

# Headline events put spotlight on compliance, risk and governance

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Recent headline-grabbing events have placed significant focus on the critical importance of sound compliance, risk and governance systems, in particular:

- tone at the top as a critical aspect of regulatory compliance;
- regulatory risk assessment and management;
- the importance of robust compliance procedures; and
- top management oversight.

The illegal voicemail interceptions (often referred to in the media as phone hacking) by *News of the World* have attracted huge media, police, parliamentary and public attention. The furore about the live cattle trade to Indonesia has also garnered a great deal of media attention. More recently, two Reserve Bank currency companies are expected to become the first Australian companies to plead guilty to paying multimillion-dollar bribes to high-ranking foreign officials.

What these events have in common is huge reputation damage and, in the case of the voicemail interceptions and the live cattle exports, huge damages/loss of income. News International has just had one of its flagship publications close, almost overnight, has lost the opportunity to purchase another major outlet, and may have worse to come in the way of criminal sanctions for very senior executives. The live cattle export trade to Indonesia, worth \$550 million last financial year, has been suspended. Some cattle producers in Western Australia,<sup>1</sup> burdened by a loss of income, will start selling up in the coming months as the industry continues to struggle despite the resumption of live cattle exports.

The above events do raise fundamental questions about the nature and effectiveness of the relevant compliance and ethics management systems, as well as legal and regulatory risk management and certain corporate governance issues. One would like to think that, had effective systems been in place, events may have turned out differently, with much less loss and reputational damage having occurred.

## Compliance management systems

### *Tone at the top*

The expression “tone at the top” has become a compliance mantra and rallying call for industry and

regulators in recognition of the significant influence that organisational leaders exert on employee attitudes and, as a consequence, on the entire range of organisational behaviours.<sup>2</sup>

The researchers for the SAI White Paper<sup>3</sup> asked interview participants how leaders could embed a culture conducive to compliance behaviour. According to these participants, it was not only important for organisational leadership to communicate regularly about compliance issues (*talk the talk*), but there must also be *congruence* between what leaders said and what they did (*walk the walk*). In essence, everyone in the organisation takes their cue from the top managers, and behaviour at the top profoundly influences organisational responses.

Some insight into the tone at the top in News International came from the evidence of Rupert Murdoch, chairman and chief executive officer of News Corporation, in his appearance before the House of Commons Culture, Media and Sport Committee. Mr Murdoch stated:

But I do believe that investigative journalism, particularly competitive, does lead to a more transparent and open society, inconvenient though that may be to many people. And I think we are a better society because of it. I think we are probably a more open society than even the United States.<sup>4</sup>

It would be reasonable to assume that the tone set by Mr Murdoch was that his media outlets engage in investigative journalism (a normal pursuit for a media outlet), but it begs the question of whether he set any parameters for such practices. Events at *News of the World* would perhaps suggest not. In this context, it is not so much the “why” but the “how”.

Some top managers may engage in “dog whistling”, in that they profess faux support for compliance but, at the same time, send signals that they are indifferent to how practices occur in the real world. A good example of this occurred in the celebrated Australian Competition and Consumer Commission (ACCC) cardboard box price-fixing case, and is summed up neatly in the following media commentary:

Sacked Amcor chief Russell Jones put pressure on executives to collude with Visy, according to one executive’s record of interview with the Australian Competition and Consumer Commission.

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The transcript, part of which has been obtained by *The Australian Financial Review*, reveals that Peter Brown, former managing director of Amcor Australia, told the ACCC in 2005 that Mr Jones had “[taken] me to task in front of the board about the low prices in corrugated boxes and how it was the most important thing to ensure the success of the business, so I felt extreme pressure to get prices up”.

Asked whether Mr Jones had said “go out and collude”, Mr Brown replied: “No, not at all, no, no, and it would not have been appropriate for him to say that in those terms anyway. But I was very, very clear in my own mind what he was looking for.”

ACCC general counsel Robert Alexander asked: “When you say you are clear in your own mind what he is looking for, he was looking for increased prices, was he?”

“Yes, and the only way to get those was essentially to collude with the competitor,” Mr Brown replied.

“I think that was everyone’s view. I don’t believe anybody who was involved in the business had a view that it was possible to achieve it in any other way.”<sup>5</sup>

Tone at the top is undoubtedly critical for a healthy culture of corporate compliance. The chief executive officer, the board chairman and the directors must be clearly seen by both word and practical example to set a culture of compliance within the organisation. But these behaviours alone won’t result in a compliant organisation. The unambiguous top corporate commitment to effective compliance must be backed up by a comprehensive compliance management system. For example, this author has developed such a system, which has 18 elements covering:

- **structural:** the compliance infrastructure or building blocks of a compliance system;
- **operational:** covering the day-to-day operations of the system, including operationalising procedures; and
- **maintenance:** monitoring processes to ensure that the system is kept in good working order.

