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Structuring the Chief Ethics and Compliance Officer position: Frequently asked questions

Q: What are the most common organizational models?
A: Types of common organizational models for positioning the chief ethics and compliance officer (CECO) include:

- Reporting to the board (or an independent board committee)
- Reporting to the chief executive officer (CEO)
- Reporting to the chief financial officer (CFO)
- Reporting to the general counsel (GC) or within the Legal department
- Jointly reporting to the GC and the CFO
- Reporting to another senior officer
- Reporting to a senior officer, “dotted line” to the governing authority
- The GC (or another senior officer) is also the CECO

Q: What do you mean by “reporting”?
A: For chief ethics and compliance officers, there are two types of “reporting”: (1) information reporting to the governing authority (e.g., periodic reports on the status of the compliance program); and (2) administrative line reporting (e.g., “hire and fire”).

The following article is Part 2 of a 2-part series and is an excerpt from a chapter in the SCCE Complete Compliance and Ethics Manual, Winter Update, January 2013. For more information, visit www.corporatecompliance.org/Products/ProductInfo/productcd/MANUAL.aspx. See Part 1 in our December 2012 issue for a discussion of the five essential features of the CECO position.

by Donna Boehme

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(FSGO) bolstered the independence of the CECO by emphasizing the value of the CECO’s “direct reporting obligations to the governing authority.” This requirement refers to information reporting, but has been incorrectly interpreted by some as administrative line reporting. People often confuse one kind of reporting with the other, but both are critical to the structuring of the CECO position. So, for instance, the CECO may report administratively to the CEO, and appear before the Audit Committee of the Board to deliver a quarterly written report.

**Q: What other features are important to consider in structuring the CECO position?**

**A:** As noted in a 2009 RAND Symposium report on the topic, “CECOs have the potential to play the pivotal role in companies, but their effectiveness depends on independence, seniority, ‘seat at the table’, and empowerment.” (These elements are briefly discussed in Part 1 of this series.) The choices a company makes on these essential features in the aggregate will land the CECO role somewhere on a spectrum ranging from strong and “best practice” (i.e., independent, empowered, and structured for success) to mere window-dressing (i.e., generally ineffective, by design destined to fail). That’s why it’s fair to say that every company has the kind of compliance program it wants, because the choices the board and C-suite make about how it is structured and led will ultimately determine success or failure.

Companies also make choices on whether to establish a so-called “Compliance Committee” populated by senior officers (e.g., CFO, GC, HR, Audit) and often the business (an element which is growing steadily in popularity) and mechanisms for giving the CECO direct access to the governing body. In a recent PWC survey of CECOs in large US companies with annual revenues of more than $1 billion, 71% of those surveyed said their companies had a form of Compliance Committee.

**Q: What is the scope of the typical Compliance Committee mandate?**

**A:** The Compliance Committee is not a substitute for the CECO, but a senior-level peer group that can be employed to support and offer input into key aspects of the compliance program and to increase ownership and engagement at the top levels of the organization. Nor should the Compliance Committee act as a mechanism to filter the independent judgment of the CECO. Topics typically discussed by the Compliance Committee are culture, accountability, values, performance criteria, training and communication plans, policies, investigations, and disciplinary matters. Compliance Committee responsibilities vary by company, but in all cases, the group should have a clear written mandate that is broad enough to support the compliance program (but does not interfere with or impinge the ability of the CECO to manage the program on a day-to-day basis), independently oversee the program, or have unfiltered access to the governing body.
Q: What is meant by board access?
A: All board access is not created equal. Many companies now stipulate that a board committee or member has an “open door” to the CECO. But what does this really mean? A mechanism that “allows” a CECO to communicate on an ad hoc basis with the board or request a meeting is the weakest form of access, because a CECO has to affirmatively exercise his/her discretion to contact the board, making this more of a nuclear option.

A better approach is a mandatory escalation policy that automatically raises to board attention certain types of matters, such as allegations involving a senior manager or acts of retaliation against the CECO or compliance team members. Information reporting is another form of board access, but its efficacy depends on the frequency of the reporting (e.g. quarterly scheduled sessions) and the degree of “filtering” by others in the organization. Filtering undermines CECO independence and the quality of the information received by the board, and negatively impacts the effectiveness of the program.

