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## **ACC's CLO THINKTANK EXECUTIVE REPORT**

### **LAW DEPARTMENT'S ROLE IN FINANCIAL COMPLIANCE & RELATIONSHIPS WITH AUDITORS**

This Executive Report provides an overview of discussion results from ACC's CLO ThinkTank session titled "Law Department's Role in Financial Compliance & The Relationships with Auditors" held in Philadelphia, PA on March 24, 2006. ACC's CLO ThinkTank sessions are designed to provide a forum for CLOs who wish to exert greater leadership at the bar, in the courts, and in the halls of government on emerging issues of greatest concern. Following is summary information on key topics and takeaways, discussion point highlights, and follow-up initiatives identified by these private company CLO thought leaders.

ThinkTank participants included the following legal leaders:

- Brad Brubaker, Senior Vice President, General Counsel & Corporate Secretary, SAP America, Inc.
- Greg Butler, Senior Vice President & General Counsel, Northeast Utilities
- Steve Feder, Senior Vice President & General Counsel, Safeguard Scientifics, Inc.
- William Gallagher, Senior Vice President, General Counsel & Secretary, Crown Holdings, Inc.
- Don Liu, Senior Vice President, General Counsel & Chief Compliance Officer, Toll Brothers, Inc.
- Robert Lonergan, Vice President, General Counsel & Corporate Secretary, Rohm and Haas Company
- Mark McGuire, Vice President & General Counsel, Eaton Corporation
- Ken Pina, Former Senior Vice President, Chief Legal Officer & Secretary, Henkel Corporation
- Helen Pudlin, Senior Vice President & General Counsel, The PNC Financial Services Group
- Andrea Utecht, Vice President, Secretary & General Counsel, FMC Corporation

### **KEY TOPICS**

Below is a list of key topics discussed during this CLO ThinkTank session:

- **Compliance Structure & Certifications**
- **Reporting Compliance Matters**
- **Ethics Officers/Ethics Committees**
- **Litigation Reserves & Reports**
- **Relationships with External Auditors**

- **Growth by Acquisitions/ Integrating Financial Compliance & Culture**
- **Compliance Training**
- **Internal Investigations**

## **KEY TAKEAWAYS**

Thought leaders participating in this session described a number of ideas and practices. Listed below are some top themes and takeaways. Ideas on additional issues are described in the Discussion Highlights section below, and thoughts on action items are summarized in the final section on Conclusions & Proposed Action Items.

- Outside Auditors are implementing a range of practices in connection with engagement letters and lawyer response to audit letters, including range of practices implemented by same auditor but with different companies.
- Certification and sub-certification practices vary from company-to-company, and include range of programs that involve no certifications to those that involve certifications by all.
- Auditors and underwriters are requesting more detailed information, including information on litigation.

## **DISCUSSION HIGHLIGHTS**

### **COMPLIANCE STRUCTURE & CERTIFICATIONS**

Compliance Structure & Certifications/ Models: Participants describe various structural models for their compliance, legal and internal audit functions and requirements for compliance training and certifications. Some include having CLO provide knowledge sub-certifications (formal or informal) for areas of responsibility or for which CLO has knowledge. Level of industry regulation and size of law department may impact model. Some approaches are summarized below:

- Global compliance program with compliance as separate department led by a Chief Governance & Compliance Officer; mandatory biannual compliance training (for all employees and the Board). In addition, the company's program requires all employees around the world to sign annually a compliance certification regarding compliance with the company's Code and noting any exceptions, which are transmitted to the CLO and shared with the Board by the CLO as appropriate.
- Global compliance program that includes receiving certifications of compliance from U.S. employees and from business unit presidents for non-U.S. operations.
- Compliance program that does not include matrix of sub-certifications to support CEO and CFO certifications.
- Compliance program with Disclosure Committee that consists of leaders from various functional divisions, including the CLO. The Disclosure Committee is led by the company's CFO.
- Compliance program with Disclosure Committee that is chaired by the company's Chief Accounting Officer/Controller. The financial compliance process includes a senior disclosure review (undertaken by the company's operating unit presidents, the CLO and CFO). The organizational compliance structure also includes an internal controls committee.

