Driving Compliance and Ethics Program Effectiveness
A Data-Driven Look at What Drives a Successful Compliance and Ethics Program

29 February 2012

The importance of compliance and ethics to business success will continue to accelerate.

- The growing gap between compliance’s strategic importance and available resources poses a danger to long-term corporate sustainability.

Our View
As compliance grows in strategic importance to the company, the compliance and ethics program will gain a strategic voice and resources to match the ability to persuasively define and measure its value.

COMPLIANCE HAS NEVER BEEN MORE IMPORTANT
Trends in Legal and Compliance Growth
Illustrative Trends

Reasons for Compliers’s increased strategic importance
- Regulatory Requirements and Enforcement
  - Regulatory and enforcement uncertainty complicates operating environments and compliance program implementation.
  - Regulatory pressures on the compliance and ethics function.

Regulatory Barriers to Market Entry
- Local regulatory requirements and related compliance expenses can hamper access to new markets.

- Reporting complex compliance environments efficiently can protect economic rents.

Public-Private Interaction
- The increase in the state’s role in the private economy and the emergence of BRIC countries on the world regulatory stage.
- Regulatory and enforcement pressures on corporate capitalization distortions from operational and legal risks.

Transparency and Public Scrutiny
- The battle for collection, ownership, and use of personal information may create friction between company and consumer.
Compliance and ethics programs now participate in a wide and growing range of activities with varying degrees of control.

- The two activity groups most directly related to compliance and ethics program goals—Risk Management and Measuring and Reporting Effectively—are areas with relatively low levels of direct compliance ownership.
- This suggests the fundamental importance of functional and business partnerships for compliance program success.

### Critical Roles of the New Corporate Compliance and Ethics Officer

- Risk Manager
- Change Manager
- Internal Monitor
- Legal Advisor
- Investigator
- Business Process and Operations Manager

### Energy and Utility companies believe the importance of each of their activities is higher than their perceived effectiveness in addressing the issue.

- Programs feel most effective at helpline administration and least effective at compliance risk assessment and assessment of company culture.

### COMPLIANCE ACTIVITY EFFECTIVENESS

Compliance and Ethics Respondent Assessment of Activity Effectiveness

Mean Effectiveness and Importance Scores, 2010

**Effectiveness**

- High (5.00)
- Medium (4.00)
- Low (1.00)

**Importance**

- High (5.00)
- Medium (4.00)
- Low (1.00)
While compliance and ethics has long focused on program measurement, most metrics track activity completion instead of results achieved.

- Measurement without a clear desired outcome can be inadequate, ineffective or, at worst, misleading.
- Common approaches to program measurement include:
  - Self-Assessments (e.g., internal evaluation against FSGs)
  - Benchmarking
  - Peer Reviews
  - Regulatory Review
  - Focus on Continuous Improvement
  - External Assessment
  - Business Perception and Cultural Surveys

Common Challenges When Measuring Program Effectiveness

I. Tracking Results
- Easier to track compliance inputs (activities) than outputs (prevention of noncompliance, changes in employee behavior)
- Difficult to prove prevention of noncompliance

II. Defining Effectiveness
- Uncertainty about the definition of program effectiveness:
  - What defines effective compliance?
  - Who defines effective compliance (e.g., government, Board, senior management, employees)?
  - Can the company tolerate any level of noncompliance?

III. Isolating Impact
- Difficult to determine which compliance activities drive demonstrated result

Most Commonly Tracked Compliance and Ethics Program Metrics

**Helpline**
- Types of violations reported to the hotline
- Volume and trend of hotline calls
- Anonymous versus non-anonymous callers

**Investigations and Case Volume**
- Open/Closed Cases During Specified Time Period
- Volume and trend of employee allegations
- Percentage of substantiated compliance cases

**Compliance Training**
- Employees completing mandatory training
- Employee feedback on training quality

**Risk Assessment and Culture**
- Risk assessment results
- Volume and trend of observed misconduct
- Changes in material risks

**SERVING MULTIPLE STAKEHOLDERS**

Principal Stakeholders and Selected Expectations

- *Government/Regulators: Definition of Program Effectiveness*
  - Systems to identify, understand and follow laws and regulations; timeliness and accuracy disclosures of corporate behavior; competitive, fair markets

- *Business: Definition of Program Effectiveness*
  - Avoidance of operational delays and costs (noncompliance); freedom of strategic action; efficient operating processes (speed of product approval, low cost of goods sold)

- *Employees: Definition of Program Effectiveness*
  - Clearly articulated expectations and limited workflow burden; belief in corporate integrity and engagement with company values
While no single definition of compliance effectiveness exists, there are common expectations behind competing stakeholder concepts.

- Compliance and ethics officers should pursue the program levers that increase performance across all activities and also fulfill stakeholder expectations.

### DEFINITIONS OF EFFECTIVENESS

#### Business

**Stakeholder Definition of Effectiveness:** Assistance of operational delays and costs; freedom of strategic action; efficient operating processes.

**Evidence of Compliance Effectiveness:**
- Minimized damages and fines
- Compliance costs as percentage of gross revenues
- Reduction in compliance-related operational delays and product approval speed
- Number of operational efficiency improvements

#### Governments/Regulators

**Stakeholder Definition of Effectiveness:** System to identify, understand, and comply with laws and regulations; accurate, timely disclosure of noncompliance; consumer protection.

**Evidence of Compliance Effectiveness:**
- Number of regulatory violations compared to industry average
- Regulatory exam/inspections results
- Independent program assessment results

#### Employees

**Stakeholder Definition of Effectiveness:** Clearly articulated expectations and limited workflow burdens. Value in corporate integrity and engagement with company values.

**Evidence of Compliance Effectiveness:**
- Minimize fear of retaliation
- Percentage of employees who feel direct managers quickly respond to their concerns
- Clarity of expectations and availability of necessary tools and guidance

Common Stakeholder Expectations of Compliance:
- Protect company assets
- Understand stakeholder needs and limit avoidable burdens
- Create a common vision of compliance
- Define roles and responsibilities
- Provide activity and performance transparency
- Create a sustainable culture of compliance and integrity
- Demonstrate value

### The CELC tested a variety of program activities and traits to benchmark current practices and identify the levers that impact overall program effectiveness.

### The STATE OF THE COMPLIANCE AND ETHICS SURVEY: TESTING EFFECTIVENESS

CELC’s State of the Function Survey

**Independent Variables Tested**

#### Program Elements

- Reporting lines
- Compliance leadership accountability
- Size and elevation of program budget
- Staff size
- Percentage of C&E staff at corporate center
- Use of C&E policies
- Staff costs
- Ownership of risk areas
- Ownership of information-sharing systems
- Ownership of program activities
- Risk assessment
- Top risk
- Type of risk assessment
- Types of top assessments
- Ownership of the risk assessment process
- Integration of compliance into ERM

#### Compliance Training

- C&E training courses required of all employees
- Mean of C&E training
- Average number of compliance courses
- Availability of C&E training
- Training certification process
- Publications of noncompliance
- Manager training for handling misconduct
- Metrics and goals
- Compliance education course
- Metrics to report to board and senior management
- Compliance program goals

#### Program Activities

- Manage, address, and fix risk
- Avoidance of regulatory exam/inspections
- Minimize fear of retaliation
- Percentage of employees who feel direct managers quickly respond to their concerns
- Clarity of expectations and availability of necessary tools and guidance

#### Program Effectiveness

- Average effectiveness across all compliance and ethics program activities.

