

LexisNexis® Emerging Issues Analysis

Steven A. Lauer on

The Compliance Department Budget and Value Maximization

2009 Emerging Issues 4378

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Gabe Shawn Vargas establishes a viable basis with which to construct a budgetary foundation for an effective compliance program. See Gabe Shawn Vargas, *Budgeting and Cost Control Strategies and the Compliance Program*, in 1 Carole Basri, Corporate Compliance Practice Guide: The Next Generation of Compliance § 24.01 (Matthew Bender 2009). As valid and reliable as that construct may be, however, it must rest, in turn, upon a more basic concept: the value of such a program. Moreover, in order to serve as the basis for such a program, that value must be agreed upon by the relevant corporate constituencies. Knowing what an effective compliance program contributes toward achieving a company's business goals, and toward preventing occurrences that can stand in the way of achieving those goals, can provide the justification needed to secure adequate resources for such a program and to secure the budgetary authority that Gabe rightly asserts is necessary for any chief compliance officer. This might help avoid the trap identified by Gabe: being "dependent—as was sometimes the case in older days—on a more hand-out or catch-as-catch-can approach to compliance budgeting."

The value of such a program must be measured in the context of the legal requirements for, and restraints on, a corporate compliance program. As discussed below, for example, the Sarbanes-Oxley Act and the regulations issued thereunder, and the Sentencing Guidelines for Organizational Defendants and the views of federal prosecutors call for the authority of a chief compliance officer that matches up against their mandates. Shortchanging the compliance function arbitrarily risks greater governmental intrusion into a company's operation than the "savings" so recognized would suggest.

How can you establish the "value" of such an effort? In retrospect, one can easily assign a value, or at least establish some conception of the benefits that do or can flow as a result of not having such a program. How valuable would have been a compliance program that could have prevented or minimized the legal and moral transgressions that the name "Enron" now conveys? Had an effective compliance program existed, might the accounting frauds at WorldCom or Adelphia been less severe? The collapse of a company resulting from such frauds and massive failures of moral or ethical leadership serves to illustrate the possible effect of the absence of an effective compliance program.

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The value of a corporate compliance program relates directly to the compliance-related challenges that the organization faces or might face. Does it do business subject to regulatory oversight? Does its operation attract significant government or media or public attention for other reasons? Do its activities implicate or pose a potential threat to public safety or welfare? In other words, to establish a value for a compliance program, you need a clear picture of the ways in which the company might run afoul of laws, regulations and applicable policies or procedures. In other words, a comprehensive assessment of the compliance-related risks that the organization faces constitutes a necessary predicate to a defensible determination of value.

To determine in advance, however, how much a program contributes—or can contribute—to achieving a company's business goals represents a much greater challenge. Many try to do so by proving a negative, akin to the process suggested in the preceding paragraph, by delineating the effects of compliance lapses elsewhere and arguing, in essence, that "there but for the grace of god go we." Such an argument likely will fall on deaf ears, especially in a trying financial environment such as this. A more positive case will be more successful.

What positive case for compliance can one make? Can you establish prospectively the benefits that will flow from an effective compliance program? What potential benefits can a compliance program offer?

- An effective compliance program can serve as the basis for a credit against the sentence possible upon conviction of a federal crime under the terms of the Sentencing Guidelines for Organizational Defendants issued by the United States Sentencing Commission.
- While conviction of a federal crime remains a remote possibility for most companies even in a time of increased regulatory and prosecutorial focus on business, an effective program might serve to dissuade a United States Attorney (*i.e.*, the prosecutors of federal crimes) from prosecuting the company under the analysis contained in the Department of Justice's "Principles of Federal Prosecution of Business Organizations," contained in that department's Criminal Resource Manual."¹

1. See http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/28mcrm.htm#9-28.710. Those guidelines call on "prosecutors [to] determine whether the corporation has provided for a staff sufficient to audit, document, analyze, and utilize the results of the corporation's compliance efforts."