Despite the strong support by the 2010 FSGO amendments for an independent CECO with unfiltered access to the board, many companies have not yet established mechanisms to do so.

Q: What are the current trends in CECO structure?
A: A few highly regulated industries are leading the way with very specific guidance or standards for the CECO reporting structure, such as the mutual funds industry, where Rule 38a-1 of the Investment Act of 1940 requires the CECO to report to the fund board. In the health care industry, various guidances from the Office of Inspector General of the Department of Health & Human Services and recent settlement agreements set expectations for CECO independence, direct access to the board, and separation from the GC and CFO.

Enforcement officials, regulators, policymakers, and members of Congress have also weighed in, taking a strong interest in CECO independence and empowerment. In 2003, Senator Chuck Grassley famously commented on the double-hatted GC/CECO role at Tenet Healthcare, “It doesn’t take a pig farmer from Iowa to smell the stench of conflict in that arrangement.” Former federal prosecutor Michael Volkov, writing in his widely-read blog “Corruption, Crime and Compliance” has said that a CECO reporting to a GC is a sign of a “bare bones” compliance program that is likely “a disaster waiting to happen.” In 2012, a senior Securities and Exchange Commission official confirmed his view that “it sends a strong message that compliance and ethics are important if a company includes an independent CECO in the C-Suite” and encouraged boards to provide CECOs with “the necessary resources, independence, standing, and authority to be effective.”
As discussed above, the 2010 amendments to the FSGO offer strong support for CECO independence. All these factors point solidly towards a trend to increase the profile and empowerment of the CECO position.\textsuperscript{10} That said, although the momentum for an elevated CECO position is clear, the levers of independence and empowerment remain inconsistently implemented. Most companies involved in headline-making C&E scandals have either a poorly designed CECO position/program or a person with inadequate competencies and experience at the helm, a topic that merits the close attention of boards.

Q: Should the CECO report to the GC?
A: The CECO-reporting-to-Legal model has generated considerable controversy, particularly among some in the in-house legal community that seeks to maintain reporting control over the CECO, and in the CECO community, where the prevailing view is strongly in favor of independence.\textsuperscript{11,12} As demonstrated by a long line of companies forced to separate their CECO from Legal under corporate integrity agreements, and headlines such as the very public Wal-Mart bribery scandal earlier this year,\textsuperscript{13} companies that structure CECO positions lacking in independence (including independence from Legal) do so at their peril. Although this structure remains common, at least one major industry survey indicates that the model is losing momentum. The 2012 PWC State of Compliance Study indicates that the number of CECOs reporting to the General Counsel fell by 6%, from 41% in 2011 to 35% in 2012.\textsuperscript{14}

In the early days of the modern CECO position, the Legal department seemed to be the natural home for the CECO in many companies. As compliance and ethics has advanced into a vibrant and multi-faceted profession,\textsuperscript{9} with an increasing depth of experience and evolving best practices, the distinctions between the CECO and the GC have become steadily apparent. The CECO and the GC have separate and distinct mandates and require different competencies and skills. Compliance is not a legal function, but a multidisciplinary management control function that interfaces with all of the other functions connected to the business. To quote one commentator: “It is the trained lawyer who chooses to operate in the attorney mind-set when in the compliance and ethics role who is likely to prove ineffective as a CECO.”\textsuperscript{15}

Former federal prosecutor Michael Volkov says “Forward-thinking companies are not relying on the general counsel to ensure compliance. They are empowering their [CECOs] by elevating them to senior management. When important business issues come up, the [CECO] is at the table.” The author’s views on this model are further discussed in “The Real Happy Marriage Between the GC and the Compliance Officer.”\textsuperscript{11}

Q: What about all the companies that seem to have a successful CECO-reporting-to-Legal model?
A: We’ve discussed the historical nature of this arrangement and the fact that all CECO positions should be fit-for-purpose. Many CECOs have commented on their good working relationship with their GC bosses. The problem is that this arrangement works until it doesn’t. In addition, if the CECO is not disagreeing with
the GC from time to time (such as times of crisis when an independent voice is most needed), then either the CECO mandate is inadequately defined or she probably isn’t doing her job correctly. As noted above, both the GC and CECO have critical responsibilities and mandates for the company, and when a conflict occurs, both views should be heard in the C-Suite. Recent headlines reflect potential for failures when the GC can automatically veto or filter the CECO’s recommendation. When considering the structure of the CECO position, boards would be well-advised to demand an institutional model that does not depend on the goodwill, personal working relationships, or temperament of an individual GC—but instead is created with sufficient checks and balances from the outset that structure the CECO position for success.