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- Average effectiveness across all compliance and ethics program activities.

**Survey Background**

- 164 participating companies
- 16 industries
- 76 program traits tested
- 16 compliance activities

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CELC research identifies effectiveness levers that not only help meet individual stakeholder needs but also drive program effectiveness.

- Top-Quartile companies—companies with program effectiveness scores above 75% of peers—share similar program traits.
- Substantially fewer companies with an effective program had an increase in regulatory fines and lawsuits in the past 12 months.

CRITICAL ACTION ITEMS: PROFILE OF AN EFFECTIVE PROGRAM

Key Program Traits with an Impact on Overall Program Effectiveness

State of the Function and RiskClarity Survey Analysis

CELC research identifies effectiveness levers that not only help meet individual stakeholder needs but also drive program effectiveness.

- Top-Quartile companies—companies with program effectiveness scores above 75% of peers—share similar program traits.
- Substantially fewer companies with an effective program had an increase in regulatory fines and lawsuits in the past 12 months.

<table>
<thead>
<tr>
<th>Percentage of Companies That Had an Increase in Regulatory Fines and Law Suits in the Last 12 Months</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bottom-Quartile Program Effectiveness</td>
</tr>
<tr>
<td>Mid-Performing Program Effectiveness</td>
</tr>
<tr>
<td>Top-Quartile Program Effectiveness</td>
</tr>
</tbody>
</table>

Creating an effective partnership with the business requires an alignment of goals and new staff competencies.

- Business expectations of the compliance program include:
  - Alignment with company goals,
  - Avoidance of operational delays and costs, and
  - Freedom of strategic action.

SECTION 1: IMPROVING BUSINESS PARTNERING

Member Articulation of Key Challenges

- “The company is a very big boat and compliance is a very small rudder. So I need more than ‘tone from the top.’ I need my CEO and other company leaders to say: ‘I adopt the compliance programs’ objectives as my objectives.’”
  - Chief Ethics and Compliance Officer, Pharmaceutical Company

Key Questions

- How do we foster a better partnership with the business?

Solution

Lever 1: Create a Common Compliance Vision to Achieve Desired Program Outcomes

- “We have to get our staff to think differently about our jobs. We are being held to a different standard—which the quality of management support we provide, how we are managing up, and how effective is our dialogue with the business?”
  - Chief Compliance Officer, Financial Services Company

Lever 2: Develop Critical Compliance Staff Competencies that Enhance Relationships with Business Partners

- “How can we build consensus between our objectives and the company’s objectives for the program?”

Potential Impact of Compelling Employee Adherence

Compliance programs with “Strong Employee Adherence” attain a 67% decrease in the most significant forms of business misconduct.

Potential Impact of Increasing Risk Awareness

Compliance programs with “Strong Risk Awareness” attain a 10% overall effectiveness increase above the typical company.

Potential Impact of Compelling Employee Adherence

Compliance programs with “Strong Employee Adherence” attain a 10% overall effectiveness increase above the typical company.

Potential Impact of Building a Culture of Integrity

Compliance programs with “Strong Culture of Integrity” may attain a 47% decrease in the number of business misconducts.
Similarly, the seniormost’s reporting relationship has no statistically significant correlation with compliance program effectiveness.

- Top-Quartile companies are statistically no more likely to maintain a direct reporting relationship with a particular executive than Bottom-Quartile companies.
- The lack of a correlation between reporting lines and program effectiveness suggests that compliance program authority and influence are not derived primarily from formal structure.

### PRIMARY REPORTING RELATIONSHIP

**Current State**

Five Most-Common Direct Reporting Relationships for the Chief Compliance and Ethics Officer (CCEO)

*Percentage of Programs, 2008 and 2010*

<table>
<thead>
<tr>
<th>Relationship</th>
<th>2008</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Counsel</td>
<td>48%</td>
<td>46%</td>
</tr>
<tr>
<td>CEO</td>
<td>12%</td>
<td>14%</td>
</tr>
<tr>
<td>Board Audit Committee</td>
<td>6%</td>
<td>5%</td>
</tr>
<tr>
<td>Chief Risk Officer</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>CFO</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Other</td>
<td>1%</td>
<td>2%</td>
</tr>
</tbody>
</table>

**CELC Data Analysis**

Direct Reporting Relationship

Mean Percentage of Respondents, 2010

- General Counsel
  - Mean: 44%
  - SD: 25%
  - Significance: $P = 0.866$
- CEO
  - Mean: 38%
  - SD: 13%
  - Significance: $P = 0.777$
- Board Audit Committee
  - Mean: 32%
  - SD: 7%
  - Significance: $P = 0.792$
- Chief Risk Officer
  - Mean: 13%
  - SD: 5%
  - Significance: $P = 0.894$
- CFO
  - Mean: 9%
  - SD: 5%
  - Significance: $P = 0.513$

**A MISALIGNMENT OF GOALS**

**Current State**

Primary Desired Outcome for the Program

Percentage of Respondents Selecting Outcome as Most Important, 2010

<table>
<thead>
<tr>
<th>Outcome</th>
<th>Top-Quartile</th>
<th>Bottom-Quartile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Promoting a Corporate Culture of Integrity</td>
<td>48%</td>
<td>40%</td>
</tr>
<tr>
<td>Protecting Company Reputation</td>
<td>33%</td>
<td>27%</td>
</tr>
<tr>
<td>Reducing Legal and Compliance Liabilities (Protecting Financial Assets)</td>
<td>27%</td>
<td>17%</td>
</tr>
<tr>
<td>Specifying Legal and Compliance Roles</td>
<td>12%</td>
<td>6%</td>
</tr>
<tr>
<td>Other</td>
<td>8%</td>
<td>19%</td>
</tr>
</tbody>
</table>

**CELC Data Analysis**

CCEO and Board Program Outcomes and Activity Effectiveness

Mean Activity Effectiveness Scores

- CCEO’s Desired Outcome
  -Mean: 3.89
  -SD: 2.12
  -Significance: $P = 0.037$
- CICO’s Perception of Board and Senior Management’s Desired Outcome
  -Mean: 3.51
  -SD: 2.07
  -Significance: $P = 0.037$

**Note:** $P$-value is the significance level of correlation between “Desired Program Outcomes” and activity effectiveness scores.
LEVER #1: CREATE A COMMON COMPLIANCE VISION TO ACHIEVE DESIRED PROGRAM OUTCOMES

Leveraging the Data: Key Action Items to Increase Your Program’s Effectiveness

**DO**

1. Build Alignment with Company Leaders—Foster consensus about program goals and ensure senior management support for program initiatives by incorporating executive feedback into the compliance value proposition and linking it to corporate strategy.

