Managing and Monitoring Conflicts of Interest
Practical Solutions

June, 2013

Urton Anderson
Clark W. Thompson Professor
Department of Accounting
The University of Texas at Austin

Sheryl Vacca
SVP/Chief Compliance and Audit Officer
University of California

Agenda

- Conflicts of Interest – A Hot Topic
- What is a Conflict of Interest?
- Assessing Risks Regarding Conflicts of Interest
- Monitoring & Auditing the Program
- 7 Key Questions
- Contacts
- Appendices
Why are Conflicts a Hot Topic?

Conflicts of Interest in the News

- **Goldman Sachs – Securities & Investment Banking – Settled 2012**
  - Goldman Sachs' offices in New York
  - Goldman Sachs advised El Paso Corp on a $30 billion sale to Kinder Morgan while having a multimillion-dollar stake in Kinder.

- **Los Angeles City Council – Government & Politics – Filed 2013**
  - Councilman voted on settlement in favor of Clear Channel Outdoor while holding stock in its parent company.
  - Councilman also participated in a vote regarding Home Depot while owning over $2,000 in Home Depot stock.
  - An investigation by the L.A. Ethics Commission has been requested.

- **University of Texas at Austin's Energy Institute – Higher Education – Settled 2012**
  - UT Professor Charles Groat issued a report stating there was no link between fracking operations and water contamination while receiving $1.5 million annually in compensation while on the board of a fracking company.
  - Dr. Raymond Orbach has resigned as head of the Energy Institute.

- **Securities and Exchange Commission – Government & Politics – Nominated 2013**
  - Mary Jo White, nominee for SEC Chairman, will receive monthly retirement payments of $42,000 upon retirement from Debevoise & Plimpton LLP.
  - John W. White, husband to Mary Jo White, is a partner at the law firm Cravath, Swaine & Moore LLP.
  - She has assisted clients such as JPMorgan Chase & Co., Deloitte & Touche, and former Bank of America chief Ken Lewis.

- **Food – Reviewed 2010**
  - Reviews by industry experts and the FDA of food manufacturers tied to outbreaks of salmonella, e. coli and other food contamination.
  - Companies were given high ratings by private third-party inspectors.
  - Inspectors are private companies with no public oversight and are paid by the companies under inspection.
Conflicts of Interest Definitions
How General Bodies Define It

- Any relationship that is or appears to be not in the best interest of the organization. A conflict of interest would prejudice an individual’s ability to perform his or her duties and responsibilities objectively.
  Institute of Internal Auditors (IIA)

- A real or seeming incompatibility between one’s private interests and one’s public or fiduciary duties.
  Black’s Law Dictionary

- A conflict between the private interests and the official responsibilities of a person in a position of trust
  Merriam-Webster

Conflict of interest as virus

...conflicts of interest can be thought of as the viruses that threaten the organization’s wellbeing. As in the microbial world, these viruses come in a vast array of constantly mutating formats, and if not eliminated or neutralized, even the simplest virus is a mortal threat to the body.

Carlo V. di Florio
Director, Office of Compliance Inspections and Examinations
October 2012 speech to National Compliance Officers

Conflicts of Interest Definitions
How We Define It

A potential moral hazard that occurs when a person or organization has competing or multiple interests from its prime directive or responsibility within an organization. Conflicts of Interest may or may not be associated with direct financial benefit for each party and therefore may be difficult to recognize, monitor, manage or uncover in an isolated or recurring environment.
Why Conflicts of Interest Matter

Regulatory Expectations

- A conflict of interest increases risk of bias or poor judgment because of an obligation or commitment to two or more competing interests
- Erodes trust and tarnishes public image
- Government regulators expect organizations to assess their exposure to the risk of conflict of interest

Why Conflicts of Interests Matter

Government regulators expect organizations to assess their exposure to conflicts of interest risks

- SEC enforcement chief called for "top to bottom" conflicts risk analysis in financial services companies (September 2003)
- Code of ethics requirements under Sarbanes-Oxley and stock exchanges
- Amended sentencing guidelines emphasis on considering risks: "... the organization shall periodically assess the risk of criminal conduct and shall take appropriate steps to design, implement, or modify each [program] requirement ... to reduce the risk of criminal conduct identified through this process."
What makes COI Compliance so Difficult

- Human nature
- Range of activities in which it can arise
- Lack of unified and comprehensive law

Common Types of Conflicts

- General financial interest
- Interest in customer or supplier
- Gift and entertainment
- Interested fiduciary transactions and self-dealings
- Competing with organization
- Usurping organization opportunities
Common Types of Conflicts

- Offer of employment by customer, supplier or competitor
- Overt Bribes or Kickbacks
- Subtle “Bribes”
- Influence
- Privileged Information

What is conflict of Interest?