Compliance Structure & Certifications/ Internal Audit: Among the reporting structures for Internal Audit are:

- Internal Audit reports to CEO and CLO (concept of reporting to CFO is viewed as a challenge)

- Internal Audit reports directly to Audit Committee of the Board, with a dotted-line to the Head of Risk Management, who in turn reports to the CEO
- Internal Audit reports directly to the Audit Committee of the Board, with a dotted line to the CFO

Compliance Structure & Certifications/ CCO: Participants describe various reporting structures for the CCO and whether the individual on point for compliance needs to have a CCO title. They also describe challenges associated with having the CLO as CCO, including separating budgets and maintaining testing and monitoring services separate from advisory services. Another issue is possible impacts to attorney-client privilege if CLO is CCO. Reporting structures range from:

- No CCO
- CLO as CCO (some by title; some de facto; some by virtue of Code)
- CCO is not part of legal dep't but reports to CLO
- CCO reports to CEO & Compliance Committee of Board
- CCO leads separate compliance dep't and reports to Vice Chair of the Board

Compliance Structure & Certifications/ Disclosure Review Committee: Some companies have a Disclosure Review Committee that helps determine matters for disclosure. The process involves asking employees to report matters that are material to their business and having the Disclosure Review Committee determine whether the matters are material to the company and require disclosure.

Compliance Structure & Certifications/ Approaches and Challenges: Participants identify challenges associated with implementing global compliance programs and requiring certifications from non-U.S. employees. One participant describes receiving some objections from U.S. employees on religious and/or political grounds. A participant notes working with European Works Councils to help develop the company's global Code. Another shares that compliance with the Code is considered a condition of employment and certifications must be provided or employees may be subject to termination; still another shares that compliance with the Code is required yet it has eliminated requirements for employee certifications. One participant's company implements practices that require employees to sign certifications as part of their performance reviews. An idea to help track awareness of the Code and the need to comply with it without an embedded certification requirement is to build capabilities into global compliance training modules that enable the company to determine who has completed the training even if certifications aren't included at the end.

Compliance Structure & Certifications/Ethics Officer and Committees: Some companies have a Chief Ethics Officer in addition to a Chief Compliance Officer. In noting the difference in the scope of responsibilities for these positions, compliance is identified as more rule-oriented. Two participants describe an Ethics Officer that reports to the Head of HR. Companies also implement practices that include having some sort of Ethics Committee comprised of top business and/or functional leaders, including the CLO. The Ethics Committee is described as an approach for dealing with major ethical or policy issues that allows key organizational leaders with different views to add perspectives and help make tough decisions. One participant described an annual practice that includes having the Head of HR/Ethics and the CLO review questionable issues identified on Conflict of Interest forms submitted each year.

#### REPORTING COMPLIANCE CONCERNS

Reporting Concerns/ Information to Board: Notion that amount of information to Board may impact definition of Board's role—whether it is oversight or management. Participants discuss relative merits and demerits of how Boards consider the quality and quantity of information received—both from a liability perspective and with regard to engaging in appropriate leadership functions.

One participant notes that all issues that are reported through the company's ethics line are communicated to the Board. Some have practices that include having the law department work the Audit Committee to develop protocols that describe the types of reported concerns that should be reported to the Board (examples include accounting issues, allegations against senior executives, etc.). Another practice includes reporting issues that could conceivably have some impact on the company's financial statement (without thresholds).

Reporting Concerns/Ombuds: Concept of having individuals in ombuds roles may help address questions or concerns. One participant notes that using ombuds practices has helped reduce EEOC claims.

Reporting Concerns/ Help Lines: Participants all have help lines that are administered by an external service provider. Practices to consider implementing to help monitor effectiveness of call intake is to test the help line system by making a call to see how the matter is processed and/or test the help line system as part of an internal audit.

#### LITIGATION RESERVES & REPORTS

Litigation Reports/ Board; Outside Auditors: Question as to whether outside auditors are excused from Audit Committee meetings when litigation reports are provided to Committee. For some, outside auditors may be present. Other approaches include: segmenting Audit Committee meeting agenda and having the CLO provide the litigation report to the Audit Committee in executive session; providing the litigation report to the company's Public Policy Committee (rather than Audit Committee); and providing information on significant litigation to the full Board. Having separate quarterly meetings on litigation with outside auditors is another practice.

