

**ARNOLD & PORTER**

# **Corporate Responsibility and Compliance After Enron and Sarbanes-Oxley**

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# Overview

- Take-Away Messages from the Enron, WorldCom and Sarbanes-Oxley (S-Ox)
- The Intersection of Sarbanes-Oxley and Compliance Program Standards
- Key Sarbanes-Oxley Issues for Compliance Professionals
- HHS OIG Initiative on the Role/Responsibility of the Board for Compliance Program
- Future Issues

# Take-Away Messages from Enron, etc.

- Regulators and enforcement agencies are under tremendous pressure to take a hard line against corporate wrongdoing. This has important ramifications for companies in heavily regulated industries (like healthcare).
  - Example: Practices once tolerated by agencies may now be the focus of civil or criminal investigations -- even though the underlying law or regulation has not changed.
  - Example: Agencies are less likely to give companies the benefit of the doubt in “gray” areas.
- Enron, like Watergate, demonstrates the age-old adage: The cover-up is worse than the initial crime.

## Take-Away Messages (cont'd)

- A well-written Code of Conduct or Compliance Program Manual does not constitute an effective compliance program.
  - Enron had a strong Code of Conduct -- at least on paper
  - Andersen had a detailed policy on document retention
- Compliance with legal and regulatory requirements is a minimum -- the best companies focus on values- and ethics-based leadership.

# **Intersection of Sarbanes-Oxley and Compliance Program Standards**

## Intersection of S-Ox and Compliance Programs

- A number of the key provisions in Sarbanes-Oxley (and related corporate governance rules) overlap with the basic elements of an effective compliance program.
- A number of these provisions are applicable to both public and privately held companies.
- Companies can and should leverage their existing compliance programs to meet S-Ox requirements.
- In the best of all worlds, companies will use S-Ox to conduct a broader review of their governance and compliance programs.

# Corporate Governance vs. Compliance Program Requirements

Compliance Program Elements (HHS OIG, USSC)	Sarbanes-Oxley, Listing Standards
Compliance officer and committee	<ul style="list-style-type: none"><li>• New Audit Committee duties</li><li>• New duties for Chief Legal Officer</li></ul>
Compliance policies and procedures	<ul style="list-style-type: none"><li>• Requirement for internal controls report, attestation by outside auditor</li><li>• Requirement for Code of Ethics</li><li>• New Financial Code of Conduct</li></ul>

# Corporate Governance vs. Compliance Program Requirements

Compliance Program Elements (HHS OIG, USSC)	Sarbanes-Oxley, Listing Standards
Education and training	<ul style="list-style-type: none"><li>• No specific new requirements.</li></ul>
Internal lines of communication & reporting	<ul style="list-style-type: none"><li>• S-Ox requirement for anonymous reporting of financial fraud</li><li>• S-Ox protection for whistle-blowers</li><li>• Lawyer reporting rules (internal)</li></ul>

# Corporate Governance vs. Compliance Program Requirements

Compliance Program Elements (HHS OIG, USSC)	Sarbanes-Oxley, Other Rules
Auditing and monitoring	<ul style="list-style-type: none"><li>Extensive new requirements on internal controls environment (which could extend beyond financial reporting issues)</li><li>Record/document retention rules</li></ul>
Enforcement of disciplinary standards	<ul style="list-style-type: none"><li>No specific new requirements</li></ul>

# Corporate Governance vs. Compliance Program Requirements

Compliance Program Elements (HHS OIG, USSC)	Sarbanes-Oxley, Other Rules
Response and remediation	<ul style="list-style-type: none"><li>• Lawyer internal reporting provisions</li><li>• Provisions requiring officers to report potential violations</li></ul>

# **Corporate Governance and Oversight**

# Corporate Governance & Oversight: Audit Committee

- Audit Committee and Independent Directors given new responsibilities for corporate governance and oversight, along with new authorities to meet these obligations
- New Audit Committee Authorities:
  - Can hire independent counsel, financial experts, and others
  - Company must provide funding
  - Outside counsel/exports work directly for, and report to, Audit Committee

# Corporate Governance & Oversight: Audit Committee (cont'd)

- New Audit Committee Responsibilities (partial list):
  - Complaint Procedures: Must establish procedures to receive and address complaints regarding accounting, internal accounting controls and auditing issues.
  - Procedures include providing mechanism for employees to submit concerns -- on a confidential, anonymous basis -- regarding questionable auditing or accounting matters.
  - Oversee “internal control report” in annual reports.

## **Written Policies and Procedures**

# Standards of Conduct

- Sarbanes-Oxley requires companies to develop a Code of Conduct for senior financial executives
  - Limited to certain financial personnel
  - Changes to/waivers from Code require reporting to SEC
- New NYSE and Nasdaq Listing Standards require companies to have Codes of Conduct addressing a wide range of substantive topics, including (partial list):
  - conflicts of interest
  - confidentiality
  - protection and proper use of company assets
  - compliance with the Code and consequences for violations

# Internal Controls and Disclosures



## Financial Reporting & Disclosure: Sec. 302 -- CEO/CFO Certifications

- CEO and CFO must certify that annual report complies with securities laws and that information in it **“fairly represents, in all material respects, the financial condition and results of operations”** of the company.
- Criminal penalties for knowingly false certification.
- “Fairly presents … the financial condition” may not be synonymous with GAAP compliance.

