., St. Martin's Press 2006

Crucial Conversations: Tools for Talking When Stakes are High, Kerry Patterson et. al., McGraw-Hill, 2002

Difficult Conversations: How to Discuss What Matters Most, Douglas Stone et. al., Penguin Books 1999

Ethical Leadership and Executive Compensation: Rewarding Integrity in the C-Suite, Ethics Resource Center, White Paper, March 2010



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Questions?