Q: Should the CECO report to the board?
A: There are some who champion this model, looking for the strongest source of independence for the CECO. The intent is correct, but some reservations about this reporting line include: (1) boards need to oversee the program and empower the CECO, but not necessarily supervise the CECO on a day-to-day basis; and (2) the CECO who reports to the board administratively runs a risk of being disconnected from the business and viewed as a pure policeman or monitor, rather than a vital function of the organization, trusted coach/advisor, and center of excellence for compliance and ethics.

Thus, as noted below, many companies have opted for an administrative reporting line to the CEO (for connectivity) with a “dotted line” to the board (to ensure independence and unfiltered access).

Q: Should the CECO report to the CEO?
A: The CECO model reporting to the CEO with direct, unfiltered, regular reporting to the board (combined with other levers of board access) is widely regarded as a best practice structure that is gathering momentum in many quarters, including with prosecutors who negotiate corporate integrity agreements. In a 2009 survey conducted by the Society of Corporate Compliance and Ethics, 55% of CECOs surveyed reported to the CEO. The CECO-reporting-to-CEO model carries with it automatic levers of independence and empowerment, and for this reason appears to be gaining in favor.

Q: What about the CECO position in small-to-medium size companies?
A: Small-to-medium size companies can make a more credible argument for a “double-hatted” CECO (where a senior officer takes on the CECO position in addition to his/her existing duties) than larger, more complex organizations with significantly more resources. That said, any company that employs this kind of structure must build it with a clear written mandate and mechanisms to strengthen the CECO position, in addition to leveraging scarce resources. Much will depend upon the individual selected to discharge the CECO responsibilities. The part-time CECO must have sufficient time, commitment, intellectual curiosity, and competencies to do the job, and be willing to become educated in how to be an effective leader and advocate for the program. That said, just because a company is small does not mean that its legal and compliance risks are minimal. Small companies with complex risks should not assume that their compliance program needs can be adequately served by a part-time CECO.

Q: Doesn’t the success of the CECO position, regardless of structure, depend on the personal qualities of the individual in the role? Are you suggesting that a best practice structure guarantees success?
A: There are no guarantees in life, and certainly not in compliance and ethics! This two-part
series addresses the structure of the CECO role only. Equally important to the success of the CECO are what the individual brings to the table by way of meaningful compliance and ethics experience (the more demonstrated in-house track record the better), business savvy, gravitas, credibility, and critical “soft skills” such as problem-solving, project management, communication, collaboration and persuasion competencies, and of course, strong ethical leadership. This is an important topic for another paper.19

Final thoughts

The above discussion is intended to support careful deliberation by the board and company decision-makers on the positioning of the CECO, and by extension, the overall compliance program within the organization. It is a decision which has enormous bearing on the potential effectiveness of the CECO position and the compliance program, and thus merits considerable strategic dialogue within the senior ranks. If a company is truly serious about culture, compliance, and ethics, and wants a program that is more than mere window-dressing, it will take careful steps to ensure that the CECO has positioning, empowerment, independence, resources, seat at the table, and line of sight to properly discharge the responsibilities of this critical position. 😊

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6. The series of OIG guidances can be viewed at http://oig.hhs.gov/compliance/compliance-guidance/index.asp
7. See http://www.grassley.senate.gov/releases/2003/p03r09-08.htm
8. See http://www.jdsupra.com/legalnews/empowering-compliance-officers-the-key-54542/
16. See, for example, settlements with Tenet Healthcare. Available at http://oig.hhs.gov/fraud/cia/agreements/TenetCIAFinal.pdf
18. See, for example, settlements with Eli Lilly Healthcare. Available at http://oig.hhs.gov/fraud/cia/agreements/fully_executed_bayer_cia_112508.pdf
19. This topic was discussed in detail at the 2012 SCCE CEI session “Building the Ship While Sailing” in Las Vegas.