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Ethics Still The Star Of Legal Department Show

Counsel Work Hard To Create Compliant Internal Audit Programs

BY CATHLEEN FLAHARDY

PREPARING A FIVE-COURSE meal for a dinner party of six could present challenges for even the most experienced chef. But imagine the chef is totally unfamiliar with the meal. He doesn't know the ingredients, has no recipe to follow, and the clock is ticking. He has only 30 minutes to serve the feast to his hungry guests. And they aren't going away.

At A Glance: Martindale-Hubbell's Counsel to Counsel Forum

"Best Practices in Managing Internal Investigations and Compliance Audits"

Co-Chairs:

- **Sean Bowen**
  Vice President & General Counsel
  Internet Security Systems Inc.
- **David Golden**
  Director, Ethics & Corporate Compliance and Senior Counsel
  Eastman Chemical Co.

Law Firm Co-Hosts:

- **Burr & Forman**
- **Constangy, Brooks & Smith**
- **Duane Morris**

Facilitator:

- **Deborah McMurray**
  Deborah McMurray Associates

COUNSEL to COUNSEL COVERAGE

Many in-house counsel may have felt a lot like that chef in 2002 with the passage of Sarbanes-Oxley. The Act created a number of new requirements and challenges for many companies and their legal departments.

One such challenge is the need for a process to allow confidential, anonymous submission of employee concerns regarding questionable accounting or auditing matters as required by Section 301 of the Act. It sounds like a good idea, but companies were expected do this with little guidance on the exact meaning of the Section 301.

In a recent Martindale-Hubbell Counsel to Counsel forum in Atlanta titled "Best Practices in Managing Internal Investigations and Compliance Audits," participants discussed what types of procedures their companies have implemented to comply with the new regulation, and how they went about creating those processes.

The Nitty Gritty

For at least one company at the forum, the solution was to use its existing 1-800 number that allowed employees to anonymously call and raise concerns about corporate conduct. A third party administers the calls to ensure anonymity.

But the company's job under 301 wasn't done there. It had to make employees aware the 1-800 number existed and determine how to handle the complaints.

The company's senior compliance counsel and a participant at the forum said the key to creating a compliant 301 investigation program is in the details.

"To make sure its 301 process was effective, we wanted to decide in advance how we would investigate incoming Section 301 complaints," he explains. "You could pass all calls from the 800 number to the audit committee, which would be great if you only got one or two complaints a year, and they were all 301 concerns. But that's never the case."

Calls from the 800 number are a mixed bag for most companies. And the vast majority do not involve 301.

"The trick is to make sure the right issues reach the right people within the right time-frame," he says. "Under our process, I review all reports coming in through the 800 number as well as all other concerns I may receive, and I pull out any that may fall within Section 301. At that point, our audit committee charter stipulates that the director of internal audit handles the concern."

When the director of internal audit (DIA), who reports to the CLO receives the concern, he determines whether the complaint should be reported to the audit committee immediately or if he needs to do some additional investigating before making a report. Ultimately, all complaints go to the audit committee.

The DIA decides whether to notify anyone on the executive team. "The process calls for us to notify certain executive team members as well, but we've also thought through the potential conflicts in advance so that our process would avoid informing a person being investigated," he says. "It's not such an effective investigation if you tell the person you're investigating right off the bat what you're doing."

Once the audit committee chair receives the complaint, he then decides on an appropriate method of investigating its validity. At this point, the chair may bring in outside counsel, if necessary, and inform the entire audit committee about the investigation.

There are at least three situations in

which the DIA would immediately report the complaint to the audit committee chair prior to any further investigation. The first is if someone reports a specific illegal act in accounting, internal controls or financial reporting.

"This is patterned after Section 10A of the SEC Act of 1934, which requires public accounting firms to inform management and the audit committee if they find it is likely that an illegal accounting or reporting act has occurred," he said.

The second is a specific allegation of any fraud that involves management or any other employee that has a significant role in the company's internal controls. This is based on Section 302(a)(5)(B) of Sarbanes-Oxley. And the third would be a specific allegation that, if true, would have a material effect on the company's financial statements.

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—Scott Burton
Corporate General Counsel

However, if the complaint doesn't meet the criteria for immediately reporting to the chair of the audit committee, the DIA will conduct his own investigation. During this process, the legal department may advise the DIA in the investigation.