- Can a co-worker sell products (e.g., Amway, Mary Kay products, etc.) to fellow employees or customers at the workplace?

What is conflict of Interest?

- One of your researchers is conducting a clinical drug study sponsored by several pharmaceutical companies. During the trials, the researcher is asked to be a consultant for one of the sponsors to assess their protocols. Is this a conflict?
ASSESSING RISKS REGARDING CONFLICTS OF INTEREST

- Assessing the Risks
- Integrated vs. Specific
- Performing a Risk Assessment
- Risk Assessment Factors
- Sample Questions for Management & Directors

Assessing the Risks

- Mere presence of a conflict of interest is not per se improper, unlawful or unethical
- Failure to identify and appropriately address conflicts of interest can result in unlawful, improper or unethical conflict with consequences to organization and the individual
- Past scandals demonstrate need for proactive approach
  - Recognize and disclose (transparency is key)
  - Focus on how to respond adequately within particular context
  - Zero tolerance is not always desirable and not typically required
  - Document and demonstrate compliance efforts
- There is no one-size-fits all approach

Integrated vs. Specific

Enterprise/integrated or specific risk assessment?

- Specific Approach – identify high risk areas for conflict of interest
- Enterprise/Integrated Approach – part of the overall company risk assessment process
Performing a Risk Assessment

- Objectives
  - Integrate into existing risk assessment processes
  - Identify key risk areas
  - Gather sufficient information for making sound policy decisions
  - Assist in designing effective compliance policies and processes (i.e., select appropriate risk response)

- Considerations
  - Regulatory considerations
  - Organizational requirements/objectives
  - Higher level employees are generally at a higher risk
  - Indicators identified from Helpline/Hotline calls
  - Consider agents and vendors

Risk Assessment Factors

- What are the duties that could be impacted by conflicts of interests?
  - Fiduciary duties to the company and clients
  - Other relationships of trust - where does one rely on the good faith and disinterestedness of your employees and agents?

- What about agents and other third parties? What is the harm they could cause your organization?

- Consider opportunity and motive for conflicts

Sample Questions for Management & Directors

1. Have any of the key executives or Board Members been associated with other organizations in the past and what was the nature of those organizations and relationships?
2. Were key members of management promoted from within the organization or recruited from the outside?
3. Have any key members of management had past regulatory or legal problems, either personally or with organizations they have been associated with?
4. Have there been significant changes in the makeup of management or the Board of Directors?
5. Has there been a high turnover of management and/or Board members?
6. Do any members of management or the Board have criminal backgrounds?
7. Other issues related to the backgrounds of key members of management or the Board of Directors.
MONITORING AND AUDITING* COI PROGRAM

- Incorporating Best Practices
- Monitoring and Auditing
  - Monitoring the Resolution & Disclosure Processes
  - Monitoring Techniques
  - Monitoring for Undisclosed Conflicts
  - Auditing the Program & Process
  - Auditing for Compliance – Gifts
  - Compliance accountability

Incorporating Best Practices

- **CULTURE:** Create a culture of ethical behavior
  - Implement an ethics policy that is communicated to employees (training, newsletters, etc.)
  - Reward behaviors in line with the ethics policy and discipline violators
- **RESOLUTION:** Ensure processes allow necessary personnel to address and resolve conflicts of interest
- **TRAINING:** Train department leaders on fraud and conflict of interest risks in the company, industry, and region
- **MONITORING & AUDITING:** Review the program for employee compliance and program applicability and effectiveness
MONITORING & AUDITING
Monitoring the Resolution Process

