

## Ethics and compliance The advantage of a values-based approach



Public companies and their senior executives and board members may be held accountable - personally accountable.

# A compelling case for change

In the context of corporate governance, compliance means obeying the law. Ethics is the intent to observe the spirit of the law, in other words, it is the expressed intent to do what is right. The aftermath of unethical behavior can be devastating for a company, as we have seen time and time again. Therefore, a program that strongly emphasizes both ethics and compliance is good business.

Recent incidents of corporate frauds in India have raised the ante for ethical behavior and effective enterprise-wide compliance programs. In addition to the existing requirements in Companies Act 1956 and the Clause 49 of the listing agreement with the stock exchanges, the Ministry of Corporate Affairs plans to seek prosecution powers for the Serious Fraud Investigation Office (SFIO), India's premier agency to investigate white collar crimes. Public companies and their senior executives and board members may be held accountable not only for the financial reporting provisions of the legislation, but also for the aspects pertaining to ethics and compliance. Conversely, companies and their leadership that adhere both to the letter and the spirit of the law may realize substantial benefits.

An interesting landscape is developing with regard to ethics and compliance. Public and private policies are being enacted that will encourage companies and their executives to "behave" better. But is compliance with these policies and related legislation enough? In reality, companies that follow both the letter and the spirit of the law by taking a "values-based" approach to ethics and compliance may have an advantage in the marketplace. Such an approach requires senior executives to understand clearly the culture and compliance controls that exist at all levels of their organizations.

Companies should position ethics and compliance programs as a responsibility of each employee and a respected part of the company culture, not just a "thou shall not" obligation. Companies' senior executives and board members must adhere to the code of ethics and compliance policies in the same way that all other employees must. Benefits of this approach can include improvements to brand equity, potentially leading to increased shareholder value.



# The risks and rewards of compliance

Certain provisions of Clause 49 are very specific with regard to ethics and compliance for public companies. Clause 49 I (D) of the Listing Agreement with the stock exchanges requires companies to institute a code of ethics for the Board and senior management and affirm compliance to the same on an annual basis. Though institution of Whistle Blower mechanism is not mandatory at present, Clause 49 II (D) requires audit committee to review procedures for the receipt, retention, and treatment of complaints—including confidential and anonymous submissions by employees—received regarding accounting, internal accounting controls, or auditing matters, providing for adequate safeguards against victimization of employees who avail of the mechanism and also provide for direct access to the Chairman of the Audit committee in exceptional cases.

The stock exchanges' corporate governance listing standards require listed companies to incorporate the code of ethics for directors and senior management and public disclosure of the code on the company's website. The guidelines changed focus away from compliance toward a broader assessment of corporate efforts to create an ethical and organizational culture.

In particular, the amended guidelines require boards of directors and executives to assume responsibility for the oversight and management of ethics and compliance programs. The provisions will help developing a valuable framework for the design of effective ethics and compliance programs.