If the DIA concludes the complaint is baseless, he reports the results to the audit committee. If he finds the reported actions likely did happen, he promptly shares the findings and analysis with the CLO and CFO, as well as the audit committee. Those people follow appropriate steps from there.

"Our process is detailed," he says. "You may not find quite as much detail in other companies' 301 procedures. But we felt it necessary to have a formalized procedure that we can pull out [when we receive a complaint] and say, 'OK, these are the steps we need to follow.'"

(Clockwise from top left): **Sean Bowen**, vice president and general counsel, Internet Security Systems Inc.; **Mary Ellen Franklin**, senior vice president and senior legal advisor, SouthTrust Bank; **Joseph Aronica**, partner, Duane Morris; **Scott Burton**, corporate general counsel, ING North America Insurance Corp.

Training Days

Another important element is making sure that employees understand what they can and can't do in a corporate setting. An easy way to reach employees is by building a Web-based compliance-training program. This helps deflect complaints because employees are trained to do what is right. Web-based training makes it much easier for employees to do the training, they can do it on their own time, and the company can monitor who is and isn't doing the training.

As the vice president and general counsel of Internet Security Systems (ISS)—a network security company based in Atlanta—Sean Bowen helped his company implement a Web-based training program on compliance.

"We combined compliance education into one Intranet training program, which incorporates a broad range of ethical issues," Bowen said. "We coupled that with an e-mail broadcast worldwide from our CEO explaining how important this training is. It sets the tone for the rest of the company."

That training provided information about how to make reports of conduct violations directly or anonymously by phone or on the Web. Employees receive e-mails reminding them to take the training courses, and the company's computer tracks who has completed the training and passed the quizzes.

"The training equips employees to make reports that trigger investigations," Bowen said.

ISS only employs 1,200. Where some larger companies would have to implement very specific detailed procedures, the smaller ISS could be a little more lax when creating its compliance processes, according to Bowen.

"We have the flexibility to do things a little more casually, but still have similar

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—Mary Ellen Franklin
Senior VP and Senior Legal Advisor
SouthTrust Bank

processes with similar objectives in mind," Bowen said.

But no matter how big or small a company is, one common attribute in any successful ethics program is trust from within.

A Solid Foundation

Netherlands-based financial services company ING has spent years building ethics into its brand. As a major player in the financial services advisory environment, the company believes in building trust not only with its customers, but also its employees.

"Trust is the key component of what our company does every day," said Scott Burton, corporate general counsel for ING North America Insurance Corp., the U.S. subsidiary of ING. "Fortunately our home office in the Netherlands and our U.S. office have that same goal in mind."

The challenge ING faced when building its ethics plan was developing a process that was understandable to the company's many different cultures.

"We actually sat down and talked with people outside of legal to find out what type of language in a codebook would be readable and understandable to them," Burton explained.

While creating the codebook, which includes information on ethics and corporate compliance, ING tweaked each section to appeal to its respective audience.

"We use virtually the same codes of ethics in Europe, the United States, Argentina, Indonesia, what have you," he said. "It may be translated into different languages, and we also take into account local culture, but the message is consistent."

Burton believes this is why ING's internal investigations process is so successful. "When you have an open culture, you develop trust, and make it much easier to conduct an internal investigation because people are not worried about retribution," Burton said.

ING also implemented a 1-800 number its employees can call at any time to file a complaint.

"We made a big deal out of whistleblower protection," he said. "And we let them know that [reporting possible illegal activity] is something they could feel good about."

Participants agreed that a significant amount of time and energy go into handling internal investigations and audits. It's important that employees feel comfortable reporting misconduct. The key to successful business and good governance is internal trust.

"Ethics and compliance programs need to be taken very seriously," said Joseph Aronica, partner at Duane Morris in Washington, D.C. "Not just because of the severe consequences of somebody screwing up, but because you create a corporate culture that instills in your employees they ought to be good corporate citizens."

Mary Ellen Franklin, senior vice president and senior legal advisor at Alabama-based SouthTrust Bank agrees.

"At the end of the day, people are going to feel better about the company," said Franklin. "What's on everyone's mind is, 'Is my company abiding by the rules so that our credibility stays high.' Let's face it, Enron can happen again."

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