

CONFIDENCE IN **COMPLIANCE**

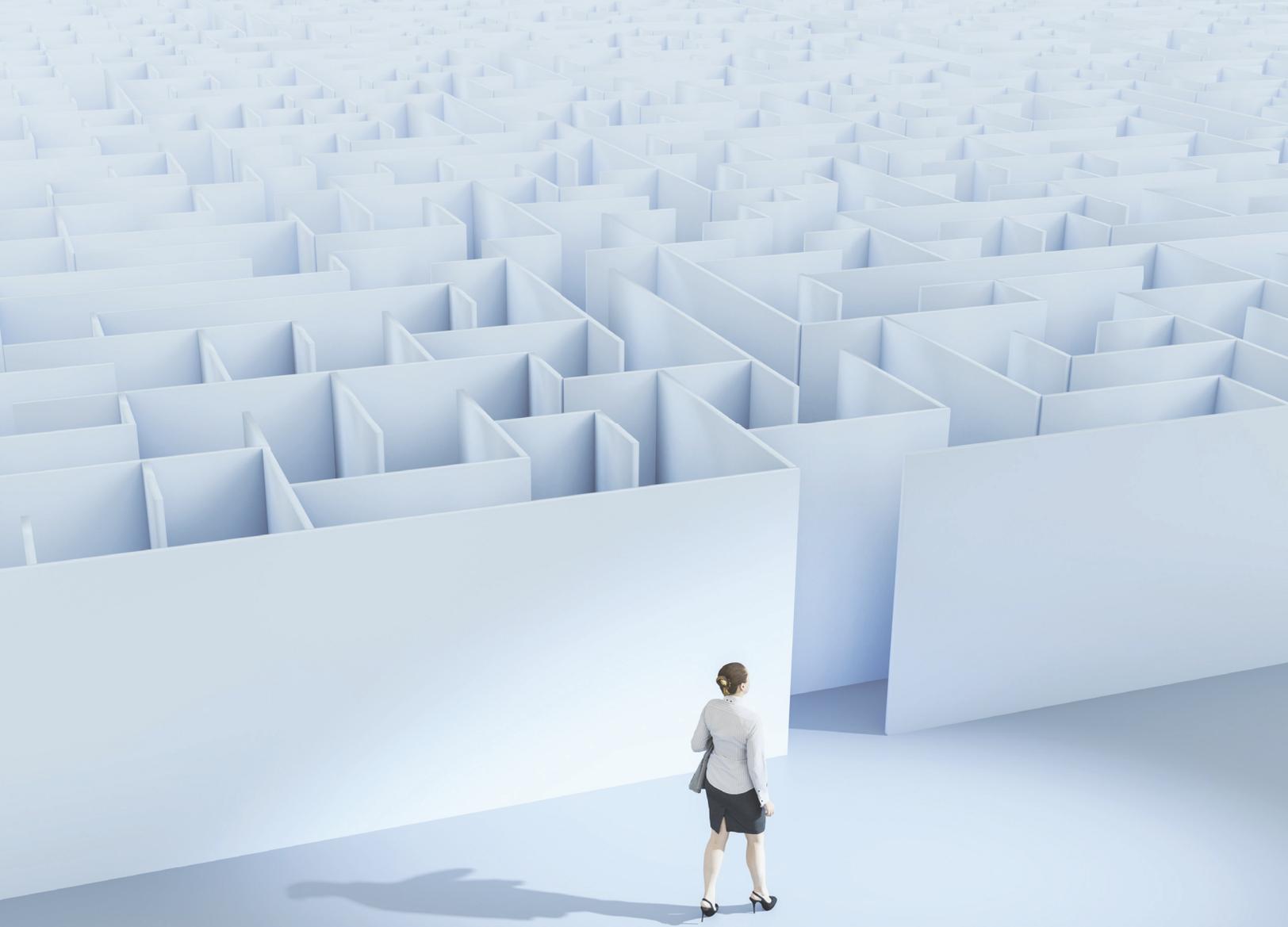
**FACED WITH ADDRESSING A MUCH BROADER SCOPE OF RISKS,
DIRECTOR CONFIDENCE IN COMPLIANCE PROGRAMS IS DWINDLING.**

A CORPORATE BOARD MEMBER/FTI CONSULTING RESEARCH STUDY



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Today's organizations face increasingly complex regulations and legislation, targeting an array of new risks that must be addressed by corporate compliance and oversight. By putting the spotlight on areas of inadequacy in corporate ethics and compliance programs, a new study conducted by Corporate Board Member in partnership with FTI Consulting sounds a warning to governing directors and legal advisors that today's rapidly shifting environment may pose a challenge to their established oversight function.