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- Beyond possible prosecution, a compliance program includes several elements that should contribute to better performance of a company, including employee training, an increased focus on accountability for compliance lapses, communications tools and channels by which employees can raise issues related to corporate performance², greater transparency regarding corporate operations and financial strength³, and appropriate responses to identified compliance lapses.⁴

In addition to establishing a value-based foundation for its budget as the best means of ensuring continuing support for its role, a compliance department must consider the extent to which it is able to secure the resources that it needs going forward without going "hat in hand" to other parts of the organization that may have divergent interests. This need of a chief compliance officer for budgetary authority and some flexibility for securing assistance arises very acutely in respect of independent advisors. The Sentencing Guidelines for Organizational Defendants, which set out the accepted elements of an effective compliance program, call for "[s]pecific individual(s) within high-level personnel [to] be assigned overall responsibility for the compliance and ethics program" and for "[s]pecific individual(s) within the organization [to] be delegated day-to-day operational authority for the compliance and ethics program." The individual with operational responsibility must have "adequate resources, appropriate authority, and direct access to the governing authority [*i.e.*, the board of directors of a corporation] or an appropriate subgroup of the governing authority."

In the context of its regulations under §301 of Sarbanes-Oxley, the SEC explained that "[a]n audit committee must have the necessary resources and authority to fulfill its function... To perform its role effectively, ... an audit committee may need the authority to engage its own outside advisors, including experts in particular areas of accounting, as it determines necessary apart from counsel or advisors hired by management, especially when potential conflicts of interest with management may be apparent." This

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2. While such tools, such as a whistleblowing hotline, are typically viewed as relevant only to reporting criminality or possible criminality or ethical lapses, they can also serve as mechanisms by which to identify possible operational improvements that might otherwise be missed, as has been done by at least one company to the author's knowledge.
 3. Greater transparency regarding such issues served as a primary goal of the Sarbanes-Oxley Act of 2002 and regulations issued by the Securities and Exchange Commission pursuant to that statute's mandate.
 4. These elements of an effective corporate compliance program are delineated in greater detail in the Sentencing Guidelines for Organizational Defendants earlier cited.

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is as true of the chief compliance officer himself or herself. The compliance program might identify an issue or a matter that creates or illustrates a conflict between one or more individuals and the company or between the compliance department and another part of the organization. Whether or not such a conflict has been identified or exists, however, the appearance of any undue influence on the compliance department on the part of another part of the company could adversely affect the credibility of any action that the compliance department might take and even cast a shadow on the compliance department itself. The selection of expert advisors for a particular inquiry or other matter, including counsel, should be independent of—and be seen to be independent of—undue influence by parties whose interests might be implicated in that inquiry or matter. Even review by a company's law department of invoices submitted by the compliance department's counsel could impugn the independence of that inquiry by creating the possibility of inappropriate influence on counsel's conduct of the matter.

In short, while addressing the budgetary issues raised by Gabe, work to establish, in the mind of corporate management, the ways in which the compliance department and program assist the company to achieve its business goals most expeditiously and, from both legal and governmental perspectives, securely. Too sharp a budgetary knife can result in cutting off too much, to the company's long-lasting regret.

For More Information

See Gabe Shawn Vargas, *Budgeting and Cost Control Strategies and the Compliance Program*, in 1 Carole Basri, *Corporate Compliance Practice Guide: The Next Generation of Compliance* § 24.01 (Matthew Bender 2009).

See Steven A. Lauer, *Setting Up a Hotline*, in 1 Carole Basri, *Corporate Compliance Practice Guide: The Next Generation of Compliance* § 9.01 (Matthew Bender 2009).

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Services in Charlotte, North Carolina for over two years. Previously, he served for over two years as Director of Integrity Research for Integrity Interactive Corporation, in which capacity he conducted research, wrote white papers and otherwise worked with clients and potential clients of the company on issues related to corporate ethics and compliance programs. He also spent over two years as Executive Vice President, Deputy Editor and Deputy Publisher of The Metropolitan Corporate Counsel, a monthly journal for in-house attorneys. He received a B.A. from the State University of New York at Buffalo and a J.D. from Georgetown University Law Center.

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