BUILDING AN EFFECTIVE COMPLIANCE PROGRAM

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Overview

• What is Corporate Compliance?

• Benefits and Key Components of an Effective Compliance Program

• Tools for Addressing Compliance Concerns

• Board Oversight

• Compliance Pitfalls
What is Corporate Compliance?

- Internal policies and procedures designed to:
  - Prevent and detect violations of applicable law, regulations, rules and ethical standards by employees and agents; and
  - Create a culture of compliance and ethical business.

- Legal risk management

- Internal controls
Benefits of an Effective Compliance Program

• Deters criminal violations, thus avoiding costs and disruptions involved in government investigations and prosecutions.

• Aids in early detection, prompt internal investigation of violations, timely corrective action, and reporting to enforcement authorities.

• Considered a mitigating factor by U.S. enforcement authorities.

• Helps to avoid government-imposed compliance program and monitor.
Why Have a Compliance Program?

- Federal Sentencing Guidelines
  - Mandate reduction of criminal fine if company had an effective compliance program in place at time offense was committed.
  - Set forth the components of an effective compliance program.
Why Have a Compliance Program?

- United States Department of Justice, Principles of Federal Prosecution of Business Organizations
  - In determining whether to charge a corporation for the criminal misconduct of its employees, prosecutors should consider “the existence and adequacy of the corporation’s compliance program.”

  - In determining whether to bring charges and what charges to bring, SEC will consider what compliance procedures were in place to prevent the misconduct.
  - Available at http://www.sec.gov/litigation/investreport/34-44969.htm
These seven effectiveness factors have become the “prescription” for corporate compliance programs:

- Establish standards and procedures to prevent and detect criminal conduct.
- Governing authority knowledge and oversight; high-level individual responsible.
- Due diligence regarding “Substantial Authority” personnel.
- Communication and Training.
- Hotline, evaluation and monitoring.
- Consistency, incentives and discipline.
- Response and modification.
Key Components of a Compliance Program

– Communication
  • Senior management must be committed to compliance. Should convey the clear message that unethical behavior is not tolerated, even if business is lost.

– Structure
  • Compliance/ethics officer(s) reporting directly to the board of directors.

– Resources
  • Sufficient resources to fund and staff program.
  • Training including well-conceived, real-life situations and dialogue.
  • Monitoring, following-up and reassessing compliance.

– Incentives
  • Include compliance efforts in promotion, compensation and evaluation process.
Key Components of a Compliance Program

- Managers themselves must comply with the letter and the spirit of the rules. If employees see managers bending the rules, they will do it too.
- Character must be made a key part of the firm's hiring criteria.
- Integrity, ethics and compliance should be part of the promotion, compensation and evaluation processes.
Key Components of a Compliance Program

• When an ethical violation occurs, the problem should be fixed and appropriate action taken against the employee – no matter how senior – as soon as possible.

• All managers must be held accountable for setting the right tone.

• Monitor, follow-up and re-assess. Make sure on a regular basis that policies and procedures are being followed.

• Don't fall victim to a checklist mentality.
Contractor Code of Business Ethics and Conduct

• Government contractors must abide by Federal Acquisition Regulation (FAR) 52.203-13.
  – Available at https://www.acquisition.gov/far/

• Regulation prescribes a Contractor Code of Business Ethics and Conduct.

• Incorporates Department of Justice Guidelines.

• Government contractor must have a written code of business ethics and conduct.
Customize Your Compliance Program for Your Industry

• Every industry has unique compliance considerations
  – Defense
  – Health Care
  – Financial services
Compliance Tools

- Code of Ethics
- Whistleblower Procedures
- Business Ethics Hotlines
- Internal Investigations
What is a Code of Ethics?

- Written policy that is reasonably designed to deter wrongdoing and to promote:
  - Honest and ethical conduct that requires compliance with applicable governmental laws, rules and regulations.
  - Complete, timely and understandable disclosure in public filings.
  - The prompt internal reporting of violations to an appropriate person or persons identified in the code.
  - Accountability for adherence to the code and sanctions for those who breach it.
Addressing Whistleblower Allegations

- Do not take any adverse action against the whistleblower prior to learning all of the facts – unless action is necessary to prevent further harm to the company.
  - Document all actions.

- If the whistleblower is known, attempt to interview him or her to gain a complete understanding of the allegations.