- Comprehensive Disclosure and Resolution Summary Report provided to each entity head and entity compliance officers
- Enables monitoring compliance to resolutions at the entity level

---

MONITORING & AUDITING
Monitoring the Disclosure Process

- Track Completion of Disclosures
  - Participation Reporting
  - Weekly system statistics during annual process
  - Entity statistics
  - Individuals who have not responded

<table>
<thead>
<tr>
<th>Category</th>
<th>Completed</th>
<th>Not Completed</th>
<th>Total</th>
<th>Percent Completed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board Members</td>
<td>7</td>
<td>2</td>
<td>9</td>
<td>77.8</td>
</tr>
<tr>
<td>Officers</td>
<td>10</td>
<td>5</td>
<td>15</td>
<td>80.0</td>
</tr>
<tr>
<td>Sr. Management</td>
<td>102</td>
<td>92</td>
<td>194</td>
<td>53.6</td>
</tr>
<tr>
<td>Managers</td>
<td>11,287</td>
<td>3,105</td>
<td>14,392</td>
<td>78.4</td>
</tr>
<tr>
<td>Employees</td>
<td>59,121</td>
<td>16,752</td>
<td>75,873</td>
<td>77.9</td>
</tr>
<tr>
<td>Grand Total</td>
<td>70,527</td>
<td>19,958</td>
<td>90,485</td>
<td>78.3</td>
</tr>
</tbody>
</table>

---

MONITORING & AUDITING
Monitoring the Resolution Process

- Track Acceptance/Adherence to Resolutions
- Acceptance Reports
  - System Statistics
  - Entity Statistics
  - Individuals who do not accept resolution

<table>
<thead>
<tr>
<th>Category</th>
<th>Normal Resolutions</th>
<th>Percent Accepted</th>
<th>Accepted</th>
<th>Not Accepted</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board Member</td>
<td>7</td>
<td>12.50</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Committee Member</td>
<td>24</td>
<td>42.50</td>
<td>11</td>
<td>13</td>
</tr>
<tr>
<td>Contracted Physician - Administrator</td>
<td>14</td>
<td>85.71</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Employee</td>
<td>152</td>
<td>90.61</td>
<td>130</td>
<td>12</td>
</tr>
<tr>
<td>Office</td>
<td>7</td>
<td>33.33</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Physician Innovat</td>
<td>15</td>
<td>73.33</td>
<td>14</td>
<td>1</td>
</tr>
<tr>
<td>Vendor / Contractor</td>
<td>2</td>
<td>100.00</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Overall Total</td>
<td>254</td>
<td>78.92</td>
<td>161</td>
<td>48</td>
</tr>
</tbody>
</table>
MONITORING & AUDITING

Monitoring Techniques

- Building notification triggers into expense and gift reporting when thresholds are reached
- Develop trend and exception reports of entertainment data
- Require close review and accountability of expense reports by managers with approval authority
- Review helpline/hotline reports for calls alleging conflicts of interest, and questions concerning conflict policies
- Review information from employee exit interviews for allegations of conflict of interest
- Periodically question vendors and suppliers (they should be required to notify you of potential conflicts)

Auditing the COI Program

Evaluate the code of conduct and conflict of interest policies

- Have unique industry risk been identified?
- Is it clear to whom the code and policies apply (board, graduate students, contractors)?
- Does the code explain why conflict of interest is important?
- Does it address appearance as well as actual conflicts?
- Are dollar limits and thresholds appropriate?
- Who owns the communication of conflict of interest policy? How are they communicated? Is the timing appropriate?

Evaluate the Conflict Disclosure Process

- How often is reporting and updating required?
- Is it clear that there is a duty to report independent of the completion of form or report?
- Is this required of appropriate level?
- Are questions clear to those completing the form?
- Interview respondents to get feedback
- Is there documentation that disclosures were reviewed and investigated?
- Were reported and identified conflicts resolved pursuant to organizational policy?
Resources for Conflicts of Interest

- American Institute of Certified Public Accountants (AICPA)
- Society of Corporate Compliance and Ethics (SCCE)
- Ethisphere Institute
- Ethics & Compliance Officers Association (ECOA)
- Ethics Resource Center (ERC)