Practices of High-Quality Ethics and Compliance Programs

2020 IIA Edmonton Chapter

December 17, 2020
Today’s Agenda

1. Overview and business case
2. Leading Practices E&C Framework
3. Impact of Corporate Culture
4. IA Mandate for E&C
About MNP

- We are a premier partner with the IIA and proudly serve and respond to the needs of our internal audit clients in the public, private and not-for-profit sectors.
- Through partner-led engagements, we deliver a collaborative and cost-effective approach to produce customized solutions to help internal auditors succeed across the country and around the world.
- MNP is one of the pre-eminent national accounting, business advisory, and tax firms serving Canada.
- This has remained our firm’s ethos and where we draw our strength.

- Founded in 1958
- 5th largest national accounting and business consulting firm in Canada
- MNP is dedicated to delivering the right solutions for you.

5,500+ Team Members  840+ Partners
Fundamental purpose for E&C programs

Integrity
- Ensure and sustain integrity in the organization’s performance and its reputation as a responsible business.

Reduce risk
- Reduce the risk of wrongdoing by parties employed by or aligned with the organization.

Reporting wrongdoing
- Increase the likelihood that, when it occurs, wrongdoing will be made known to management within the organization.

Response
- Increase the likelihood that the organization will responsibly handle suspected and substantiated wrongdoing.

Mitigate penalties
- Mitigate penalties imposed by regulatory and governmental authorities for violations, if they occur.
Ethics and Compliance Definitions

Compliance
• Designed to prevent, detect and deter violations of law and regulation, as externally imposed.

Ethics
• Designed to encourage the establishment of a set of values and a culture that encourages ethical decision-making consistent with those values.

More common that ethics and compliance are separated in large organizations. However, ethics and compliance are interdependent: the successful execution of either function is strongly dependent on successful execution of the other.
Four main challenges

Increasingly intense regulatory environment
- Increase in enforcement activity
- Want organizations to implement “thoughtfully designed” programs
- Regulators are upping their game with technology and analytics

Increasing global standards
- Many countries have passed new legislation
- Significant challenge for multi-national organizations

Rapidly expanding public scrutiny and reputational risk
- Expectations for organizational conduct are increasing
- Access to information is increasing
- Single news event can harm reputation rapidly

Rising costs of misconduct
- Single incidents are becoming very expensive in terms of fines, penalties and sanctions
- Examples include FCPA and securities class action lawsuits
Guidance and Corporate Response

Current Guidance

- Investor confidence rules (SOX and CSOX)
- FCPA/CCPA/UK Bribery Act
- Workplace Safety
- Environmental Management
- Reliability (e.g., NERC, FERC)
- OSFI and other (Financial Institutions)
- ISO 19600 – Compliance Management System

Is this sufficient for your organization?

- Regulatory frameworks only specify the minimum requirements - articulate what constitutes compliance with regulation and/or the law.
- Usually established as a response to increasing evidence of compliance and ethical lapses in organizations

What is your company’s objective? Do they know what they should comply with?
Polling Question #1

What is your organization’s stated or commonly understood objective for its ethics and compliance program?

1. Not sure, still trying to figure out its obligations
2. Comply with minimum requirements
3. Planning for enhanced integrity and assurance – going beyond minimum requirements but work needs to be done
4. Recognized leader in its industry for its high standards of ethical conduct
Business Case for Strong E&C Programs

01 Employee Engagement: Employee engagement drops by 11% and intent to say decreases by 23% when misconduct is observed.

02 Less Misconduct: Misconduct has been shown to be reduced by as much as 66% in organizations with effective programs.

03 Competitive Advantage: Higher brand recognition and attractive for recruiting talent.

04 Reduced costs: Prevention is cheaper than fixing. Long-term costs of sustainment are generally lower in high performing organizations.

05 Stronger Culture: High quality programs increase cultural strength in organizations by enormous amounts. More to come on this later.
Principle 1 - Ethics and compliance is central to business strategy

• The E&C program is designed to integrate with business objectives.
• E&C is given the resources and access needed to ensure both proper integration with operations and an independent voice to leaders.
• E&C personnel are consistent participants in key strategic discussions.
• The organization continuously improves the impact of its E&C program through leadership, innovation and continuous feedback loops.
• The board of directors is knowledgeable about the impact of the E&C program and actively monitors its implementation across the business.