- Investigate the allegations in a privileged context, if possible.
Business Ethics Hotlines Required In Today’s Business Environment

- Sarbanes-Oxley §301 Requires Audit Committees of issuers to establish procedures for:
  - The receipt, retention and treatment of complaints regarding accounting, internal accounting controls and auditing matters; and
  - The confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.
Business Ethics Hotline Best Practices

- Operate the hotline independently from management.
  - Often outsourced to credentialed third parties.
- Ensure that hotline is answered by a trained professional.
- Provide a live interviewer available 24 hours a day / 365 days a year.
- Have a standardized in-take sheet to ensure that you gather sufficient information to evaluate the alleged conduct.
- Document all calls, follow-up actions and conclusions reached.
Business Ethics Hotline Basic Parameters

- Communicate to employees how to report concerns.
- Provide employees with periodic reminders about the hotline’s existence.
- Draft procedures regarding how to respond to time sensitive issues.
- Conduct an internal investigation where appropriate.
- Where appropriate, advise employee(s) of actions taken in response to Business Ethics Hotline calls.
Business Ethics Hotline Complaint Follow-up

• Who should receive and follow-up on the complaints?
  – The audit committee or the chairman of the audit committee.
  – The company's general counsel.
  – The company’s risk management department or human resources department.
  – An outside consultant or advisor.

• Establish a standard distribution of complaint recipients.
Internal Investigations

- Company Hotline Tips
- Employee Complaints
- Third Party Complaints
- Informal Statements by Government Regulator
- Internal Audit Findings
- Outside Auditor Findings
- Informal Requests for Information or Documents by Government
- Grand Jury Subpoenas
- Critical Pronouncements or Inquiries by Legislative Bodies
- Civil Suits or Complaints by Disgruntled Former Employees
- Press Inquiries or Reports About Questionable Practices
- Credible Information from Any Source
Purposes Served By An Internal Investigation

• Determine Facts and Identify Potential Wrongdoing by Officers or Employees to:
  – Respond to Government Investigation
  – Take Action to Avoid Recurrence
  – Position Company in Context of Litigation
  – Take Proactive Measures to Recoup Damages
Who Should Conduct the Investigation?

- Corporate Audit, In-House Counsel and/or Outside Counsel
  - Subject matter of the investigation
  - What prompted the investigation
  - Purpose of the investigation
  - Probability of litigation
  - Independence Issues
  - Attorney Client Privilege Issues
Board Oversight

• How can the board exercise compliance program oversight?
  – What should directors know?
  – How should they be kept informed?

• How can the Board support an ethical corporate culture?

• Amendments to Federal Sentencing Guidelines for Organizations incentivize companies to vest compliance operations personnel with direct reporting obligations to Board or appropriate subgroup.
What Should Directors Know?

- Sources and scope of Board compliance oversight responsibilities
  - Sentencing Guidelines’ Criteria
  - Legal/regulatory/prosecutorial guidance
  - Best practices

- Elements of an effective ethics and compliance program
What Should Directors Know? (cont’d)

• Major risks and compliance problems

• Board should be kept abreast of changes in risks
  – Changes in business
  – Changes in business structure (e.g., acquisition/merger) laws
  – Changes in laws or regulations
What Should Directors Know? (cont’d)

• Board should know the key components of the company’s compliance program:
  – Tone at the top
  – Policies
  – Training
  – Controls/oversight
  – Auditing/monitoring/reporting mechanisms
How Should Board Be Kept Informed?

• Monitor Compliance
  – Receive briefings from compliance officer, at least semi-annually, on program initiatives and results.
  – Obtain evidence that program meets the Sentencing Guidelines’ criteria.
  – Conduct non-executive sessions with compliance officer.
  – Understand procedures for filtering/handling whistleblower complaints and track reported problems and their handling.
  – Review compliance systems evaluations.
Directors Should Demonstrate a Strong Tone at the Top

- Devote adequate meeting time to compliance matters.
- Make clear to management to report red flags/warning signs of improper conduct or questionable risk.
- Oversee management’s involvement in and commitment to the Compliance Program.
- Scrupulously adhere to the Code of Conduct and other company policies applicable to directors.
- Know what questions to ask . . . and ask them.
Compliance Pitfalls

- Boilerplate programs
- Standards without established procedures
- Poor communication
- Lack of enforcement
- Double standards regarding discipline
- Lack of management commitment
Conclusion

- Corporate compliance should be a top priority for your company.
- Monitor risks and act appropriately when risks are identified.
- Keep the Board apprised of compliance developments.
- Set a compliance “tone at the top.”
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