The 19th annual edition of the Law in the Boardroom study, which surveys U.S. public company directors on the legal risks and challenges the organizations they serve face, takes an in-depth look into anti-corruption and anti-bribery oversight practices in the boardroom. More than 300 board members, representing organizations from many different industries, provided their perspectives on the issue. This report presents our findings.

KEY FINDINGS

- Confidence in ethics and compliance programs is eroding
- Six directors out of 10 report not having measurable guidelines for compliance monitoring
- An increasing number of directors say whistleblower/hotline reports are exposing potential or existing compliance problems
- A third of board members have not yet leveraged advanced technologies to enhance compliance monitoring

DIRECTOR CONFIDENCE IN THE EFFECTIVENESS of their internal ethics and compliance programs is eroding. This year, only 35 percent of respondents reported feeling “very confident” compared to 46 percent just a year prior. Similarly, 11 percent said they weren’t confident compared to 1 percent in 2018.

While this may be surprising, considering compliance is one of the foundational issues within boards’ oversight, several reasons may serve to explain the change of heart: the increasing complexity of rules and regulations; the array of new risks that must be addressed, often for the first time; the pace of change and disruption; the uncertainty brought on by advanced technologies—all are great examples of the scope of challenges today’s directors must face.

Furthermore, all publicly traded companies are subject to regulators’ scrutiny, having to monitor and audit their practices to ensure the business remains compliant with ever-changing laws and regulations. And that scrutiny is intensifying. Surveyed directors pointed to the fact that some organizations, particularly in certain sectors such as finance, are now in a continuous audit process by federal and state regulators. It’s no wonder that directors at financial services companies were more likely to report allocating more resources for compliance (44 percent) compared to all other industries surveyed (28 percent).

The survey also indicates that the lack of formal metrics for measuring the effectiveness of compliance programs may be yet another reason for the decreasing levels of confidence. While one of the published hallmarks of an effective compliance program is ongoing monitoring, six directors out of ten say their board does not have measurable guidelines for compliance monitoring in place.

This finding is concerning. Without formal metrics around measuring the effectiveness of the programs, organizations under scrutiny by regulators will have difficulty demonstrating that their boards and management teams had conducted adequate oversight. Based on recent enforcement cases, this can lead to additional criminal and civil penalties, not to mention the reputational damage to the organization.

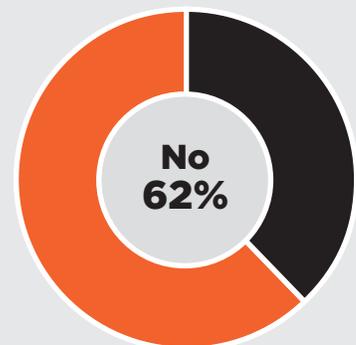
Case in point: in 2018, the U.S. Department of Justice (DOJ) brought 21 criminal enforcement actions against organizations for violating the U.S. Foreign Corrupt Practices Act (FCPA). The U.S. Securities and Exchange Commission (SEC) brought 17 civil enforcement actions. Together, these criminal and civil enforcement actions totaled more than \$1 billion in fines and penalties. In many instances, the amounts of the fines and penalties imposed by the DOJ and SEC were predicated, in part, on the organizations’ failure to maintain adequate compliance programs and internal controls.

On the other hand, the DOJ and SEC also have recognized organizations that have properly designed ethics and compliance programs in place. In certain cases, those programs played a role in the declination to bring enforcement action against an organization. For instance, the DOJ recently declined to bring an enforcement action against a leading UK-based technology solution provider due, in part, to the existence and effectiveness of the company’s pre-existing compliance program and internal accounting controls. Of the more than 360 enforcement actions brought by the DOJ since 1977, this declination was only one of a dozen in the history of FCPA enforcement, four of which were issued in 2018.

How confident are you that your company’s internal anti-corruption, ethics and compliance programs are working effectively?

	2019	2018
Very confident	35%	46%
Confident	54%	53%
Not entirely confident	11%	1%
Not at all confident	0%	0%

Does your board have formal metrics in place for measuring the effectiveness of your ethics and compliance program?



DIRECT AND AUTONOMOUS BOARD REPORTING

In addition to defined metrics, the oversight of an organization’s ethics and compliance program by the board of directors depends on timely, complete and accurate information delivered directly and autonomously to the board or a committee of the board. In FTI’s experience, agency guidance has evolved to expect that the organization’s ethics and compliance leader will have direct and autonomous access to the board. It can, therefore, be inferred that any systemic interference with this access and reporting undermines the operating effectiveness of a well-designed ethics and compliance program and ultimately exposes the organization to increased risk.