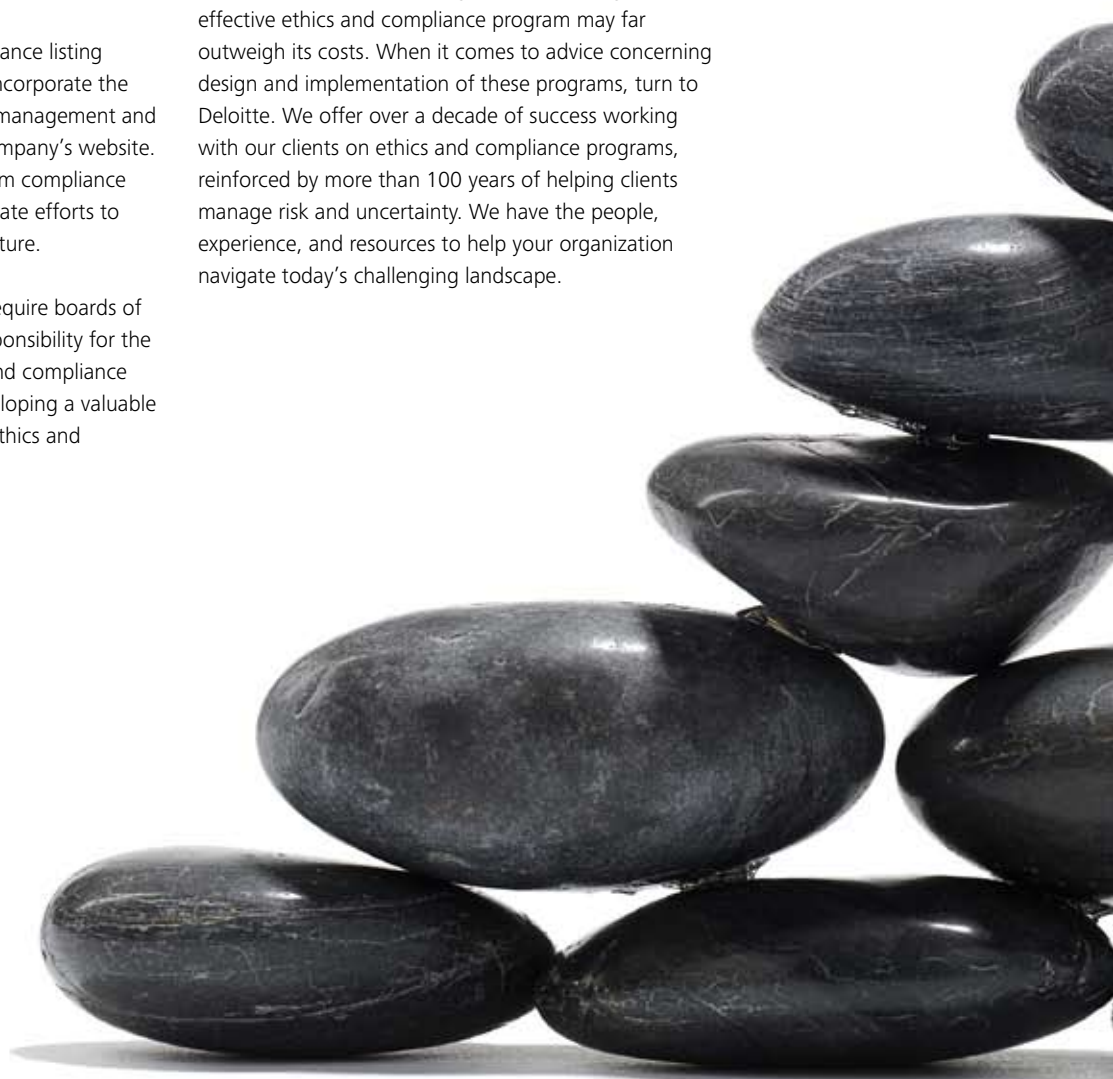
Compliance with these requirements may produce positive results at several levels:

Companies that embed positive ethics deep within their culture may enjoy healthy returns through employee and customer loyalty and public respect for their brand, both of which can translate into higher shareholder returns.

Companies that go the extra mile with their ethics and compliance programs lay the foundation for an effective internal control environment.

Company officials who observe the law may avoid stiff personal penalties, both monetary and potential jail time.

The benefits of implementing and maintaining an effective ethics and compliance program may far outweigh its costs. When it comes to advice concerning design and implementation of these programs, turn to Deloitte. We offer over a decade of success working with our clients on ethics and compliance programs, reinforced by more than 100 years of helping clients manage risk and uncertainty. We have the people, experience, and resources to help your organization navigate today's challenging landscape.





# Elements of an effective ethics and compliance program

Some key elements of such a program include:

- An organizational culture that encourages ethics and compliance with the law
- Day-to-day oversight by a high-level individual who has adequate resources and authority (e.g., Chief Ethics and Compliance Officer)
- Clear responsibility on the part of senior management and active oversight by the board of directors
- Effective communication of standards and procedures, as well as periodic training for all levels of the organization, including the board, management, employees and agents
- Care in delegation of substantial discretionary authority to individuals (e.g., background checks)
- Reasonable steps taken to achieve compliance and consultation (e.g., monitoring and reporting systems, helpline)
- Incentives for compliance with the Guidelines, appropriate response after detection of an offense, and consistent enforcement of disciplinary mechanisms
- Periodic risk assessments



# How we can add value to your organization

Ethics and compliance issues, of course, are nothing new. The Companies Act vide its provisions in Sec 274-323 clearly spells out powers, duties, restrictions and disclosure requirements for the Board. Clause 49 (V) also requires the CEO/CFO to certify and accept the responsibility for establishing and maintaining internal controls. They have to disclose to the Audit Committee the deficiency in the design and operating effectiveness of these controls and steps they are taken to rectify the same. All these aim to protect stakeholders and shareholders from corporate misconduct.

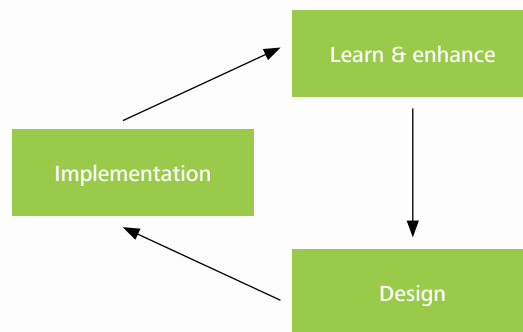
Instituted in 1992, our Ethics and Compliance Services practice was the first dedicated practice of its type among major public accounting firms. We are focused intently on helping our clients design, implement, and improve their ethics and compliance programs, as well as create sustainable processes to communicate expectations and monitor compliance. And ours is a record of helping corporations deal with these important issues.