**DONT**

2. Over-Invest Your Capital in Changing the Program’s Structure—Reporting lines for the CCEO and the program’s location are not correlated with higher overall program effectiveness.

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**After personnel costs, compliance training activities are the second largest expenditure for compliance and ethics programs.**

- On average, investments in most budget items show no program improvement, while investing in staff compensation is correlated with overall program effectiveness.
- Additional staff can help demonstrate compliance value and improve business partnering.

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**COMPLIANCE AND ETHICS BUDGETS**

**Current State**

Average Allocation of Compliance and Ethics Budget Percentage of Budget, 2010

- Salaries, Benefits: 52%
- Training and Communication: 11%
- Inside/Outside Consultant: 11%
- Legal: 5%
- Travel: 5%
- Technology: 4%
- Compliance Processes: 4%
- Other: 5%

**CELC Data Analysis**

Overall Program Effectiveness and Budget Allocated to Staff Compensation

- **P-value = 0.235**, the significance level of correlation between Budget Allocated to Staff Compensation and Overall Program Effectiveness Scores.

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On average, an additional dollar invested in compliance and ethics staff has the greatest positive impact on overall program effectiveness of any budget item.
### Compliance and Ethics Staff Skill Sets

**Current State Rankings of Compliance and Ethics Skill Set, 2010**

<table>
<thead>
<tr>
<th>Skill Set</th>
<th>Importance of Skill to CCEO</th>
<th>Current Skill Depth</th>
<th>Impact of Skill on Overall Effectiveness</th>
</tr>
</thead>
<tbody>
<tr>
<td>Communication Skills</td>
<td>1</td>
<td>4</td>
<td>High</td>
</tr>
<tr>
<td>Business Unit Partnering Skills</td>
<td>2</td>
<td>3</td>
<td>Highest</td>
</tr>
<tr>
<td>Problem-Solving Skills</td>
<td>3</td>
<td>1</td>
<td>Insignificant</td>
</tr>
<tr>
<td>Regulatory/Legal Analysis Skills</td>
<td>4</td>
<td>2</td>
<td>High</td>
</tr>
<tr>
<td>Project Management Skills</td>
<td>5</td>
<td>5</td>
<td>High</td>
</tr>
<tr>
<td>Auditing/Risk Management Skills</td>
<td>6</td>
<td>6</td>
<td>Low</td>
</tr>
<tr>
<td>Ability to Work Across Cultures</td>
<td>7</td>
<td>7</td>
<td>Insignificant</td>
</tr>
<tr>
<td>Human Resources Skills</td>
<td>8</td>
<td>8</td>
<td>Medium</td>
</tr>
<tr>
<td>Quantitative Skills</td>
<td>9</td>
<td>10</td>
<td>Insignificant</td>
</tr>
<tr>
<td>Technology Skills</td>
<td>10</td>
<td>9</td>
<td>Low</td>
</tr>
</tbody>
</table>

The seven skill sets with an impact on effectiveness account for 39% of the variation in overall program effectiveness.

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**Steps in the Creation of a Compliance Training Curriculum**

1. **Diagnose Development Needs**
   - Discuss development objectives with senior compliance leaders.
   - Consult experts in field of Learning and Training.
   - Consult with Risk and Audit functions that may already have programs within their disciplines.

2. **Define Content and Assess Availability of Materials**
   - Research available internal and external training courses for each topic/module.
   - Select topic experts to prepare first draft of each module.

3. **Develop Training Materials**
   - Consider how adults learn: need for interactive training, case studies, exercises, video clips, and class participation.
   - Utilize instructional designers and subject matter experts to develop a comprehensive curriculum.

4. **Consider the Logistics**
   - Consider format for facilitator and student guides.
   - Identify who will facilitate and train and create a plan for logistics.

5. **Prepare Next Steps**
   - Provide students with other training offerings that will complement the course.

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**Prudential**

- Prudential recognized the absence of meaningful core training within the compliance profession.
- Prudential saw the opportunity to develop the skills and competencies of its compliance professionals.
- The skills necessary for compliance professionals are simply not developed in today’s law or business schools.
- Prudential’s curriculum is designed to be:
  - Foundational
  - Week-long course
  - Required of all 400 compliance professionals, globally
  - Delivered by Senior Compliance Officers who are subject matter experts
  - Interactive including case studies, exercises, and videos.
LEVER #2: DEVELOP CRITICAL COMPLIANCE STAFF COMPETENCIES THAT ENHANCE RELATIONSHIPS WITH BUSINESS PARTNERS

**DO**
1. Allocate the Budget Strategically—Allocate additional budget dollars to hire compliance and ethics staff over other program investments.

**DO**
2. (Re)prioritize the Compliance and Ethics Staff Training Curriculum—Target the development of skills and competencies that can improve your ability to partner with the business while positively driving the program’s overall effectiveness.

**DON’T**
3. Prioritize the Three Skills That Have Less Immediate Impact on Program Effectiveness—Although seemingly important, these three skills do not have a significant impact:
   - Problem solving skills,
   - Quantitative skills, and
   - The ability to work across cultures.

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SECTION 2: INCREASING RISK VISIBILITY

Risk visibility requires vigilant employees, clear role accountabilities, and an informed, alert Board.

- Regulator expectations of the compliance program include:
  - Compliance with laws and regulations,
  - Assessment and mitigation of risks, and
  - Timely, accurate disclosures.

<table>
<thead>
<tr>
<th>Member Articulation of Key Challenges</th>
<th>Key Questions</th>
<th>Solution</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;It’s almost always been the case that upon finding wrongdoing in the organization, multiple employees come forth with knowledge of the problem. Why didn’t we get this critical information earlier?&quot; Chief Ethics and Compliance Officer Defense Company</td>
<td>How can we capture better data about on-the-ground risk conditions?</td>
<td>Lever 3: Increase Employee Reporting</td>
</tr>
<tr>
<td>&quot;At our company, everyone is responsible for spotting regulatory risks and new regulations. So basically no one does it.&quot; AGC and Chief Compliance Officer Energy Company</td>
<td>How can we improve regulatory tracking efforts?</td>
<td>Lever 4: Clarify Risk Management Responsibilities</td>
</tr>
<tr>
<td>&quot;For years we have been reporting program data to the Board. But which is the information that really matters for protecting the company? That’s where I want to focus Board attention.&quot; Director, Compliance and Ethics Program Chemical Company</td>
<td>What is the most meaningful data about risks we can share with company leaders?</td>
<td>Lever 5: Report Cultural Data to the Board</td>
</tr>
</tbody>
</table>

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Allegations per employee are generally high across regulated industries.

- Survey results provide additional support for increased allegation activity as a positive, albeit limited, indication of improved performance.

"Learning about the 'small' issues that employees know about—and are in a position to report—is what helps you know how mature your program really is."