Principle 2 - Ethics and compliance risks are identified, owned, managed, and mitigated

- The E&C program is calibrated to key risk areas identified through a robust, continuous risk assessment process.
- Leaders across the organization are assigned responsibility for the ongoing identification and mitigation of risks that are endemic to their operations.
- Self-assessment, early issue spotting and prompt remediation of compliance gaps are recognized and rewarded.
- Ethics and compliance, both the program and the state of the organization from an E&C perspective, are regularly monitored as risk areas.
- Guidance and support for handling key risks are provided to employees according to their role.
- The organization maintains rigorous third-party due diligence processes that screen for integrity.

Top Risks 2021

- Business Continuity and Crisis Management
- Culture
- Cybersecurity
- Disruptive Innovation
- Economic and Political Volatility
- Third Party
- Sustainability
- Talent Management
- Data Governance
- Board Information
- Organizational Governance

Source: On Risk, Institute of Internal Auditors, 2021
Principle 3 - Leaders at all levels across the organization build and sustain a culture of integrity

- Leaders are expected and incentivized to personally act with integrity and are held accountable if they do not.
- Leaders across the organization own and are accountable for building a strong ethical culture.
- Values and standards are communicated effectively through many channels.
- All employees are supported and expected to act in line with company values and are held accountable if they do not.
- The organization communicates directly with individual reporters and more broadly with all employees when cases are closed.

Principle 4 - The organization encourages, protects and values the reporting of concerns and suspected wrongdoing

• Leaders create an environment where employees are prepared and empowered to raise concerns and resources are provided to support employees in ethical decision-making.
• The organization respects all employees’ rights to report to government authorities.
• The organization provides a broad and varied number of reporting avenues, each with effective tracking for escalation and response of significant matters.
• The organization treats all reporters the same – with consistency and fairness – throughout the entire process.
• The organization has proactive processes in place to prevent retaliation; including awareness training for leaders; monitoring of employee reporters; and demonstrated consequences for violations.
• The organization communicates directly with individual reporters and more broadly with all employees when cases are closed.

Polling Question #2

Which of the following six specific types of misconduct is your organization most at risk for?

1. Abusive behaviour
2. Conflicts of interest
3. Corruption
4. Discrimination
5. Sexual harassment
6. Violations of health and/or safety regulations
Survey Says

Employees Who Feel Pressure Are About 2X as Likely to Observe Various Types of Misconduct

Source: Global Business Ethics Survey, ECI, 2020
Principle 5 - The organization takes action and holds itself accountable when wrongdoing occurs

• The organization regularly communicates that individuals who violate organizational standards or the law will be disciplined.
• The organization maintains investigative excellence.
• Disciplinary action is consistently taken when violations are substantiated.
• Systems for escalation and response are well-developed and regularly tested, and leaders are held accountable for compliance.
• Appropriate disclosures are made to regulatory or other government authorities.

Ethics and Compliance Program Maturity Model

Five Principles
• Strategy
• Risk Management
• Culture
• Speaking Up
• Accountability

MATURITY

1. Underdeveloped
   A new or existing E&C program that has not progressed in embedding high quality practice elements.

2. Defining
   An E&C program that has a few high quality elements, but still lacks may important attributes.

3. Adapting
   An E&C program that contains a number of high quality elements reflecting important attributes, but with room to further grow.

4. Managing
   An E&C program that is effective and has adapted many high quality elements.

5. Optimizing
   An E&C program that contains the majority of, if not all, high quality elements.
Polling Question #3

Based on the E&C Maturity Model described, what would you assess your organization’s level to be:

1. Underdeveloped
2. Defining
3. Adapting
4. Managing
5. Optimizing
Culture versus Conduct

Culture represents the invisible belief systems, values, norms, and preferences of the individuals that form an organization. Conduct represents the tangible manifestation of culture through the actions, behaviors, and decisions of these individuals.

Oliver Wyman
Measuring Conduct and Culture: A How-To Guide for Executives¹
Culture is the Rocket Fuel to Drive E&C Quality

1. **The Higher the Program Quality, the Stronger the Culture**
   - Organizations with high-quality programs (shown here as optimizing) demonstrate a 546% increase in culture strength over organizations at the lowest level of program quality.

