The Relationship Between the Board of Directors and the Compliance and Ethics Officer

A survey by the Society of Corporate Compliance and Ethics and the Health Care Compliance Association

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Introduction

The proper relationship between the board and the chief ethics and compliance officer (CECO) is critical to an effective compliance program. Without board access, the compliance officer may be impeded in his or her efforts to prevent, identify and correct wrongdoing, especially if laws or policies are violated by senior management.

From a legal perspective, the U.S. Sentencing Guidelines call for an organization's governing authority—typically the board—to "…exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program." Without that oversight, a company may face much larger penalties when wrongdoing is uncovered.

In addition, the Sentencing Commission recently sent changes to Congress which would enable organizations to get credit for having an effective compliance program, despite wrongdoing by senior leadership, if the individual with operational responsibility for compliance in the organization has direct reporting authority to the board level.

To assess the level of interaction between the board and the compliance team a survey was conducted among compliance and ethics professionals. 481 responses were collected from private and public companies, as well as from non-profits. Approximately three-quarters of the responses were from the healthcare industry.

Executive Summary

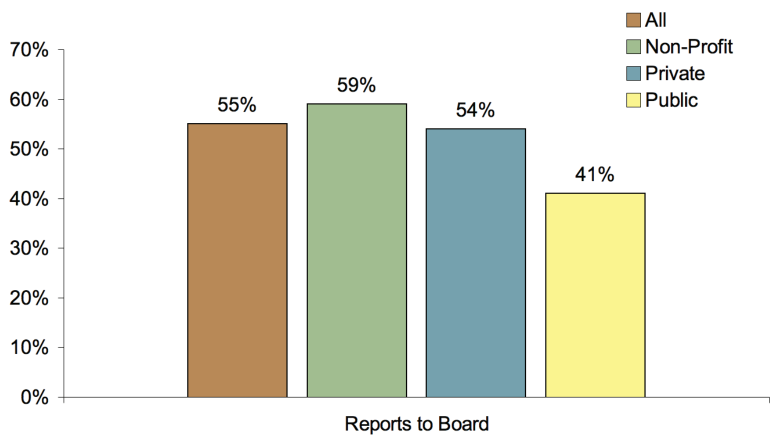
Despite all the talk of integrated Governance Risk and Compliance (GRC) programs, despite SOX requirements for stronger internal controls, compliance remains farther down the pecking order at publicly traded companies than it is at either privately held or non-profit organizations.

The data, based on a survey conducted among compliance and ethics professionals, reveals that boards and even CEOs have less contact with CECOs than recent legislation would suggest is necessary. This could pose a significant risk for companies as they seek to implement compliance programs that have the ability to meet both the common and legal meaning of the term "effective."

Findings

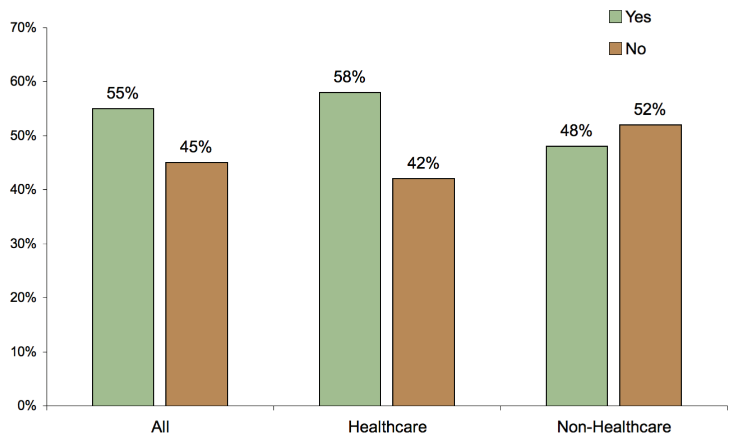
- **Publicly traded companies were far less likely than privately held and non-profit organizations to have a compliance officer reporting directly to the board.** Just 41% of respondents at publicly traded companies reported directly to the board, compared to 54% for privately held companies and 59% of those from non-profit industries.

