Building a World-Class Compliance Program: Best Practices and Strategies for Success

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Agenda

• The case for effective compliance
• “Tone at the Top” but not “tone-deaf” in the middle
• Case studies of best in class companies and those emerging from compliance failures
• The global risk of corruption
• The “Skunk in the Room”
A History of NYPD Police Corruption

- **1894 Lexow Committee**: “Systematic police extortion and payoffs from gambling operations”
- **1911 Curran Committee**: “Systematic monthly police extortion of gambling and brothel operations”
- **1932 Seabury Commission**: “Police Department was deeply involved in extortions from speakeasies, bootleggers, and gamblers”
- **1950 Harry Gross Investigation**: “Large scale protection by police of a gambling syndicate”
- **1972 Knapp Commission**: “Corrupt police officers were either ‘grass-eaters’ or ‘meat-eaters’”
- **1994 Mollen Commission**: “Shakedowns and protection by corrupt officers but also trafficking in cocaine and other drugs”

Effective Corporate Compliance

- The United States’ Federal Sentencing Guidelines for Organizations state that “to have an effective compliance and ethics program, an organization shall exercise due diligence to prevent and detect criminal conduct; and otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.”
A Brief History of Compliance

- Jay Cooke & the Robber Barons of the 19th Century
- 1872: enactment of Mail Fraud Statute
- Teddy Roosevelt and “Trust-Busting”
- FDR and a “New Deal” for investors
- 1977: FCPA enactment
- Early 1980s: Defense contracting scandals
- 1985: Committee of Sponsoring Organizations (COSO) formed
- 1986: Defense Industry Initiative (DII) formed
- “Greed is Good” on Wall Street
- 2002: Sarbanes-Oxley
- 2004: FSG amendments

Who Said This?

“The responsibility of our board—a responsibility which I expect them to fulfill—is to ensure legal and ethical conduct by the company and by everyone in the company....What a CEO really expects from a board is good advice and counsel, both of which will make the company stronger and more successful; support for those investments and decisions that serve the interests of the company and its stakeholders; and warnings in those cases in which investments and decisions are not beneficial to the company and its stakeholders. And let me conclude by acknowledging that it is not an easy task to get all of this just right.”
The Importance of Tone at the Top

• “If the CEO chooses, he or she can by example and through oversight, induce corporate colleagues and outside auditors to behave ethically. Companies run by people with high ethical standards arguably do not need detailed rules in how to act in the long-run interests of shareholders and, presumably, themselves. But, regrettably human beings come as we are – some with enviable standards and others who continually seek to cut corners. Rules cannot substitute for character.”

  - Alan Greenspan

• “The proof of sincerity and seriousness of a management is uncompromising emphasis on integrity of character.”

  - Peter Drucker

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Joe Murphy’s How the CEO Can Make the Difference

1. Have a well-used, dog-eared copy of the company’s code of conduct on the top of your desk, and be seen using it.

2. Make sure the C&E officer has plenty of clout, including direct reporting to the board’s audit committee.

3. At your senior executive meetings, have each senior officer report on what they have done specifically to promote the C&E program.

4. Insist that C&E be tied to incentives and evaluations.

5. Be the model in your business decisions.

6. Be the model for the compliance program.


8. Recruit a C&E officer from another company for your board.

9. Get a truly independent review of your C&E program.

10. Ask your vendors to embrace your commitment to C&E.
John Rigas and Adelphia Communications

- Once 6th largest cable company
- Filed for bankruptcy protection in June 2002 listing $18.6B in debt
- Allegation that 80-year old founder & sons looted company of more than $1B
- Secret cash payments, personal loans not disclosed to the board, personal use of corporate assets
- Used the company as a “personal piggy bank”
- Sentenced to a “life sentence” of 15 years in prison

Former Adelphia CEO John Rigas following his conviction on 7-8-04

“I did nothing but try to improve the conditions of my employees” Rigas told sentencing judge on 6-20-05

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Adelphia Communications Corp. Stock Price & Volume
March 25, 2002 to June 7, 2002

Source: U.S. Dept. of Justice (attachment to criminal complaint)
CA, Inc. & the “35-Day Month” Fraud

• The “35-Day Month” was a practice extending CA’s fiscal quarters beyond their normal conclusion to prematurely recognize revenue. The multi-billion dollar fraud allowed the company to fraudulently prop up the price of the stock and consistently meet or exceed Wall Street analyst’s revenue and earnings expectations.

