

# AN EFFECTIVE ETHICS AND COMPLIANCE PROGRAM REQUIRES DIRECT AND AUTONOMOUS ACCESS TO GOVERNING AUTHORITY

## Introduction

It is well-settled that an organization's governing authority (typically the board of directors) has a fiduciary duty to protect the organization from malfeasance by being knowledgeable about the organization's ethics and compliance program. To help ensure this duty is fulfilled, enforcement agency guidance has evolved to expect that the organization's ethics and compliance leader will provide timely, complete, and accurate information directly and autonomously to the governing authority. Any systemic interference with this access undermines a well-designed ethics and compliance program, ultimately exposing the organization to increased risk.

Since 1996, courts have interpreted Delaware law to obligate corporate directors to protect their organization from risk by implementing internal compliance measures. This obligation includes a duty to assure the existence of a corporate information and reporting system, and that failure to do so under some circumstances may render directors liable for losses caused by non-compliance with applicable legal standards. Having become known as the Caremark standard, this expectation establishes that directors have a fiduciary duty to be knowledgeable about the existence and the operation of their affiliated organization's ethics and compliance (E&C) program.

Over the decades, this comprehensive duty of oversight and care has been established and re-affirmed in a variety of guiding frameworks, agency guidance, and relevant case law that define an effectively designed E&C program. Most organizations count between seven and a dozen programmatic elements that compose their E&C programs.

The number varies because the form and substance of the program can be organized in different ways, but there is a common expectation among various guiding frameworks that directors should understand the content and operation of all programmatic elements across key risk areas, and not just be familiar with the organization's hotline data or significant investigations.<sup>1</sup>

To help an organization's board fulfill its obligations under the Caremark standard and other guidance, there is an expectation that the senior E&C leader make periodic reports and have direct and autonomous access to the board. The key words that are common to almost every set of guidelines outlining an organization's governing authority to fulfill its fiduciary duty of care and oversight are direct and autonomous, describing the type of access that the organization's senior E&C leader should have to the board.

## STEPS TOWARD DIRECT AND AUTONOMOUS REPORTING

Until more recently, the United States Federal Sentencing Guidelines, the most widely recognized and adopted framework for an effectively designed E&C program, remained silent on the specific expectation of autonomous reporting; however, the Federal Sentencing Guidelines did expect an organization's E&C leader to (1) ensure that the organization has an effective E&C program; (2) have direct access to the organization's governing authority; and (3) report periodically to the governing authority on the effectiveness of the program.<sup>2</sup> However, other guiding frameworks and more recent agency guidance address the autonomy expectation in various ways.

- In 2003, when the Office of Inspector General (OIG) issued guidance to pharmaceutical companies as to effective E&C governance structures and reporting processes, the OIG indicated that E&C officers should have the authority to "report directly to the board of directors ... [and the ability] to exercise independent judgment."<sup>3</sup> The OIG has also inquired into direct and autonomous access when reviewing the design of an organization's E&C program outside the pharmaceutical industry.<sup>4</sup>
- In 2010, the Organization for Economic Co-Operation and Development's (OECD) framework for an effectively designed anti-corruption compliance program expects E&C leaders to report matters directly to the organization's governing authority with an adequate level of authority and autonomy from management.<sup>5</sup>
- The 2016 standard of the International Organization for Standardization expects an organization's governing authority to be knowledgeable around the content and operation of the compliance program, and for the E&C leader to report to the authority on the program's performance. The ISO standard further expects that the compliance function will be adequately resourced, have appropriate "authority and independence," and enjoy direct access to the governing authority."<sup>6</sup>

## DOJ AND SEC STEP UP GUIDANCE

In 2012, the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) echoed the notion of direct access from other frameworks and took the expectation one step further to include the concept of autonomy. In its combined guidance with regard to an organization's compliance with the Foreign Corrupt Practices Act (FCPA), the DOJ and SEC advised that the senior E&C leader should have "adequate autonomy" from management and "direct access" to the organization's governing authority.<sup>7</sup> Direct and autonomous access helps to ensure that the information provided by the senior E&C leader to the governing authority is timely, accurate, and complete.