Chief Compliance Officer
Financial Services Company

COMPLIANCE AND ETHICS ALLEGATIONS

Current State
Total Allegations and Hotline Allegations, by Industry
Median Number of Allegations per 1,000 Employees, 2009

<table>
<thead>
<tr>
<th>Industry</th>
<th>Total Allegations Median</th>
<th>Hotline Allegations Median</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking and Financial Services</td>
<td>13.5</td>
<td>2.5</td>
</tr>
<tr>
<td>Health Care and Health Insurance</td>
<td>17.2</td>
<td>2.7</td>
</tr>
<tr>
<td>High Technology and Telecommunications</td>
<td>6.8</td>
<td>2.6</td>
</tr>
<tr>
<td>Pharmaceuticals and Biotechnology</td>
<td>10.2</td>
<td>6.1</td>
</tr>
<tr>
<td>Consumer Products, Food, and Tobacco</td>
<td>9.0</td>
<td>4.2</td>
</tr>
<tr>
<td>Manufacturing/Auto/Heavy Manufacturing</td>
<td>6.9</td>
<td>6.9</td>
</tr>
<tr>
<td>Utilities</td>
<td>5.4</td>
<td>6.9</td>
</tr>
<tr>
<td>Energy</td>
<td>4.9</td>
<td>5.9</td>
</tr>
<tr>
<td>Building and Construction</td>
<td>23.2</td>
<td>10.2</td>
</tr>
</tbody>
</table>

"A higher number of allegations is significantly correlated with higher overall program effectiveness scores."

P-value = 0.051, the significance level of correlation between Total Allegation Rates and Overall Program Effectiveness Scores.

More than two-thirds of compliance and ethics programs train managers on how to handle a report of misconduct.

- What We Already Know
  - Fifty percent of observed misconduct is never reported.
  - Fifty percent of information reported to managers by employees never leaves the local business group.
  - The compliance program directly receives only 6% of available employee information about major, potential compliance breakdowns.

Training managers to handle reports of misconduct is significantly correlated with higher overall program effectiveness scores and with higher measuring and reporting effectiveness scores.

PREPARING MANAGERS TO HANDLE EMPLOYEE REPORTS

Current State
Managers Trained to Handle a Report of Misconduct
Percentage of Respondents, 2010

- 31% Managers Are Trained
- 69% Managers Are Not Trained

CELC Data Analysis
Training Managers to Handle Reports and Overall Program Effectiveness
Mean Overall Program Effectiveness Scores

Training managers to handle reports of misconduct is significantly correlated with higher overall program effectiveness scores and with higher measuring and reporting effectiveness scores.

Note: P = P-value, the significance level of correlation between Preparing Managers to Handle Misconduct Reports and Overall Program Effectiveness Scores and Measuring and Reporting Activity Effectiveness Scores.
LEVER #3: INCREASE EMPLOYEE REPORTING, ENABLING YOU TO DETECT FRONTLINE RISK

Leveraging the Data: Key Action Items to Increase Your Program’s Overall Effectiveness

DO
1. Insist on a Non-Retalloatory and Open Workplace—Promote non-anonymous employee reporting to increase the flow of potentially critical risk information.

DO
2. Extract Meaning from Allegation Data—Analyze allegation data, especially variations in anonymous versus non-anonymous allegation trends across business units, to spot areas of higher risk.

DO
3. Prepare Managers to Handle Reports of Misconduct—Educate managers to properly receive and escalate employee concerns to ensure more risk information reaches the corporate center.

DON’T
4. Rely Exclusively on the Hotline to Source Critical Risk Information—Instead, advertise and promote other available reporting channels to capture a larger volume of business misconduct reports.

Varying degrees of program involvement in compliance risk management activities highlights a missed opportunity to increase the program’s overall effectiveness.

Types of Risk Assessment Processes and Level of Program Involvement in Risk Management Activities Percentage of Respondents, 2010

<table>
<thead>
<tr>
<th>Level of Risk Assessment Involvement</th>
<th>Percentage of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compliance Risk Assessment</td>
<td>60%</td>
</tr>
<tr>
<td>Compliance Risk Monitoring</td>
<td>43%</td>
</tr>
<tr>
<td>Compliance Risk Mitigation</td>
<td>41%</td>
</tr>
<tr>
<td>Review New Business Partners</td>
<td>38%</td>
</tr>
<tr>
<td>Market Third Party Controls</td>
<td>35%</td>
</tr>
<tr>
<td>Mean Overall Program Effectiveness</td>
<td>0.74</td>
</tr>
</tbody>
</table>

CELC Data Analysis

Level of Risk Assessment Involvement and Overall Program Effectiveness

Mean Overall Program Effectiveness Scores

DO
Participates

DON’T
Odd Not Participate

Owning the compliance risk assessment is significantly correlated with overall program effectiveness.

The specific risk assessment model used (e.g., top-down, bottom-up, hybrid) is not statistically correlated with overall program effectiveness.

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Top-Quartile programs more frequently use centralized tools to create and maintain real-time visibility into changing conditions.

### CORPORATE-WIDE TRACKING TECHNOLOGY

**Current State**
- Using Versus Not Using Tracking Systems (Percentage of Respondents, 2010)
  - Corporate Policies:
    - Use Enterprise-Wide System: 67%
    - Does Not Use Enterprise-Wide System: 33%
  - Investigations Case Management:
    - Use Enterprise-Wide System: 65%
    - Does Not Use Enterprise-Wide System: 35%
  - Regulatory Developments:
    - Use Enterprise-Wide System: 63%
    - Does Not Use Enterprise-Wide System: 37%

### CELC Data Analysis
- Use of Tracking Systems and Overall Program Effectiveness (Mean Overall Program Effectiveness Scores)
  - Regulatory Developments: 3.68
  - Corporate Policies: 3.55
  - Investigations Case Management: 3.76
  - Case Management: 3.47
  - Corporate Policies: 3.73
  - Investigations Case Management: 3.54

Note: P = P-value, the significance level of correlation between the Use of Enterprise-wide Tracking Systems and Overall Program Effectiveness Scores.

### CREATING A REGULATORY RISK TRACKING SYSTEM

The formality of regulatory risk tracking processes should vary with the intensity of the company’s regulatory environment and its number of regulators.