Former CA CEO
Sanjay Kumar

The Massive Accounting Fraud

“The 35-Day Month”
• Practice extending Computer Associates’ fiscal quarters beyond their natural conclusion to prematurely recognize revenue

DOJ, SEC & FBI Investigation
• Massive accounting fraud perpetrated by the company’s senior most executives from the late 1980s to 2001 & then a cover-up through 2004

The Outcome
• Convictions of 8 senior executives including CEO, CFO, General Counsel, and SVP F&A
• $2.2 billion restatement
• Deferred Prosecution Agreement (DPA)
“Don’t Lie, Don’t Cheat, Don’t Steal”

- With this phrase, Pat Gnazzo introduced himself to over 1,200 CA employees
- Former Chief Compliance Officer for United Technologies Corporation for 10 years

Patrick J. Gnazzo, former Sr. Vice President, Business Practices & Chief Compliance Officer, CA, Inc.
## Changing the Culture at CA

- Recruiting a Chief Compliance Officer
- “Unfettered Access”
- Joining the Defense Industry Initiative
- Upgrading the prior Code of Conduct
- “We weren’t sure you could raise an issue back then. It was thought that by raising an issue you could only get in trouble, or worse, get fired.”

## Promoting Tone at the Top

- Has the executive taken the required ethics courses?
- Has the executive handled compliance matters appropriately when they have occurred in his or her organization?
- Has the executive communicated the importance of the Code of Conduct throughout his or her organization?
- Has the executive set the appropriate “tone at the top” and is it communicated and practiced?
Redflex Traffic Systems

- Redflex Traffic Systems, based in Scottsdale, AZ, manufactures photo-enforcement cameras to catch red-light runners and speeders
- June 8, 2006 – St. Peters, MO city government approves ordinance for enforcement cameras and selects Redflex
- Approx. June 15, 2006 – Mayor Shawn Brown solicits bribe from Redflex representative
- June 16, 2006 – Brown signs ordinance & receives bribe of $2,750
The World is Flat

- 85% of companies plan to expand operations in emerging markets
- 52% of future revenue growth & 59% of sourcing opportunities will come from Asia Pacific
- BRIC countries have potential to become among the four most dominant economies by the year 2050
  - Forecasted to be 39% of world’s population and combined GDP of $15.4 Trillion Dollars
  - By 2025, it is estimated that over 200 million people in BRIC nations will earn over $15,000 per year, creating a large middle-class
- Goldman Sach’s N-11

Emerging Markets Due Diligence

Key findings of 2007 D&T survey on developing business in emerging markets:

- Just 67% of companies always conduct background investigations before M&A activity
- Integrity checks are not always thorough especially in AML, terrorist financing, and FCPA
- 70% pulled out of deals as a result of uncovering negative information
- Larger companies conduct more thorough background investigations
The Foreign Corrupt Practices Act (FCPA)

**Halliburton is Linked to Nigeria Bribe Probe**

**Siemens Slush Fund for Bribes Detailed**

**Bribe Probe Exposes Alstom Network in Brazil**

**Willbros to Pay $32.3 Million in Bribery Settlement**

**Probe May Tie Top Siemens Execs to Scandal**

**An Increase in FCPA Enforcement**

- Different regulatory environment after Enron/WorldCom
- U.S. Department of Justice Fraud Division lists FCPA as one of its top three priorities
- Increased scrutiny from SOX 404 testing and controls
- Increase in the number of companies self-disclosing FCPA violations
- More countries working in the context of the Organization for Economic Cooperation and Development (OECD) Anti-Bribery Convention
- Greater level of cooperation between international regulatory bodies
- Tighter scrutiny in cross-border dealings as dictated in the USA PATRIOT Act