Five years later, the DOJ issued guidance that reiterated the need for direct and autonomous access. The agency indicated that, when evaluating E&C programs in the context of criminal proceedings, it would inquire whether the high-level individual responsible for designing and implementing the organization's E&C program has direct reporting lines to the organization's governing authority.<sup>8</sup> In addition, the DOJ indicated that it inquires whether the senior E&C leader participates in executive or private sessions with the board or a committee of the board – an example of autonomous access.<sup>9</sup> The DOJ's focus on the question of executive or private sessions underscores the importance of, and need for, direct and autonomous access in the context of effectively designed E&C programs.

In April 2019, the DOJ released further updated guidance on the "Evaluation of Corporate Compliance Programs" that includes a subsection on "Autonomy and Resources"<sup>10</sup> that specifically directs prosecutors to evaluate the answers to the following:

1. Do compliance and relevant control functions have direct reporting lines to anyone on 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?

The new guidance is presented as neither a checklist nor a formula. Rather, the new guidance highlights how the answers to these questions can be applied to demonstrate whether the compliance program is well-designed and effectively implemented. This new guidance heightens the obligation imposed on organizations not just to have an ethics and compliance program, but to have one that is operating effectively.

#### EXAMPLES OF INTERFERENCE

Over the years, guiding frameworks, agency guidance, and relevant case law has clarified and enhanced the need for direct and autonomous access of the E&C leader to the board – and the need for timely, complete, and accurate E&C reporting. On the flip side, any aspect of the E&C governance structure or reporting process that interferes with the board’s ability to fulfill its duty stands in direct contradiction to this expectation.

Examples of such interference may exist when a member of management, including the CEO, establishes or requires an internal “review” step that creates an opportunity to inappropriately modify, filter, or censor the information. Another example may exist when a member of management participates in board or committee meetings and attempts to downplay, explain away or, euphemistically “put into context” the information being reported by the organization’s E&C leader to the board.

When read together, the multiple sources of guidance and case law all point to an expectation that the governing authority should be knowledgeable about all aspects of the E&C program across key risk areas. These programmatic drivers also expect that an organization’s E&C leader will have direct and autonomous reporting access to the board.

And any aspect of an organization’s structure or reporting process that interferes with these fundamental expectations undermines the design of an effective E&C program, inhibits the board’s ability to fulfill its duties, and ultimately exposes the organization to increased risk.

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<sup>1</sup> See e.g., the International Organization for Standardization's (ISO) standard 37001, which deals with effective anti-corruption compliance program design; *Evaluation of Corporate Compliance Programs*, Department of Justice Criminal Division, Fraud Section, § 2 (2016); and *In re Caremark International Inc.*, 698 A.2d 959 (Del. Ch. 1996).

<sup>2</sup> See United States Sentencing Commission, *Guidelines Manual*, §§ 8(B)(2)(1)(b)(2)(B) and (8)(B)(2)(1)(b)(2)(C).

<sup>3</sup> See Office of Inspector General's Guidance for Pharmaceutical Manufactures, Federal Register / Vol. 68. No 86 23731 (2003).

<sup>4</sup> See e.g., *Florida A&M University Anti-hazing Program Preliminary Report of Investigation*, U.S. Office of Inspector General, Complaint No. 2011-038 (2012) (when, in the context of reviewing the adequacy of the university's anti-hazing compliance program, the OIG reviewed, among other things, the compliance-related information provided directly by FAMU's Council for Student Affairs to Student Affairs Committee of the Board of Governors).

<sup>5</sup> See Recommendation of the Council for Further Combating Bribery of Foreign Government Officials in International Business Transactions, *Good Practice Guidance on Internal Controls, Ethics, and Compliance, Annex II § A.(4)* (2010).

<sup>6</sup> See ISO 37001 § 5.1.1(c)(e) and ISO 37001:2016 § 5.3.2(d).

<sup>7</sup> See *Resource Guide to the U.S. Foreign Corrupt Practice Act*, Department of Justice and Security and Exchange Commission, §§ 314 and 315 (2012).

<sup>8</sup> See *Evaluation of Corporate Compliance Programs*, Department of Justice, Criminal Section, Fraud Division (2017).

<sup>9</sup> See *id.*

<sup>10</sup> See *Evaluation of Corporate Compliance Programs*, Department of Justice, Criminal Section, Fraud Division (2019) § 2(B).

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