- **Effective regulatory tracking systems:**
  - Define scope
  - Identify key aspects of regulation
  - Assign ownership
  - Leverage business knowledge
  - Assess impact

<table>
<thead>
<tr>
<th>Regulatory Intensity</th>
<th>Regulatory Risk Tracking Matrix</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>High</strong></td>
<td>Companies in Intense Regulatory Environment (e.g., Financial Services, Energy)</td>
</tr>
<tr>
<td></td>
<td>You should:</td>
</tr>
<tr>
<td></td>
<td>• Formally assign risk tracking responsibilities to multiple individuals in discrete areas</td>
</tr>
<tr>
<td></td>
<td>• Implement a formal tracking system and create a single, central repository</td>
</tr>
<tr>
<td></td>
<td>• Assess and report potential regulatory risks</td>
</tr>
<tr>
<td></td>
<td>• Develop clear, regular channels and processes to communicate information</td>
</tr>
<tr>
<td></td>
<td>• Involve business units in risk tracking and risk mitigation on a regular basis</td>
</tr>
</tbody>
</table>

| **Moderate**         | Companies in Moderate Regulatory Environment (e.g., Consumer Products) |
|                      | You should: |
|                      | • Designate several individuals with tracking responsibilities for specialized risk areas |
|                      | • Develop a process for tracking and storing risk information |
|                      | • Introduce regulatory risk information into existing risk planning processes |
|                      | • Establish protocols for escalating and communicating risk information |
|                      | • Incorporate sources of business unit regulatory information |

| **Low**              | Companies in Mild Regulatory Environment (e.g., Professional Services) |
|                      | You should: |
|                      | • Assign a few individuals to monitor changes |
|                      | • Develop a list of key regulatory risks that most affect the company |
|                      | • Evaluate regulations and changes for impact on the business |
|                      | • Identify individuals within business units who should provide regulatory risk information |

<table>
<thead>
<tr>
<th>Regulatory Intensity</th>
<th>Regulatory Risk Tracking Matrix</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Low</strong></td>
<td>Companies in Low Regulatory Environment (e.g., Professional Services)</td>
</tr>
<tr>
<td></td>
<td>You should:</td>
</tr>
<tr>
<td></td>
<td>• Assign specific tracking tasks based on responsibilities or functional expertise</td>
</tr>
<tr>
<td></td>
<td>• Standardize tracking processes across the organization</td>
</tr>
<tr>
<td></td>
<td>• Evaluate regulatory risk</td>
</tr>
<tr>
<td></td>
<td>• Establish communication channels within the business</td>
</tr>
<tr>
<td></td>
<td>• Involve business units in risk tracking and risk mitigation</td>
</tr>
</tbody>
</table>

Note: See Appendix for complete D&B and DTE Energy case profiles.

---

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LEVER #4: CLARIFY RISK MANAGEMENT RESPONSIBILITIES TO IMPROVE RISK INFORMATION FLOW

Leveraging the Data: Key Action Items to Increase Your Program’s Overall Effectiveness

✔️ **DO**

1. Maintain Program Ownership of the Compliance and Ethics Risk Assessment—Despite a growing trend in managing risk at the enterprise level (e.g., ERM), compliance and ethics officers should continue to maintain full ownership of the compliance and ethics risk assessment process.

2. Create Clear Lines of Regulatory Tracking Responsibility—Define clear lines of risk ownership and assign formal responsibilities to business staff and subject-matter experts throughout the organization.

3. Use a Central Database to Track and Manage Risks Information—Create a single, centralized repository to track potential risks and internal and external compliance requirements, including company policies and regulatory developments.

✘️ **DON’T**

4. Focus on Creating the Perfect Risk Assessment Process—Overall program effectiveness is not affected by the specific type of risk assessment process (top-down, bottom-up, hybrid), so focus instead on increasing the flow of risk information that reaches the compliance office.

---

**REPORTING TO THE BOARD**

Current State
Top 10 Metrics That Top-Quartile Programs Report to the Board, in Rank Order

1. Volume and trend of employee allegations
2. Volume and trend of employee inquiries
3. Volume and trend of observed misconduct
4. Volume and trend of employee helpline calls
5. Types of violations reported to the hotline
6. Improvements in behavior (as measured by employee culture survey)
7. Percentage of anonymous versus non-anonymous callers
8. Percentage of substantiated compliance cases
9. Business and functional perceptions of program effectiveness
10. Business unit risk assessment results

Bottom Five Metrics That Top-Quartile Programs Report to the Board, in Rank Order

22. Employee feedback on training content quality
23. Satisfaction of helpline users
24. Percentage of key compliance risks covered by training
25. Hours of compliance training per employee per year
26. Average employee score on post-training tests

**CELC Data Analysis**

Cultural Metrics Reported to the Board

<table>
<thead>
<tr>
<th>Current State</th>
<th>Top-Quartile Programs</th>
<th>Bottom-Quartile Programs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage of Respondents, 2010</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- **Volume and trend of observed misconduct**
  - Top-Quartile Programs: 83%
  - Bottom-Quartile Programs: 53%

- **Improvements in behavior (as measured by employee culture survey)**
  - Top-Quartile Programs: 52%
  - Bottom-Quartile Programs: 25%

- **Percentage of anonymous versus non-anonymous callers**
  - Top-Quartile Programs: 42%
  - Bottom-Quartile Programs: 16%

83% of respondents reported to the board in 2010, significantly correlated with higher program effectiveness scores.

*P-value < 0.001, the significance level of correlation between Reporting Cultural Metrics to the Board and Overall Program Effectiveness scores.*
To help the Board accurately assess program performance, and improve risk oversight, compliance and ethics officers should report cultural metrics.

- **Why should the Board care about culture?**
  - According to Cultural Diagnostic Survey data, companies with a higher culture of integrity have 10-year total shareholder returns that are 16 percentage points higher than companies with low integrity scores.
  - An integral component of an ethical culture is comfort speaking up, which culture metrics—including employee fears of retaliation—can help measure.

**REPORTING CULTURAL METRICS TO THE BOARD**

### Building an Effective Board Report
1. Divide report information into specific misconduct categories and show year-over-year fluctuations, highlighting data about the overall health of the company’s corporate culture.
2. Provide report information in a pre-meeting memorandum to give directors the opportunity to recognize and question significant trends, improving their ability to ask the right risk management questions.

### Effective Cultural Metrics
Cultural metrics, as defined in the State of the Function survey, include:
- Volume and trend of observed misconduct,
- Improvements in employee behavior, and
- Data about employees’ fear of retaliation.

### Other Meaningful Metrics to Assess the Company’s Culture:
- Company responds quickly and consistently to verified or proven unethical behavior
- Percentage of employees who feel direct manager respects his/her employees
- Percentage of employees who feel direct managers quickly respond to minimize operational problems when they are identified

### New Allegations by Month

**Building an Effective Board Report**

1. Divide report information into specific misconduct categories and show year-over-year fluctuations, highlighting data about the overall health of the company’s corporate culture.
2. Provide report information in a pre-meeting memorandum to give directors the opportunity to recognize and question significant trends, improving their ability to ask the right risk management questions.

### LEVER #5: REPORT CULTURAL DATA TO THE BOARD TO IMPROVE RISK OVERSIGHT

**Leveraging the Data: Key Action Items to Increase Your Program’s Effectiveness**

**DO**
1. Report Cultural Metrics to the Board and Senior Management—Focus on reporting metrics that provide insight into the organization’s cultural maturity, including volume and trends of observed misconduct, improvements in employee behavior, and employee fear of retaliation.

**DON'T**
3. Report Data Without Context—Don’t encourage company leaders to extract meaning from standalone metrics, such as hours of compliance training, without also providing the context for interpreting this type of data (e.g., how your company compares to industry peers).
SECTION 3: COMPELLING EMPLOYEE ADHERENCE

Driving desired compliance and ethics behaviors is central to program success and effectiveness.