2. **The Stronger the Culture, the Bigger the Impact**
   - As the culture strengthens, employee conduct improves. Organizations with strong cultures are 467% more likely to demonstrate a positive impact on employees than organizations with weak-leaning cultures. This impact includes employees’ recognizing and adhering to organizational values, feeling prepared to handle key risks, reporting suspected wrongdoing, and reduced levels of misconduct overall.
**Externalities** refers to the impact of employee misconduct beyond the individual and even the organization.

**Adverse selection** occurs when those particularly ill-suited for something are the most likely to participate.

**Principal-agent problems** occur when the incentives of employees don’t align with the broader interests of management or shareholders.

Culture is one part of executing business strategy, closely tied to engagement and leadership.

**CULTURE**
*The way things work around here*

- Behaviors aligned with strategy
- Includes values, beliefs, behaviors, artifacts, and reward systems influencing behavior
- Driven by top leadership and is deeply embedded in processes, reward systems, and behaviors

*Culture* predicts Company performance.

**ENGAGEMENT**
*The way people feel about the way things work around here*

- Way of describing employees’ level of commitment
- When engagement is poor, employees feel uneasy or uncommitted
- Declining engagement leads to decline in productivity

*Engagement* predicts Individual performance.

**LEADERSHIP**
The driving force behind setting and maintaining culture and engagement via modeling behaviors and expectations for the workforce.
OECD Model of Ethical Culture

The OECD created a Two-Factor Model of Ethical Culture, which includes positive aspects (Qualifiers) that will motivate employees to exhibit ethical behavior and negative factors (Disqualifiers) that are likely to increase unethical behavior.¹⁴

<table>
<thead>
<tr>
<th>QUALIFIERS</th>
<th>DISQUALIFIERS</th>
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<tbody>
<tr>
<td>Organizational trust</td>
<td>Organizational unfairness</td>
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<tr>
<td>Ethical leadership</td>
<td>Abusive manager behavior</td>
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<tr>
<td>Benevolent orientation</td>
<td>Selfish orientation</td>
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<tr>
<td>Empathy</td>
<td>Lack of awareness</td>
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<tr>
<td>Efficacy and speaking out</td>
<td>Fear of retaliation</td>
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Navigating Multiple Layers of Stakeholders

| Board/ Governance                  | • Seek assurance and “level of comfort”  
                               | • Inundated with governance trends and emerging risks |
|---------------------------------------------------------------|
| Executive Leadership                                         | • Short term focus – ethics and culture may be regarded as “soft”  
                               | • Usually preoccupied with strategic focus, transformation, and current performance |
| Second Line of Defense                                       | • Develop policies and standards based on industry, regulatory or corporate needs  
                               | • Training and guidance  
                               | • Ensuring compliance, putting out fires, mixed management reporting lines |
| Operations Shop Floor                                        | • Driven by leader’s objectives and style  
                               | • Generally, follow supervisors’ examples – subculture characteristics?  
                               | • “Ground level” view of organization and leadership |
Polling Question #4

Which organizational level is the most pressured in your organization to “bend the rules”? 
1. Board of Directors
2. Top Management
3. Middle Management
4. First-line direct supervisor with direct reports
5. Employee – front line
Survey Says

The Incidence of Pressure Was Almost 2X as High Among Top Management Compared with Individual Contributors

Percentages shown are based on the global median.

Source: Global Business Ethics Survey, ECI, 2020
Mandate for Internal Audit

• Aligns internal audit with many of the principal risks facing organizations today
• Build awareness of ethics and compliance risks across the organization
• Monitor key controls by specific engagement level testing or by deploying continuous auditing and/or data analytics to high-risk areas
• Emphasize management’s responsibility to identify, own, manage, and mitigate ethics and compliance risks
• Coordinate assurance and advise on lines of defense around high-risk areas
• Invest and deliver specific aspects of the program, if appropriate, such as ethics training
Final Thoughts
Time Well Spent

- Ethics and compliance is more than just another “box to check” in the changing regulatory landscape.
- If carried out well, and E&C monitoring and assessments can provide great insight into an organization’s risks and may lead to high-impact enhancements in the control environment.
- Educate your stakeholders on the up-front investment of time and resources required to properly evaluate E&C risks with the time and cost of suffering the effects of non-compliance, lapses, and wrongdoing.
Thank You, Best Wishes in the Festive Season, and Stay Safe

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