CECO REPORTS DIRECTLY TO BOARD



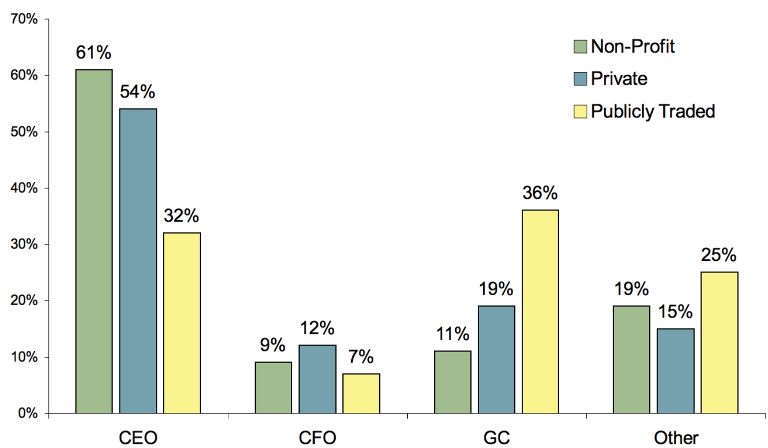
- **Looking at the data by industry, healthcare, which is dominated by non-profits, was more likely than the rest of industry to have a compliance officer reporting directly to the board.** Among healthcare respondents 58% reported a board relationship, compared with just 48% from all other industries.

DOES THE CECO REPORT DIRECTLY TO THE BOARD?



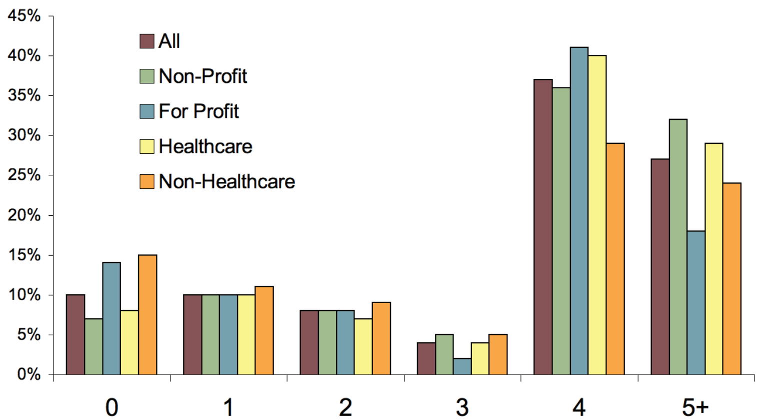
- **Perhaps surprisingly after SOX and its emphasis on financial controls and CEO certifications of results, relatively few CEOs of publicly traded firms were reported to be the overseers of compliance and ethics programs when the CECO doesn't report directly to the board.** The survey asked respondents who did not report directly to the board "To what position within your organization does the CECO report?" Just 32% of respondents at publicly traded companies reported that their CECO reports to the CEO. Another 36% responded that they reported to the General Counsel, and 7% reported to the CFO. By contrast, for non-profit and privately held companies a majority reported to the CEO: 61% and 54%, respectively.

IF NOT THE BOARD, TO WHAT TITLE DOES THE CECO REPORT?