I turn now to discuss some of the critical elements of a compliance management system.

## Risk assessment and management

An organisation needs to undertake a systematic assessment of its entire exposure to legal/regulatory risks, so that it is then in a position to manage these risks. One concern is that some enterprise management risk processes may put overall emphasis on financial risks and simply have a “blind spot” when it comes to assessing legal/regulatory risks. Regulatory compliance is now seen as an important risk to manage because breaches of laws can result in:

- loss or suspension of a licence to operate;
- imposition of conditions on a licence;
- large fines;

- harm to reputation through action by regulators in the courts;
- large legal fees in defending an action for a breach of the law; and
- lost opportunity cost (eg, executive time).

Those with responsibility for compliance need to collect and maintain a portfolio of information as a resource and reference basis to assist in identifying reasonably *foreseeable* regulatory risks. Information to drive this action this should include, but not be limited to:

- copies of relevant press releases/directives and policy changes from the regulators (eg, those that involve operators in the same industry, and issues that are relevant for the organisation’s industry);
- press clippings of any regulatory issues relevant to the organisation’s industry;
- complaints data with compliance implications;
- material from legal advisers (eg, changes to legislation and relevant case notes);
- online research data (eg, Google search for local and overseas regulatory issues relevant to the industry); and
- research on relevant legislation for consequences (eg, penalty and orders powers).

The compliance manager should prepare a précis of this material and circulate it to all risk assessment participants before the exercise.

One would guess that some elements of illegal voicemail interceptions should have been a foreseeable regulatory/legal risk for News International, and failure by abattoirs to follow recognised animal welfare rules should have been a foreseeable risk for Meat and Livestock Australia. The outcomes for both organisations suggest that such assessments were not undertaken and, even if they were, appropriate controls were not implemented or, at the very least, were not monitored.

Part of the risk management process is to develop processes not merely to identify foreseeable risks, but also to manage and control such identified risks.

## Compliance processes

Once regulatory risks have been identified, procedures need to be developed, implemented and monitored. Principle 9 of AS/NZ 3806, the standard on compliance programs, recommends that compliance procedures should include:

- documented operating policies and procedures;
- work instructions;
- systems and exception reports;

- approvals;
- systems of recommendations;
- segregation of duties; and
- system controls.

Behavioural processes aimed at producing compliant behaviour include the face-to-face training of “at risk” staff, employing real-life scenarios and interactive role playing, and the assessment of understanding. This may need to be backed up by mentoring and/or coaching to ensure a complete understanding of the way relevant rules operate in day-to-day activities.

A leading judgment by his Honour Justice French<sup>6</sup> in *Australian Securities and Investments Commission v Chemeq Ltd*<sup>7</sup> in the Australian Federal Court clarified the need for robust procedures which should be implemented and monitored. His Honour said:

In considering the appropriate penalty for the contravention by a corporation of a regulatory requirement, whether it be a requirement imposed by the [Corporations Act 2001 (Cth)] or the Trade Practices Act 1974 (Cth) or other regulatory frameworks, it is relevant to consider whether the corporation has in place policies and procedures designed to achieve compliance with such requirements.

*The Court will consider the form and content of the policies and procedures and also the measures adopted by the corporation to ensure that they are understood and applied.* A well drafted set of policies and procedures will mean little if there is no follow up in terms of training of company officers (including directors) and, where appropriate, refresher training. In the present case there is provision for induction training but no clear evidence of follow-up and refresher training.

Compliance policies and procedures will not be effective unless there is, within the corporation, a degree of awareness and sensitivity to the need to consider regulatory obligations as a routine incident of corporate decision-making. This kind of general sensitivity to the issues underpins what is sometimes called a “culture of compliance”. It does not require a risk averse mentality in the conduct of the company’s business, but rather a kind of inbuilt mental check list as a background to decision-making.<sup>8</sup>

James Murdoch indicated<sup>9</sup> to the House of Commons committee that every employee and every colleague around the world of News Corporation receives the code of conduct. It was, he said, a pamphlet that has some detail in it — but not too much, so that people read it. He added<sup>10</sup> that the company’s legal counsel also internally conducted workshops around the world with staff, from Mumbai to Manchester, around those rules and code of conduct. This is commendable, but it is important that it not be a one-off event, as employees soon forget the details. Mr Murdoch also did not address the question of how soon inductees to the company were trained on this important control mechanism.

If codes of conduct are to be anywhere near effective in gaining compliance outcomes, they must at least:

- be presented in a user-friendly and engaging format aimed at encouraging employees to embrace the communication as a useful business tool;
- address the organisation’s real-world, day-to-day identified legal and regulatory risks;
- have inductees trained on the code as soon as they join, and at least annually for all employees;
- employ “front-of-mind” techniques between the annual training programs to emphasise ethical dealings;
- contain prominent contact details for advice from experts, such as the compliance manager, in-house counsel and external lawyers;
- be readily accessible as a reference tool (intranet or brochure formats) that is *actually* and *actively* used;
- have penalties for serious infringements;
- include monitoring devices to detect breaches (eg, reporting hotlines); and
- be regularly revised, updated and overhauled, as new risks will emerge for any organisation.