- Employee expectations of the compliance program include:
  - Clearly articulated expectations,
  - Limited workflow burden, and
  - Safe and ethical work conditions.

### Member Articulation of Key Challenges

<table>
<thead>
<tr>
<th>Key Questions</th>
<th>Solution</th>
</tr>
</thead>
<tbody>
<tr>
<td>How can we deliver necessary training without unnecessarily burdening employees?</td>
<td>Lever 6: Tailor Training Initiatives for Individual Employee Needs</td>
</tr>
<tr>
<td>“Our program shouldn’t be seen as the owner of compliance and ethics. We need employees to take ownership for the organization’s values and rules.”</td>
<td></td>
</tr>
<tr>
<td>Director, Compliance and Ethics Program, Chemicals Company</td>
<td></td>
</tr>
<tr>
<td>How can we drive personal responsibility for adhering to compliance and ethics expectations?</td>
<td>Lever 7: Foster Individual Accountability</td>
</tr>
</tbody>
</table>

### Eighty-five percent of compliance programs require five or fewer hours of training of all employees per year.

#### Current State

<table>
<thead>
<tr>
<th>Hours of Compliance And Ethics Training Required of All Employees per Year</th>
<th>Percentage of Respondents, 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>3%</td>
<td>More Than 10 Hours</td>
</tr>
<tr>
<td>14%</td>
<td>None</td>
</tr>
<tr>
<td>22%</td>
<td>One Hour</td>
</tr>
<tr>
<td>49%</td>
<td>Two to Five Hours</td>
</tr>
<tr>
<td>12%</td>
<td>Six to 10 Hours</td>
</tr>
<tr>
<td>1%</td>
<td>Other</td>
</tr>
<tr>
<td>1%</td>
<td>In Person by Manager</td>
</tr>
<tr>
<td>3%</td>
<td>In Person by Subject Matter Expert</td>
</tr>
<tr>
<td>21%</td>
<td>Online</td>
</tr>
<tr>
<td>n = 160.</td>
<td></td>
</tr>
</tbody>
</table>

#### Delivery Channel for Compliance and Ethics Training

- 74% Blended (Online and Live)
- 21% Online
- 3% In Person by Manager
- 3% In Person by Subject Matter Expert
- 1% Other

### CELC Data Analysis

#### Program Effectiveness, by Number of Training Hours

<table>
<thead>
<tr>
<th>Number of Training Hours</th>
<th>Mean Overall Program Effectiveness Scores</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
<td>3.65</td>
</tr>
<tr>
<td>One Hour</td>
<td>3.83</td>
</tr>
<tr>
<td>Two to Five Hours</td>
<td>3.77</td>
</tr>
<tr>
<td>Six to 10 Hours</td>
<td>3.46</td>
</tr>
<tr>
<td>More Than 10 Hours</td>
<td>3.37</td>
</tr>
<tr>
<td>n = 160.</td>
<td></td>
</tr>
</tbody>
</table>

Beyond approximately five hours per year of general compliance training, there seems to be diminishing returns on additional training investments.
Caterpillar leverages questions at the end of its annual code training module to tailor the rigor of each employee’s individual learning plan.

- Employees who answer “No” move on to the next standard question without investing time in answering questions that do not pertain to them.
- Employees who answer “Yes” are asked additional questions to determine the exact degree of risk they are exposed to in the course of their day-to-day activities.
- Sixteen standard questions ask about six core compliance risk areas:
  - FCPA/Improper Payments
  - Competition Law/Antitrust
  - Import-Export Compliance
  - Intellectual Property
  - Government Contracts
  - Hazardous Materials

STREAMLINING TRAINING BASED ON INDIVIDUAL NEEDS

Caterpillar’s Training Needs Questionnaire, Excerpt

**OUR VALUES IN ACTION**
Caterpillar’s Worldwide Code of Conduct

It is important for you to understand ethics and compliance requirements that apply to your job. In order to ensure that you receive the necessary training appropriate to your position, please answer Yes or No to the following questions as they apply to your responsibilities at the company:

Q1: Do you have any contact with non-US government officials or government customers, including employees of any company or entity controlled by a non-US government?

- Yes
- No

If “Yes”:

1a. Do you have any approval authority regarding entering into or negotiating contracts with such officials?
1b. Do you engage in any of these activities (e.g., contact with non-US government officials or entering into or initiating contracts with such officials) more than three times a year?

**Beyond Traditional Segmentation**

Specific follow-up questions—such as asking about a minimum number of high-risk interactions—serves as an additional screen for targeting training needs, and helps segment employees better than less nuanced criteria such as employee title or role.

**OUR VALUES IN ACTION**
Caterpillar’s Worldwide Code of Conduct

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Q1: Do you have any contact with non-US government officials or government customers, including employees of any company or entity controlled by a non-US government?

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- No

If “Yes”:

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1b. Do you engage in any of these activities (e.g., contact with non-US government officials or entering into or initiating contracts with such officials) more than three times a year?

**Beyond Traditional Segmentation**

Specific follow-up questions—such as asking about a minimum number of high-risk interactions—serves as an additional screen for targeting training needs, and helps segment employees better than less nuanced criteria such as employee title or role.

LEVER #6: TAILOR TRAINING INITIATIVES FOR INDIVIDUAL EMPLOYEE NEED

Leveraging the Data: Key Action Items to Increase Your Program’s Overall Effectiveness

**DO**
1. Rationalize the Amount of Compliance Training—Limit general compliance and ethics training to two to five hours per year per employee. Additional training should be limited to clearly-defined, high-risk employee groups.

**DO**
2. Spread Compliance Education into Multiple, Time-Limited Installments—Deliver compliance guidance in at least five separate training courses per year. More frequent communications, especially from direct managers, can reinforce compliance throughout the year.

**DON’T**
1. Neglect Proven Education and Communication Strategies—When creating and delivering compliance and ethics training and communications, don’t forget to:
   - Clarify expectations and disciplinary guidelines,
   - Enlist managers as ethical advocates, and
   - Ensure the applicability of training to daily work.
**From the COMPLIANCE AND ETHICS LEADERSHIP COUNCIL of the CORPORATE INTEGRITY PRACTICE**

**www.celc.executiveboard.com**

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### Current State

#### Inclusion of Compliance and Ethics Components in Performance Reviews

Percentage of Respondents, 2010

- **67%** No
- **33%** Yes

n = 173.

**CELC Data Analysis**

Inclusion of Compliance and Ethics in Performance Reviews and Overall Program Effectiveness

Mean Overall Program Effectiveness Scores

<table>
<thead>
<tr>
<th>Inclusion of C&amp;E in Performance Reviews</th>
<th>Mean Overall Program Effectiveness</th>
<th>n = 169; P = 0.004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does Not Include C&amp;E in Performance Reviews</td>
<td>3.55</td>
<td></td>
</tr>
<tr>
<td>Includes C&amp;E in Performance Reviews</td>
<td>3.79</td>
<td></td>
</tr>
</tbody>
</table>

Note: P = P-value, the significance level of correlation between Including Compliance and Ethics in Performance Reviews and Overall Program Effectiveness Scores.