In April 2019, the DOJ released guidance related to ethics and compliance programs. In this guidance, the DOJ made clear that when reviewing ethics and compliance programs, the agency inquires:

1. Whether compliance has direct reporting lines to the board of directors and/or audit committees?
2. How often do compliance and relevant control functions meet with directors?
3. Are members of senior management present for these meetings?
4. How does the company ensure the independence of the compliance and control personnel?

In this guidance, the DOJ has clarified and enhanced the need for direct and autonomous access of the ethics and compliance leader to the board—and the need for timely, complete and accurate ethics and compliance reporting. On the flip side, any aspect of the ethics and compliance governance structure or reporting process that interferes with the board’s ability to fulfill its duty stands in direct contradiction to this expectation.

CORRUPTION ON DOMESTIC SOIL

Compliance-related issues involving ethical breaches and fraudulent activity, such as money laundering or bribery, can occur at any organization, regardless of geographical footprint. For instance, travel and entertainment fraud, improper flow of funds and know your customer (KYC) are all risks that can transpire domestically or internationally. Unfortunately, according to surveyed directors, the risk of bribery or corruption is too often not the focus of boardroom discussions, despite the current enforcement climate that requires greater diligence and understanding of laws—and the risk that such activity presents.

Has information from your whistleblower or other ethics hotlines ever sparked an internal investigation that revealed a potential or existing compliance problem or fraud?

	2019	2018
No	49%	56%
Yes	36%	28%
Not sure	11%	8%
Prefer not to say	5%	8%

**Percentages may not add up to 100 due to rounding.*

A large majority of board-level directors surveyed (80 percent) say they receive regular ethics or whistleblower reports, and only 5 percent of those directors report low confidence in the effectiveness of their internal anti-corruption programs. Among directors who did not receive regular reports, 38 percent report feeling less than confident about the effectiveness of their programs. If board members are not receiving regular reports about whistleblowers and ethics hotlines, there’s a good chance they also are not feeling confident about the organization’s ethics and compliance program.

The lack of confidence is not surprising when one considers the rising number of internal investigations that have revealed potential issues. According to our survey, 36 percent of directors say their whistleblower or hotline reports have revealed a potential or existing compliance problem or fraud, compared to 28 percent just a year ago.

While nearly half of survey respondents report no internal investigations stemming from ethics hotlines or whistleblower complaints, this non-activity might be deceptive. Whistleblowing programs must be properly designed and communicated to be effective. For example, do all employees know about the

available ways to report irregularities inside of the organization? Do the hotlines have appropriate language and time options? Are they staffed by independent personnel? Do the whistleblowers have assurance their reports will be confidential and acted on and results reported back to them? And, does the investigation process bypass the people who might seek to stop it? If your hotline isn't ringing, you shouldn't assume there's no corruption or fraud happening.

The pace of internal investigations may also be affected by the U.S. Supreme Court's 2018 decision in *Digital Realty Trust, Inc. v. Somers*,

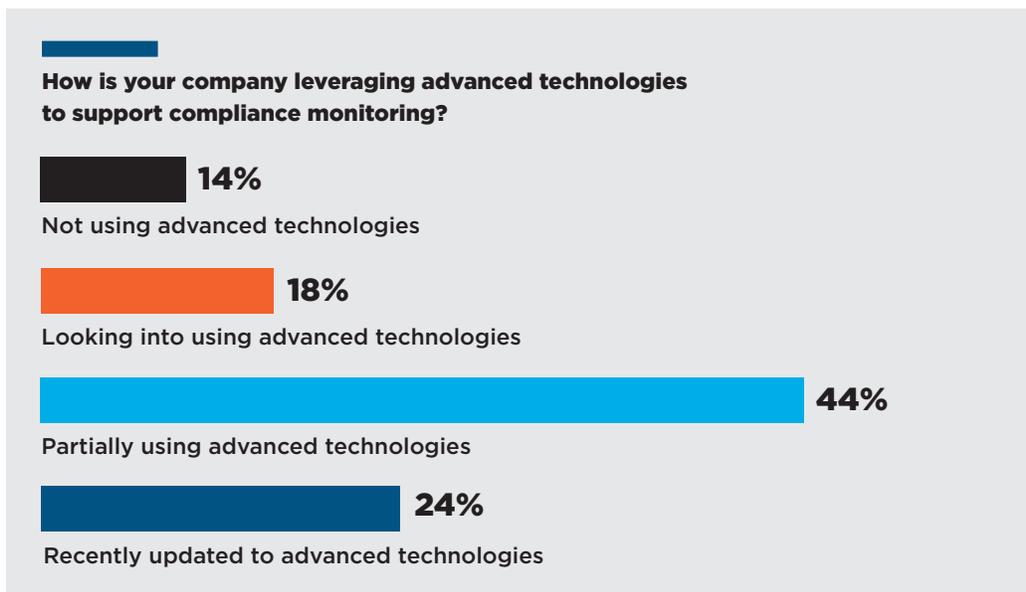
which held that anti-retaliation protections for whistleblowers provided by the Dodd-Frank Wall Street Reform and Consumer Protection Act extend only to those who provide tips directly to the SEC—regardless of whether they report to the company. This may have a chilling effect on employees reporting suspected illicit activity, but it will also have the effect of incentivizing employees to report directly to regulators and possibly bypassing their internal compliance department. While whistleblowers and hotlines will continue to be important anti-corruption tools, organizations must also be prepared to respond to inquiries from regulators before an internal report is made.