Litigation Reports/ Underwriters: Question of whether underwriters are requiring disclosures that are more detailed than public disclosures, and whether joint defense-type arrangements among counsel may allow for additional detail when required.

Litigation Reports/ Outside Auditors & Reserves: The general sentiment is that auditors are looking for more justification for numbers. Companies are implementing a range of practices for setting litigation reserves, including quarterly meetings with auditors. Some outside auditors have taken the position that settlement offers should be viewed as a minimum for reserve purposes, but this raises difficulties because of a need for reasonable belief that the offer would be accepted. Example of how a settlement demand could be as unrealistic as a number included in a complaint. Some cases may be viewed as a corporate distraction where a company may be willing to settle the matter to avoid distraction but the number may not qualify as probable for reserve purposes and this situation can present additional challenges.

Litigation Reports/ Audit Response Letters from Lawyers: Outside auditors appear to be implementing a range of practices in connection with requiring audit response letters from in-house and/or outside counsel. Practices range from audit response letters from in-house lawyers only to audit response letters from both in-house and outside counsel. Some also require periodic 'bring-down' letters from in-house and/or outside counsel.

#### OUTSIDE AUDITOR ENGAGEMENT LETTERS

Outside Auditor/ Terms of Engagement: Provisions in audit engagement letters have changed post-Sarbanes Oxley. Among the provisions most heavily negotiated are: privilege, dispute resolution, and indemnification. These provisions can be negotiated and companies have had success in excluding ADR and limits on liability from the engagement letter. Several participants note practice of working with audit firm partners rather than more junior auditors. In addition, companies note an issue regarding disclosure of terms of engagement.

#### GROWTH BY ACQUISITIONS; INTEGRATING FINANCE FUNCTIONS

Growth by Acquisitions/ Timing to Integrate & Culture: Due diligence provides an opportunity to obtain baseline information on financial practices; however, there can be challenges associated with integrating corporate culture and tension between the finance and legal departments. An issue to consider includes how quickly to integrate the finance departments, and answering this question may depend in large part on operational issues. Another financial compliance issue area for consideration relates to corporate tax departments and related practices and interpretations.

#### COMPLIANCE TRAINING

Compliance Training/ Budget: Participants discuss where the budget sits for compliance training. If governance and compliance is on the CEO's budget rather than the law department's, then it may be easier to obtain the necessary budget for training.

Compliance Training/ Methods & Products: Participants use a broad range of compliance training practices, including web-based products (both off-the-shelf and customized). The law department often plays a role in pre-screening content. One participant's company tracked the preference for web-based vs live training and found a marked preference among employees for web-based training.

#### INTERNAL INVESTIGATIONS

Internal Investigations/Role of Law Department: Law department's role includes lawyers on internal audit teams, and some have lawyers lead investigations. In-house lawyers also provide training to internal audit members on preparing written communications and the distinction and significance between facts and conclusions.

Internal Investigations/ Who Takes Lead: Views on what entity should take the lead in conducting internal investigations vary and may depend on what expertise is at issue. One participant notes that the in-house finance department would generally take the lead on financial matters unless there are questions about conduct of internal resources and then forensic accountants may be brought in. Another participant notes that if the issue is significant, outside counsel would likely be engaged. Participants also note the merits of using companies that specialize in conducting investigations (as an alternative to outside counsel) and the possibility of conducting such investigations as privileged if the law department retains/directs the investigation. Additional practices include having a specialized outside counsel list of independent firms and using retired employees (for matters that might be considered 'routine') or security personnel (which might include retired FBI personnel).

#### CONCLUSION & PROPOSED ACTION ITEMS

The session ended with the CLOs sharing ideas on possible tools or action items, including:

- **Develop Resource on Compliance Training Programs:** with a focus on how to create a program that's practical, effective and sustainable.
- **Survey on Audit Engagement Experiences:** survey CLO members on experiences relating to negotiating and enforcing provisions in audit engagement letters.
- **Model Engagement Letter:** consider having ACC (perhaps in concert with other bar organizations) work with audit firms to create model audit engagement letter language.
- **Explore Strategic Resource Options for Smaller Companies:** concept is that larger companies may have more resources than smaller companies for e-learning initiatives; explore whether leverage in numbers or support resources on e-learning for smaller law departments.