### INCORPORATING COMPLIANCE INTO PERFORMANCE REVIEWS

#### Current State

Inclusion of Compliance and E&I Components in Performance Reviews

Percentage of Respondents, 2010

- **47%** No
- **53%** Yes

n = 173.

**CELC Data Analysis**

Inclusion of Compliance and Ethics in Performance Reviews and Overall Program Effectiveness

Mean Overall Program Effectiveness Scores

<table>
<thead>
<tr>
<th>Inclusion of C&amp;E in Performance Reviews</th>
<th>Mean Overall Program Effectiveness</th>
<th>n = 169; P = 0.004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does Not Include C&amp;E in Performance Reviews</td>
<td>3.55</td>
<td></td>
</tr>
<tr>
<td>Includes C&amp;E in Performance Reviews</td>
<td>3.79</td>
<td></td>
</tr>
</tbody>
</table>

Note: P = P-value, the significance level of correlation between Including Compliance and Ethics in Performance Reviews and Overall Program Effectiveness Scores.

### DISCIPLINARY ACTIONS

**Current State**

Principal Disciplinary Actions Taken for 2009 Substantiated Allegations

- **20%** Written Warning
- **26%** Termination of Employment
- **25%** Verbal Warning
- **18%** Demotion or Decrease in Salary/Other Compensation
- **2%** Removal from Position/Job Transfer
- **1%** Other

n = 162

**CELC Data Analysis**

Terminations and Overall Program Effectiveness

Mean Overall Program Effectiveness Scores

<table>
<thead>
<tr>
<th>Companies Least Likely to Terminate</th>
<th>Mean Overall Program Effectiveness</th>
<th>Companies Most Likely to Terminate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Companies least likely to terminate include programs with a proportion of substantiated allegations resulting in termination that accounted for 0% to 10% of disciplinary actions.</td>
<td>1.68</td>
<td>3.93</td>
</tr>
<tr>
<td>2 Companies most likely to terminate include programs with a proportion of substantiated allegations resulting in termination that accounted for 40% to 100% of disciplinary actions.</td>
<td>1.93</td>
<td></td>
</tr>
</tbody>
</table>

Note: P = P-value, the significance level of correlation between Terminations and Overall Program Effectiveness Scores.

* Demonstrating the importance of compliance to the company, when warranted, sends a powerful message to the employee base.
LEVER #7: FOSTER INDIVIDUAL ACCOUNTABILITY TO REINFORCE ORGANIZATION’S COMMITMENT TO ETHICS

Leveraging the Data: Key Action Items to Increase Your Program’s Overall Effectiveness

**DO**

1. Formalize Individual C&E Responsibilities—
   Even if senior management or functional partners are not prepared to tie C&E performance to financial outcomes in performance reviews, begin by adding qualitative C&E objectives and measures into the organization’s individual performance scorecard.

2. Hold the Business Financially Accountable—
   Ensure that the business pays for costs associated with instances of noncompliance, especially preventable violations. Affecting the bottom line increases individual/business leaders’ ownership of C&E responsibilities.

**DON’T**

1. Implement C&E Responsibilities Only on Paper—Create that you have the ability to enforce C&E standards before actively promoting them to the employee base.

---

On average, 67% of companies do not charge back any compliance expenses to the business.

- Effective compliance programs hold the business accountable for noncompliance without undermining willingness to report problems.

**COMPLIANCE AND ETHICS CHARGEBACKS**

<table>
<thead>
<tr>
<th>Current State</th>
<th>Percentage of Compliance and Ethics Expenses Charged Back to the Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do Not Charge Back Any Expenses</td>
<td>67%</td>
</tr>
<tr>
<td>Investigation of Violations</td>
<td>17%</td>
</tr>
<tr>
<td>Conducting Investigations</td>
<td>17%</td>
</tr>
<tr>
<td>Business Induced By Compliance Training</td>
<td>17%</td>
</tr>
</tbody>
</table>

**CELC Data Analysis**

Charging Back to the Business and Overall Program Effectiveness

Mean Overall Program Effectiveness Scores

*Note: P = p-value, the significance level of correlation between Charging Back to the Business and Overall Program Effectiveness Scores.*
SECTION 4: BUILD A CULTURE OF INTEGRITY

Employee perception of ethical culture is directly related to how quickly and consistently the company responds to unethical behavior.

Member Articulation of Key Challenges
"Employees are heavily interested in real life examples that demonstrate how the integrity program and culture are working.”
Corporate Compliance Manager, Industrial Company

Key Questions
How can we enhance transparency in an effort to improve employee perception of the company’s ethical culture?

Solution
Lever 8: Foster Organizational Justice

DECONSTRUCTING THE COMPONENTS OF INTEGRITY

The RiskClarity Survey Analyzes the Strength of Key Attributes That Impact a Culture of Integrity.

INTEGRITY INDEX
- Clarity of Expectations
- Comfort Speaking Up
- Direct Manager Leadership
- Trust in Colleagues
- Tone at the Top
- Openness of Communication
- Equity of Expectations
- Organizational Justice

Key Demographics of Survey Participants to Date

1. Multiple Industries
Participating companies represent the following industries: Energy, Mining and Fuel, Pharmaceuticals and Medical Supplies, Financial Services, Non-Profit, Professional Services, Retail, Construction and Building Materials, Manufacturing, Food Services, Chemical, and Consumer Product Goods.

2. All Employee Levels
Over 500,000 employees at all levels, from CEO and senior management to frontline employees, have participated.

3. Global Coverage
Respondents work in more than 80 countries across North America, Europe, Asia, the Pacific Rim, and Latin America.

4. All Business Functions
Respondents represent all business functions, including Finance, Sales, Marketing, Information Technology, Call Centers, Human Resources, and Manufacturing.
SMALL DIFFERENCES, BIG CONSEQUENCES

Relative to Employees at Top Quartile Companies, Employees at Bottom Quartile Companies Are...

1.6 times as likely to observe misconduct.
Two times as likely to observe HR–related misconduct.
Three times as likely to observe misconduct in high-risk compliance areas such as conflicts of interest or accounting irregularities.

Even relatively small changes in RiskClarity Integrity Index scores are linked to significant differences in misconduct levels.

A few ethical missteps can have a significant impact on overall employee perceptions of a company’s culture of integrity and can increase the company’s risk profile.

**EMPLOYEE PERCEPTIONS OF CULTURE**

Distribution of Employees By Overall Perception of Culture

- Employees with “Least Favorable” perceptions of company culture are nearly 10 times more likely to observe misconduct than employees with “Most Favorable” perceptions of culture.

Improving employee perceptions of culture increases their willingness to adopt compliance and ethics standards.

- Employees with “Least Favorable” perceptions of company culture are nearly 10 times more likely to observe misconduct than employees with “Most Favorable” perceptions of culture.