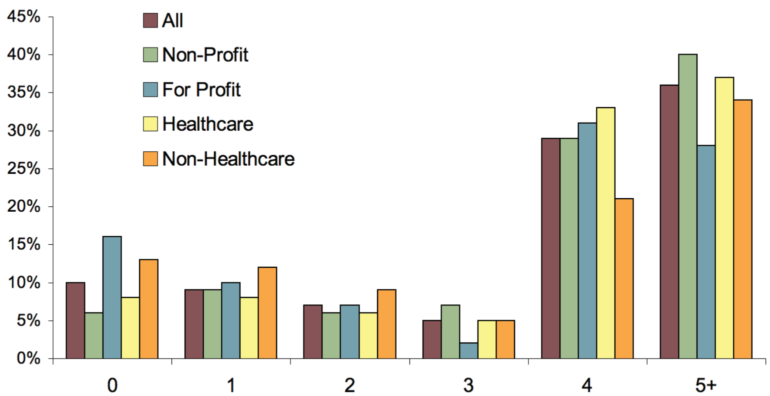
- **Even if CECOs do not report to the board, there appears to be regular interaction with it.** Across all respondents, 65% reported that the CECO has four or more regularly scheduled meetings with the board. The overall responses were consistent across for and non-profit companies. Industry, though, was a factor. Four or more meetings a year were reported by 69% of healthcare respondents but just 53% of respondents outside of healthcare.

NUMBER OF REGULARLY SCHEDULED MEETINGS PER YEAR BY CECO WITH THE BOARD



- **In terms of total meetings—regularly scheduled and not—between the CECO and board, industry is less important than profit orientation.** Overall 36% of respondents reported that five or more meetings take place with the board annually. For not-for-profit entities the percentage was at 40%, but for publicly traded companies the figure was just 26%. Again, this number is surprising given the large number of risks faced by publicly traded companies.

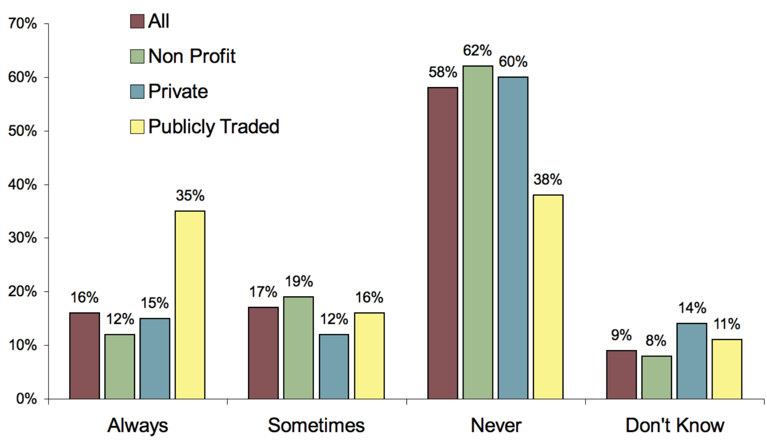
NUMBER OF TOTAL MEETINGS PER YEAR BETWEEN CECO AND BOARD



- **Meetings in executive session were relatively uncommon.** Regular board interactions far outnumbered those in executive session. Just 22% reported meeting in executive session four or more times a year, while 46% reported that they have no meetings in executive session in the course of a typical year.

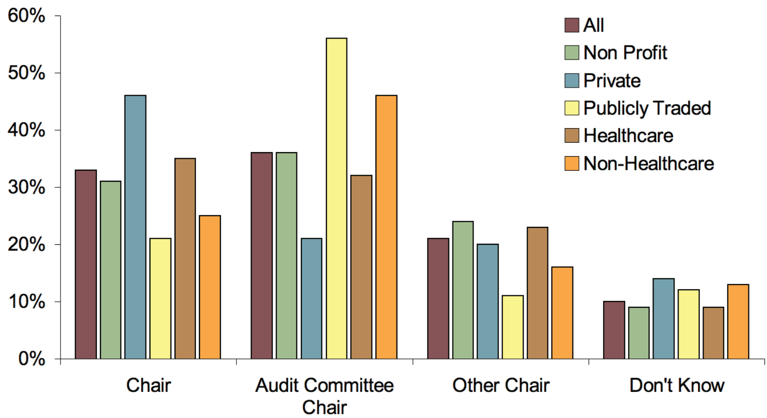
- **When it comes to getting their reports in front of the board without screening and editing, publicly traded companies again fall short.** 35% of respondents from publicly traded companies answered that reports by the CECO to the board are always screened and/or substantively edited by the general counsel or some other executive. Such was the case for just 15% of respondents from privately held companies and 12% from non-profits.