ENHANCING COMPLIANCE THROUGH ADVANCED TECHNOLOGIES

Advanced technologies are generating significant opportunities for growth and new efficiencies, but when we asked public company directors whether their organization was leveraging technologies to support compliance monitoring, a third (32 percent) said they have not yet leveraged the advantages that advanced technologies provide over traditional compliance monitoring programs. Directors from the consumer industry are most likely to be using or considering advanced technology (82 percent), possibly due to the industry's reliance on technology in general. Directors at companies that recently updated to advanced technologies also report a higher confidence level in their compliance programs than directors from other groups.

FTI Consulting's experience demonstrates that compliance teams supported by new technologies are better equipped to focus on high-risk activities and to protect the business from the reputational damage and hefty fines we've seen in recent history. As an example, by leveraging the capabilities of machine learning to analyze historic events and identify typical red flags, compliance teams can proactively assess and prevent potential adverse events from occurring in the future. Others have developed KPIs and bespoke analytical dashboards to monitor activities for transactional red flags.

As companies grow, so does their need for technology. Less than 2 percent of large organizations surveyed (more than \$2 billion in revenue) report neither using nor considering advanced technologies to support compliance, compared to 21 percent of smaller organizations. While the upfront investment to develop these monitoring tools is considerable, the ability to monitor compliance risks routinely and efficiently in this fashion has proven to be extremely valuable and can pay off over time. For instance, web-based tracking tools can help companies log, approve, track and report previously untracked events, such as gifts, donations and non-routine meetings with government officials.



More complex asset-tracing algorithms work to identify relationships and enable companies to answer crucial questions, such as “Where did the money in account X go? What are the sources of funds in account Y? Which intermediary accounts are involved in moving the money from X to Y?” Using technology in this manner can help companies avoid costs associated with reacting to compliance violations and regulator-driven investigations.

Advanced technology will be extremely valuable for corporations to monitor and manage compliance requirements successfully going forward. And the successful boards of tomorrow are grasping the opportunities to leverage technology in their ethics and compliance oversight function.

CONCLUSION

An organization’s governing board has a fiduciary duty to protect the organization from fraud and corruption by being knowledgeable about its ethics and compliance function. The Corporate Board Member/FTI Consulting survey shows eroding confidence among board directors in the ethics and compliance programs of their organizations—a troubling sign when regulatory enforcement is becoming increasingly commonplace, complex and costly.

Organizations can bolster confidence among their directors by taking a hard look at their internal ethics and compliance programs and ensuring that they meet high standards in the following areas:

1. Establish direct and autonomous reporting by the head of compliance to the board
2. Set formal metrics for the board to measure the effectiveness of the compliance program
3. Ensure effective hotline and whistleblower processes and report activity to the board regularly
4. Enhance compliance functions by using advanced technology

SURVEY METHODOLOGY

In May and June 2019, Corporate Board Member and FTI Consulting surveyed 303 directors at public companies to gain an inside look into boardroom practices regarding the oversight of anti-corruption and anti-bribery risk, as part of the 19th annual Law in the Boardroom study. The survey was conducted online, anonymously.

Title/Role:

Executive director	4%
Outside director	65%
Board chair	12%
Committee chair	37%
Lead director	9%

Tenure:

Fewer than 2 years	12%
3 - 5 years	21%
6 - 10 years	24%
More than 10 years	43%

Sector:

Financials	26%
Industrials	16%
Real estate/REIT	9%
Information Technology	8%
Energy	9%
Consumer Discretionary	11%
Materials	5%
Healthcare	9%
Consumer Staples	3%
Telecommunications	1%
Utilities	3%

Company Size (by revenue):

Less than \$299.9 million	20%
\$300 million to \$1.99 billion	36%
\$2 billion to \$9.99 billion	26%
\$10 billion to \$299.99 billion	17%
More than \$300 billion	1%

For more details about the survey methodology, please contact Corporate Board Member’s research director, Melanie Nolen, at mnolen@ChiefExecutive.net.

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