<table>
<thead>
<tr>
<th>% See Misconduct</th>
<th>% Don't Know If I See Misconduct</th>
<th>% Reported What I Saw</th>
</tr>
</thead>
<tbody>
<tr>
<td>Least Favorable</td>
<td>61.0%</td>
<td>22.1%</td>
</tr>
<tr>
<td>Neutral</td>
<td>33.1%</td>
<td>30.3%</td>
</tr>
<tr>
<td>Moderately Favorable</td>
<td>21.8%</td>
<td>21.8%</td>
</tr>
<tr>
<td>Most Favorable</td>
<td>7.2%</td>
<td>8.0%</td>
</tr>
</tbody>
</table>


1 Percentage of employees within category who observed misconduct in past year.
2 Percentage of employees within category who said they didn’t know if they saw misconduct.
3 Percentage of employees within category who reported the misconduct they observed.
Top quartile companies outperformed the bottom quartile companies by more than 16 percentage points in average 10-year total shareholder return.

Average 10-Year Total Shareholder Return for Bottom and Top Quartile of 48 Companies

Culture as Competitive Advantage?
While promoting a culture of integrity may not always be a high corporate priority, failure to properly engage with employees represents a strategic (as well as compliance) risk that threatens long-term competitive advantage.

Employee perceptions about organizational justice explain the vast majority of their perceptions about the ethical culture of their company.

- Organizational justice is the employees' degree of agreement that:
  - Their company responds quickly and consistently to verified or proven unethical behavior and
  - Unethical behavior is not tolerated in their department.

- Companies with strong belief in organizational justice note lower levels of misconduct and higher reporting rates.

What the Numbers Mean
Addressing organizational justice is the most effective way to impact ethical culture.

73% Organizational Justice

27% All Other Integrity Components

1. Establish companywide escalation criteria and channels, disciplinary guidelines, and investigations procedures alongside HR and other relevant parties.
2. Publicize your company’s reporting and investigations procedures (i.e., how and where to report allegations, how reported information is treated throughout the company).
3. Publicize the actions taken by your company and clarify the preferred actions for employees. Follow up with a cascade of the bulletin to senior managers to share with their direct reports.
4. Establish a regular communications cadence to continue reinforcing compliance messages before employees.
5. Provide tools, resources, and support to managers and compliance representatives (or liaisons) in bringing transparency into corporate processes on information treatment to their employees.
6. Issue an annual, company-wide end-of-year report that includes information about compliance disciplinary actions and activities promoting organizational justice.
7. Encourage senior leaders and managers to publicly accept responsibility for ethical lapses.

1 Research from CELC’s Cultural Diagnostic Survey.

**ORGANIZATIONAL JUSTICE DRIVES CULTURE**

**Culture of Integrity**

**Illustrative**

Key Action Steps for Building Organizational Justice

- Establish companywide escalation criteria and channels, disciplinary guidelines, and investigations procedures alongside HR and other relevant parties.
- Publicize your company’s reporting and investigations procedures (i.e., how and where to report allegations, how reported information is treated throughout the company).
- Publicize the actions taken by your company and clarify the preferred actions for employees. Follow up with a cascade of the bulletin to senior managers to share with their direct reports.
- Establish a regular communications cadence to continue reinforcing compliance messages before employees.
- Provide tools, resources, and support to managers and compliance representatives (or liaisons) in bringing transparency into corporate processes on information treatment to their employees.
- Issue an annual, company-wide end-of-year report that includes information about compliance disciplinary actions and activities promoting organizational justice.
- Encourage senior leaders and managers to publicly accept responsibility for ethical lapses.

**Culture as Competitive Advantage?**

HIGHER INTEGRITY, STRONGER LONG-TERM TOTAL SHAREHOLDER RETURNS

Average 10-Year Total Shareholder Return for Bottom and Top Quartile of 48 Companies

Correlation (r) = 0.58
Significance level of Correlation: P-value < 0.01

n = 48.
Appendix
Designing Compliance and Ethics Metrics

While regulators ask compliance programs to demonstrate effectiveness, many companies track only activity-focused metrics.

COMMON COMPLIANCE AND ETHICS METRICS

Top Helpline and Employee Feedback Metrics
Percentage of Respondents, 2008

Activity-Focused Metrics
- Percentage of Respondents, 2008
  - 82%
  - 64%
  - 22%
  - 8%

Results-Focused Metrics
- Satisfaction of Helpline Users
  - 30%
  - 20%
  - 60%

Top Compliance and Ethics Training Metrics
Percentage of Respondents, 2008

Activity-Focused Metrics
- Number of Employees Completing Training
  - 89%
  - 70%
  - 13%
  - 8%

Results-Focused Metrics
- Average Employee Score on Training Test
  - 80%
  - 70%
  - 90%
**Screen metrics for economic relevance and appropriate update frequency.**

**DO** Test metrics for economic relevance before you add them to compliance scorecards.

**DON'T** Report all metrics at the same cadence. Reduce the information burden by only reporting metrics on a timeline aligned with their variability and how quickly operating plans can be changed.

---

**CREATING MEANINGFUL METRICS**

**Metrics Criteria**

- **Meaningful**
  - Is the metric clearly defined?
  - Does the metric measure a desired compliance outcome?

- **Clarity of Purpose**
  - Can you clearly articulate the issue or assumption this metric addresses?

- **Related to Key Assumptions**
  - Does this metric form the basis of or allow you to test if a key assumption is valid?
  - Does a change in this metric impact your strategic plan?

- **Variability**
  - How often and by what margin does the value of this metric change?
  - How predictable are future values of this metric?

- **Responsiveness**
  - How critical is it that you respond at a given time to a change in this metric?
  - Is this metric a leading or lagging indicator?

- **Pragmatic**
  - Does the business have the technological capability necessary for measuring/tracking the metric?
  - Is the metric easily collected and reported with a low margin of error?

---

**Economic Relevance**

- **Frequency of Update**
  - Economic relevance

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**To accurately assess performance, Compliance and Ethics Officers must capture feedback from all relevant stakeholders.**

**BUILDING A BALANCED COMPLIANCE SCORECARD**

**Regulatory Metrics**

- Number of regulatory violations compared to industry average
- Number and type of substantiated allegations and related discipline
- Risk assessment results and resultant process changes
- Year-over-year volume and costs of legal settlements

**Operating Business Metrics**

- Feedback from senior business leaders on compliance’s effectiveness and support
- Efficiency of regulatory approval process
- Demonstrated business knowledge and acumen of compliance staff
- Applicability of discretionary compliance training materials

**Employee/Cultural Metrics**

- Percentage of employees who fear retaliation in response to reported allegations
- Company responds quickly and consistently to verified or proven unethical behavior
- Percentage of employees who feel direct manager respects his/her employees
- Percentage of employees who feel direct managers quickly respond to minimize operational problems when they are identified

**Functional Metrics**

- Number of identified compliance gaps, material weaknesses, or policy violations
- Compliance cost per $100M in revenue
- Number of operational process improvements made annually
- Allegation and investigation case-cycle time
- Inventory of relevant policies, procedures, and guidelines is maintained and easily accessible