HOW OFTEN ARE CECO REPORTS SCREENED AND SUBSTANTIVELY EDITED BY GC OR OTHERS?



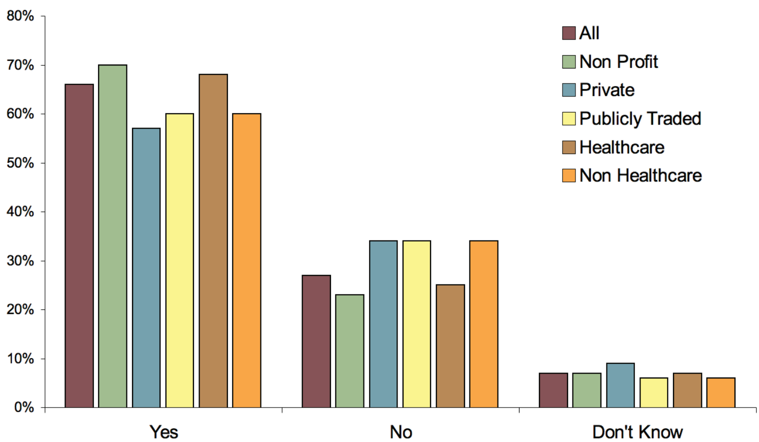
- **There was no consistency in the CECO's primary contact on the board.** Overall 33% had the board's chair as the primary contact, and 36% cited the chair of the audit committee. For publicly traded companies the majority reported that the audit committee chair was their primary contact, but for privately held companies it tended to be the board chair.

CECO PRIMARY BOARD CONTACT



- **Surprisingly, less contact with the board and senior management did not leave publicly traded company CECOs dissatisfied with the number of contacts with the board.** 60% reported that they were satisfied with the amount of interaction. This was lower, but not hugely so than the 70% of non-profit respondents who reported that they were comfortable with the quantity of contacts.

SATISFACTION WITH NUMBER OF BOARD MEETINGS



- **When it comes to exit interviews with the board, the numbers were universally low.** The departure of a CECO could be the sign of serious problems in terms of a company's willingness to find and fix problems. Yet, just 8.5% of respondents reported that a representative of the board conducts an exit interview with the CECO. Another 39% were not aware if there was even a policy. Notably, the numbers on this measure were fairly consistent across industries and business structures.

Conclusions and Implications

- **Organizations, both public and private, will have a great deal more to do to ensure that they can take full advantage of potential fine reductions under the U.S. Sentencing Guidelines.** The proposed changes to the Guidelines require a direct relationship with the board, if a company is to receive credit for having an effective compliance program, even if there was wrongdoing by senior management. Clearly, many companies do not meet those obligations, and troublingly, the publicly traded companies are the least likely to meet them at present. Without significant changes in practices, the companies most at risk for large fines are likely to have the least effective defense.

- **Despite all the efforts to promote better governance, it does not appear that there is yet a fully developed connection between governance and compliance.** Many compliance officers don't report either to the board of directors or even the CEO. The General Counsel is still charged with responsibility in a large number of organizations despite the recent Pfizer settlement which ordered that the CECO specifically not report to the GC. More, with compliance reports heavily vetted in many cases, it is difficult to know how true a picture of the compliance program many board members see.

- **The satisfaction of CECOs with their frequency of contact with the board is both heartening and puzzling.** It is encouraging to see that CECOs don't feel as if they are not seeing the board enough. But, in hindsight, it would likely to have been worthwhile assessing the satisfaction levels with the quality of those contacts.

Methodology

Survey responses were solicited during the first quarter of 2010 from compliance and ethics professionals in the database of the Health Care Compliance Association and Society of Corporate Compliance and Ethics. Responses were collected and analyzed using Zoomerang, a web-based third party solution. A total of 481 responses were received.