# Financial Reporting & Disclosure: Sec. 404 – Internal Controls Report

- Internal control report states management's responsibility for establishing and maintaining adequate internal control structure and procedures for financial reporting
- Management must assess effectiveness of internal control structure and procedures for financial reporting as of the end of the most recent fiscal year
- Attestation by external auditor (Section 404 and 103)

## Financial Reporting (cont'd)

- Certifying officers must disclose to the company's auditors and to the Audit Committee:
  - All significant deficiencies in the design or operation of internal controls;
  - Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal controls; and
  - Significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses

# Financial Reporting (cont'd)

- **Internal Control** is defined (in COSO and US auditing standards) as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:
  - *Effectiveness and efficiency of operations*
  - *Reliability of financial reporting*
  - *Compliance with applicable laws and regulations*
- The scope of disclosure controls and procedures includes all financial reporting controls along with operational and compliance procedures to the extent that these controls generate *either financial or non-financial* disclosures in a filing.

# **Document Retention and Management**

# New Provisions on Document Retention and Destruction



18 U.S.C. § 1519: “Whoever knowingly alters, destroys . . . with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any [U.S.] department or agency . . . or in relation to or contemplation of any such matter or case . . .”

# Obstruction Statute -- Key Issues

- Applies to obstruction involving any offense -- not just securities law/accounting offenses
- Interpretation of “in relation to” -- clearly covers more than pending investigations, but how much more is unclear
- Particularly important for compliance professionals and lawyers (generally not involved in initial misconduct, but likely to be involved in subsequent investigation/mitigation activities)
- Prosecutors place high priority on obstruction cases (e.g., Enron/Andersen)

# New Provisions on Document Retention and Destruction



18 U.S.C. § 1512(c): Whoever corruptly --

(1) alters, destroys, mutilates, or conceals a record, document, or other object, or attempts to do so, with the intent to impair the object's integrity or availability in an official proceeding; or

(2) otherwise obstructs, influences, or impedes any official proceeding or attempts to do so,

shall be fined under this title or imprisoned not more than 20 years, or both.

# Protecting Against Obstruction of Justice Claims for Destruction of Documents

- Need to develop a business justification for every element of the document retention plan
- Document retention program should exempt from destruction all documents that could be used in future investigations

# **Whistleblower and Related Provisions**

# Whistleblower Protections

- Sweeping new protections for whistleblowers -- need to be reviewed in conjunction with new internal reporting requirements
- Two new provisions to protect whistleblowers
  - 18 U.S.C. § 1513 (criminal)
  - 18 U.S.C. § 1514A (civil)



# Whistleblowers -- Criminal Offense

- 18 U.S.C. § 1513: “Whoever knowingly, with the intent to retaliate, takes any action harmful to any person . . . for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense . . .”
- Key elements of new 18 U.S.C. § 1513(e):
  - Knowing and intentional action to retaliate
  - Against any person (not just an employee)
  - Providing truthful information relating to commission or possible commission
  - A law enforcement official (not just a Federal agent)
  - Regarding any Federal offense

# Whistleblowers -- Civil Statute

- New civil provision (18 U.S.C. § 1514A):
  - Prohibits a company from sanctioning an employee because of any lawful act to provide information about “fraud against shareholders” to (1) a Federal agency, (2) Congress, or (3) employee’s supervisor.
  - Prohibits a company from sanctioning an employee because of any lawful act to “file, cause to be filed, testify, participate in, or otherwise assist in” any proceeding relating to alleged violation of federal law relating to fraud against shareholders.

## Whistleblower -- §1514A (cont'd)

- Modeled after airline safety reporting systems
- Authorizes civil action for damages and equitable relief, including reinstatement, back pay, attorneys' fees, etc.
- 90-day statute of limitations: employee must file claim within 90 days of retaliation with the U.S. Department of Labor.

## **Future Issues**

## HHS OIG Initiative: Board Role in Compliance

- Innovative effort by the HHS Inspector General to promote greater involvement in corporate governance and compliance issues at the Board/Trustee level.
- Effort recognizes that some Directors/Trustees don't fully appreciate their legal responsibility for ensuring that their company has compliance systems and procedures in place.
- Compliance officials should use this to prompt a thorough discussion of compliance program issues.

# Future Issues for Compliance Professionals

- Identify how new Corporate Governance rules intersect with Compliance Program activities (e.g., Codes of Conduct)
- Use HHS OIG initiative to prompt/advance discussion with the Board and Senior Management
- Ensure appropriate coordination of overlapping activities (e.g., new whistleblower, internal reporting requirements)
- Analyze heightened risks associated with internal investigations, document retention issues
- Remember, rules are a minimum -- experience shows ethics- or values-based programs are more effective from a compliance AND business perspective