Whether your organization already has an ethics and compliance program in place or is seeking to establish one for the first time, we can help.



# Ethics and compliance is an ongoing process

Even established programs can benefit from a periodic review. Issues raised through an organization's program and changes in the regulatory and business environment should be considered to identify any necessary improvements.



# Five-phase approach

Our five-phase approach for assisting you in creating or enhancing an ethics and compliance program may encompass the following activities.

## **Phase One**

### **Risk/cultural assessment**

Through employee surveys, interviews, and document reviews, we can help you validate your culture of ethics and compliance at all levels of the organization or establish a baseline for change. Our report will provide detailed observations and identify gaps between your current practices and leading company benchmarks. From these assessments will emerge a detailed plan.

## **Phase Two**

### **Program design/update**

In this phase, we help you create guideline documents that outline the reporting structure, communication methods, and other key components of the code of ethics and compliance program. This encompasses many aspects of the program, from grass roots policies to structuring board committees that oversee the program; from establishing the mandatory anonymous complaint reporting mechanism - i.e., ethics and compliance helpline or whistleblower hotline - to spelling out the specifics of the code of ethics in a way that is easily understood by everyone at all levels of your organization.

## **Phase Three**

### **Policies and procedures**

Working with your Compliance officer, we help you develop or enhance the detailed policies of the program, including, but not limited to, issues of financial reporting, antitrust, conflicts of interest, gifts and entertainment, records accuracy and retention, employment, the environment, global business, fraud, political activities, security and privacy, and harassment.

## **Phase Four**

### **Communication, training, and implementation**

Even the best policies and procedures are ineffective if they are not institutionalized - they must become part of the fabric of your organization. We can help you articulate, communicate, and reinforce not only the specifics of the program, but also the underlying philosophy, and its day-to-day realities. In this way, your key stakeholders are more likely to embrace the program and incorporate it into their attitudes and behaviors. Our professionals can help you reach all levels of the organization - from the boardroom to the mailroom - in an effective and cost-conscious manner.

## **Phase Five**

### **Ongoing self-assessment, monitoring, and reporting**

The true test of your ethics and compliance program comes over time. How do you know in one year or five that both the intent and letter of the law are still being embraced throughout your organization? How does the program - and your organization - adapt to changing legislation and business conditions? As your organization evolves - for example, through mergers and acquisitions - will the program remain relevant? The cultural assessment, mechanisms, and processes that we help you put in place today, including employee surveys, monitoring and auditing programs, can help you achieve sustained success.



# The cultural assessment - A critical first step

One of the biggest risk factors for companies today revolves around culture. If employees, the eyes and ears of the company, are afraid to raise issues or challenge management, the company is disadvantaged, if not doomed.

If management does not listen to employees, they place themselves at grave risk.

- Do rank-and-file employees understand the tone set by senior management?
- Does your organization's culture encourage ethical behavior at all levels?
- Can employees throughout your organization describe the company's code of ethics?
- Do employees in all areas of your organization feel free to ask questions and express concerns?
- Do your employees believe that the mechanisms are in place to allow them to voice opinions without fear of retribution?

A cultural assessment is the first step in answering these and other critical questions. The benchmarks that result from the assessment process become the foundation for an ethics and compliance program, as well as an effective control environment.

## Building an ethical culture: Starting with our youth

Ethical behavior may not happen on its own. But there is a fundamental belief that people who practice good business ethics are more successful than people who don't. The challenge for companies is to reinforce this belief by demonstrating it - in words and in actions.

# The board's oversight responsibilities

As evidenced by the explicit recommendations in the amended Guidelines, the board of directors should play a visible role in overseeing ethics and compliance. Their involvement is particularly important when it comes to whistleblowers or any other employee who voices concerns about company or individual actions.

The boards are today expected to be more actively engaged in the ethics and compliance reporting process. We can help directors address critical questions, such as:

- Is there a process for management and the board to respond to issues that arise from any level of the organization?
- Is there an effective reporting mechanism in place?
- Is management willing to take action on reports?

- Are employee surveys conducted to determine awareness of and willingness to participate in the ethics and compliance program?
- What is the culture and "tone at the top" regarding ethics? Is the employee's view of the tone aligned with senior management's?
- Does the reward system consider performance in light of the ethics and compliance program objectives?

The answers to these and other questions can raise the board's awareness of the alignment between the company's intent to comply with its code of ethics and applicable laws and the company's actual practices.



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