The trend of increasing numbers of enforcement actions and voluntary reporting will continue.
Schnitzer Steel and the FCPA

Schnitzer Steel’s Remedial Efforts

• Hired compliance consultant for three years to review and evaluate SSI’s internal controls, record-keeping, and financial reporting policies & procedures related to FCPA.
• Full cooperation with compliance consultant.
• Evaluation of SSI’s policies and procedures to determine if they are reasonably designed to detect and prevent FCPA violations.
• Report compliance consultant’s findings to SEC and DOJ.
• Adoption by SSI of all of the compliance consultant’s recommendations.
**U.S. v. Metcalf & Eddy**

- In *United States v. Metcalf & Eddy* (D. Mass. 1999), the court approved a consent judgment and issued an injunction prohibiting the company from engaging in any future conduct in violation of the FCPA. The particular conduct at issue involved the payment of airfare, travel expenses, and pocket money to an Egyptian official and his family during business trips to the United States. The Department of Justice interpreted this conduct as exceeding the affirmative defense for *bona fide* promotion expenses.

**FCPA Compliance Standards**

- Clear FCPA policy establishing compliance standards and practices to be followed by employees, consultants, and agents.

- Creating and maintaining a committee to review the hiring of agents, consultants, or other representatives to do business in a foreign country, and the related contracts as well as prospective joint venture partners.

- Clear corporate procedures to assure that the necessary precautions are taken to make sure the company only does business with reputable and qualified individuals.

- Communicating FCPA policies, standards, and procedures to employees, agents, and consultants; requiring regular training on the FCPA and other applicable foreign bribery laws to officers and employees involved in foreign projects.

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FCPA Compliance Standards

- Including in all foreign business contracts provisions banning foreign bribery.
- Periodic review, at least once every five years, of corporate policies and FCPA compliance program, to be conducted by independent legal and auditing firms retained for such purpose.
- Prompt investigation and/or reporting of any alleged violations of the FCPA or other applicable foreign bribery laws.
- The company must determine the regions or countries in which it does business that pose higher risks of corruption, and then on a periodic basis, conduct rigorous FCPA audits of its operations in such areas.

Ensuring FCPA Compliance

Sample Compliance Activities Checklist

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<thead>
<tr>
<th>Strategies in Practice</th>
<th>Yes</th>
<th>No</th>
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<tbody>
<tr>
<td>Maintain a compliance hotline and past records</td>
<td>X</td>
<td></td>
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<tr>
<td>Conduct mandatory FCPA training seminars</td>
<td>X</td>
<td></td>
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<tr>
<td>Require FCPA certification for senior employees</td>
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<td>X</td>
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<tr>
<td>Conduct due diligence reviews</td>
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<td>X</td>
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<td>Pre-approve all agents, consultants, JV partners, etc</td>
<td></td>
<td>X</td>
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<tr>
<td>Include FCPA compliance clause in written agreements</td>
<td></td>
<td>X</td>
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<tr>
<td>Review existing contracts</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Pre-approve all facilitating payments</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Conduct accounting &amp; bookkeeping audits at foreign sites</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Conduct thorough operational audits at foreign sites</td>
<td></td>
<td>X</td>
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Source: General Counsel Roundtable Research; Compliance and Ethics
### Global C&E Program

- Global code of conduct
- Appropriate structure for global C&E programs
- Local business practice officers, regional compliance committees, HR, legal
- Encouraging overseas employees to report business conduct violations
- Train local C&E staff
- Assess local risks and cultural sensitivities
- Obtain support of key leaders in the various subs
- Gift policy

### The Skunk in the Room

- World-class compliance requires speaking up.
- “A skunk in the room is that contrary person who says no when everyone else is saying yes—the person who is not afraid to ask the tough questions, especially when others do not even want to hear them.”
- Compliance, not defiance.
THANK YOU. QUESTIONS?

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