## Top management oversight

Effective corporate governance involves direct, practical top management oversight.

A leading American authority on the issue of the liability of directors for failure to provide effective compliance systems in their companies is the decision of the Court of Chancery of Delaware in *Re Caremark International Inc.*<sup>11</sup> Caremark had contravened federal and state laws and regulations applicable to health-care providers. As a result, it paid out civil and criminal fines and made reimbursement payments totalling \$250 million. A derivative action was brought in 1994 against the directors, seeking recovery of those losses. The action was settled and the decision of the court was required to determine if the settlement was fair. The remarks made in the course of that decision led to the case being treated as an authority for the proposition that the failure to provide a compliance program may be a cause of action or head of civil liability to be sheeted home against individual company directors.

Many authoritative sources, including Principle 1 of AS/NZ 3806, highlight board/top management involvement. In fact, this element is critical if the compliance management system is not to be seen as mere window dressing. Indeed internal compliance structures — in the hands of a competent and committed management team — may play a central role in the organisation’s preventative approach to organisational misconduct.<sup>12</sup>

How should these tenets and principles of organisational behaviour become transformed and embedded in the real world?

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As stressed above, boards and CEOs set the tone at the top for a company. This means that top management must send clear signals that breaches, particularly deliberate and serious breaches, will *not* be tolerated, that offenders will be on their own if caught, and that they will be subject to dismissal. This should be not merely a one-off message, but constantly reinforced. In particular, employees should be clearly advised that they will not be indemnified for wrongful behaviour, as appears to have been the case with News International employees or contractors.

It also means that the board and the most senior management must do the following.

- Ensure that serious compliance breaches and, especially, regulatory concerns are escalated to them.
- Ensure that reporting systems to the board are in place and are not merely perfunctory or formulaic, and that reporting is timely. Reporting involves not only reporting non-compliance, but also reporting back against strategies to improve or rectify compliance.
- Understand compliance (education at all levels may be needed).
- Ensure that the compliance manager has access to all relevant board committees and to the board (and relevant documents), if needed.
- Provide resources to embed and empower compliance — ie, put board authority squarely behind compliance.
- Receive and *act upon* incisive reporting (not just “noting” it).
- Ask probing questions at board meetings, such as: “What are the identified or identifiable risks and relevant mitigating actions if the board acts upon this recommendation?”
- Have access to *and utilise* actual compliance expertise.

The questions that directors need to ask include the following.

- What are our high regulatory risk areas, particularly in terms of severity impact on the business? Are there risks involving reputation, damages, criminal sanctions, regulatory intervention, loss of market share, and costs of remediation?
- Are these risks regularly reviewed?
- What controls are in place to manage these risks?
- Are the controls still adequate?
- Do these controls mesh with the company’s commercial goals? If not, why not?

- Is there any pushback/resistance by staff on compliance processes? If so, what is being done about this?
- Are there enough resources to cover these risks, and all possible abatement and treatment and management systems?
- Are these systems cost-effective?
- What are the “hot” regulatory issues, and how is the company placed in relation to these?
- What are the messages/policy directions coming from the regulators?

A telling indicia of commitment from top management is the adequate resourcing of the compliance function.

## Conclusion

If a CEO or director has not turned his or her attention to leading ethically by example — ensuring that a rigorous regulatory risk assessment has been undertaken and that appropriate controls have been implemented, with accountability mechanisms set in place — then he or she runs a real risk of reputation harm extending to damaging media coverage and associated monetary loss and damages.



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## Footnotes

1. AAP, “Cattle producers begin selling up in Western Australia”, [News.com.au](http://News.com.au), 31 July 2011.
2. SAI Global, *White Paper: Leading Contemporary Compliance — Control, Cooperation or Collaboration*, Compliance Culture Research Project, p 1.
3. Above note 2, p 4.
4. House of Commons, oral evidence taken before the Culture, Media and Sport Committee, uncorrected transcript, 19 July 2011, p 39.
5. Drummond P, “Price fixing ‘pressure’ with Amcor”, *Australian Financial Review*, 15 October 2007, p 3.
6. Then a Federal Court judge, now Chief Justice of the High Court of Australia.
7. *Australian Securities and Investments Commission v Chemeq Ltd* (2006) 234 ALR 511; 58 ACSR 169; [2006] FCA 936; BC200605606.

8. Above note 7, at [84]–[86], emphasis added.
9. House of Commons, above note 4, p 16.
10. House of Commons, above note 4, p 17.
11. *Re Caremark International Inc* (1996) 698 A 2d 959.
12. Krawiec K D, “Organizational misconduct: beyond the principal–agent model” (2005) 32 *Florida State University Law Review* 571, p 614.