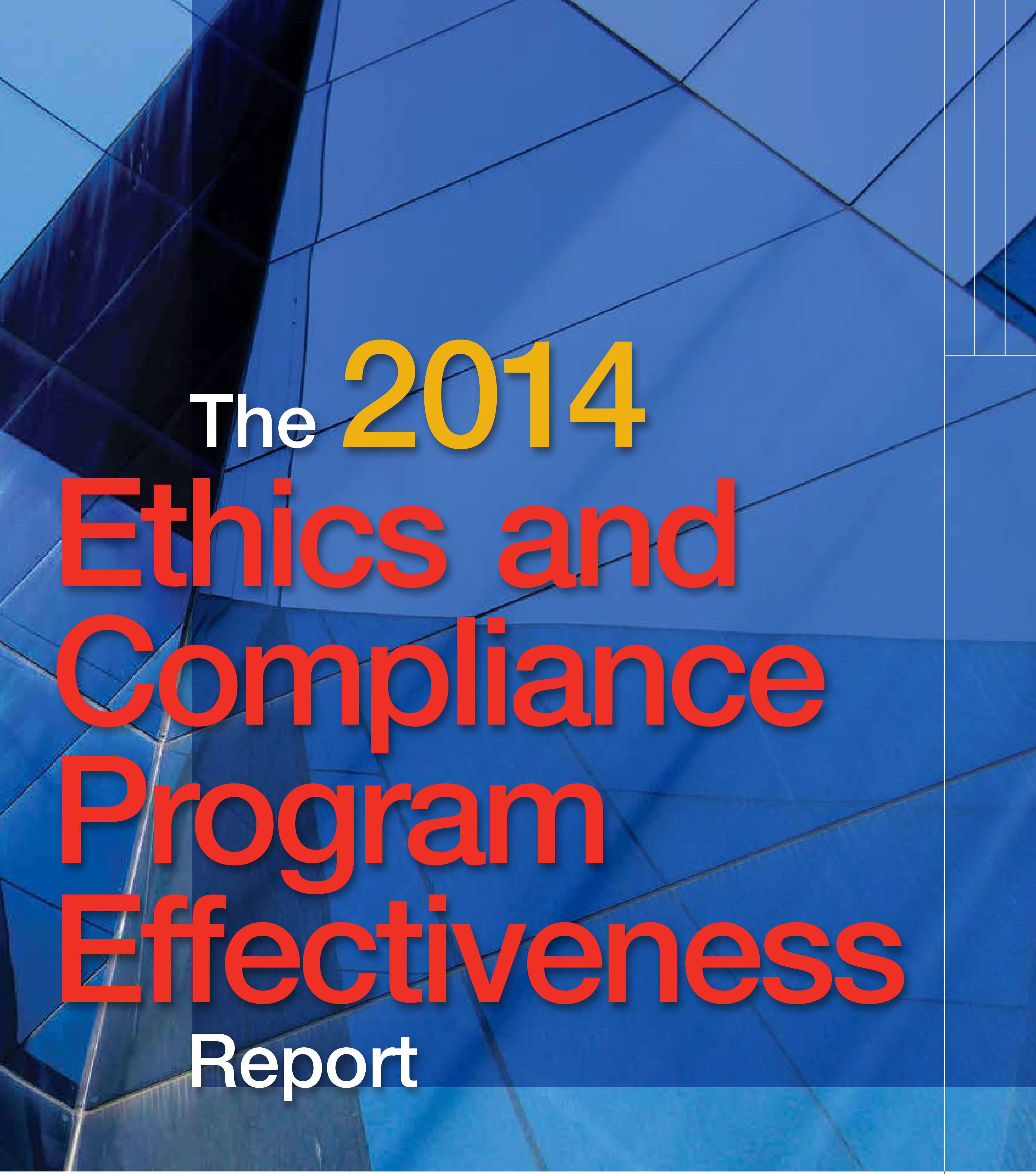


The 2014 Ethics and Compliance Program Effectiveness Report

LRN® Inspiring Principled Performance℠

Contents

3 **Introduction**

4 **The Ongoing Development of the Program Effectiveness Index**

5 **How to Read This Report**
The Index
Comparing the Top 20 Percent to the Bottom 20 Percent
Statistical Significance

7 **Of Effectiveness and Impact**

8 **Context Matters**
Reporting Structures
Tone v. Tone: What Matters Most
Celebration and Impact
Program Goals Matter, Too
Built-In Is Better Than Bolted-On

14 **The Hallmarks of an Effective Program**
Not All Hallmarks Are Created Equal
The Hallmark Hallmark
Not All Programs Are Created Equal

18 **Above and Beyond**

21 **Program Management**
Budgets and Resources
E&C 2014 Budget Adjustments
Regulation and Headcount

23 **Program Management Matters**
Program Assessment
Risk Assessment
Goals, Metrics and Tools: More Matters

26 **Education and Communication**
What's the Point?
Who Gets What and How Much

30 **The 20 Things Most Everyone Does**

32 **Conclusion**

33 **Methodology**

34 **Demographics**

The 2014 Ethics and Compliance Program Effectiveness Report

LRN has conducted its annual survey of Ethics and Compliance (E&C) programs for seven years. That has involved collecting in-depth information on a wide range of issues, behaviors, and program attributes from a diverse and representative sample of programs around the world. Throughout that period, the survey report has been a very popular source of information for E&C practitioners in search of benchmarking data, suggestions of leading practices, and trends. During that same period, LRN developed a robust analytics practice, employing data scientists, organizational psychologists, and statisticians (among other experts) to expand our capacity to measure, analyze, and influence corporate cultures. Members of that practice have spent years exploring the elements of organizational culture (clusters of behaviors) that drive specific outcomes, including those closely associated with compliance and other aspects of ethical conduct.

Late in 2012, we began to explore new ways to examine the E&C survey data. We knew what programs did, statistically and based on our own deep experience. But we were in search of a better means to show what works. The Program Effectiveness Index (PEI) was born as a result of that search; the first serious, comprehensive analysis of "program effectiveness" in terms of its impact on the behaviors and attitudes that make up organizational culture.

For at least the last decade, since the promulgation of the 2004 edition of the *Federal Sentencing Guidelines Manual,* E&C practitioners have understood the need for the periodic assessment of program effectiveness. Despite several references to the importance of regular evaluation, the guidelines provide little insight into the meaning of "effectiveness." So among those programs attending to the matter, the evaluation in question has most often been relegated to confirmation that each of the structural elements to which the *Guidelines* make reference has been addressed. Such confirmation now usually also extends to best practices identified by the Organization for Economic Cooperation and Development (OECD) in its *Good Practice Guidance on Internal Controls, Ethics, and Compliance* and within the guidance issued by the U.K. Ministry of Justice in relation to the U.K.'s Bribery Act 2010.

While not insignificant, these checklists for program design and implementation beg the underlying question: Has the E&C program actually promoted an organizational culture that encourages ethical conduct and a commitment to compliance? Put simply, has it worked?

"Due diligence and the promotion of an organizational culture that encourages ethical conduct and a commitment to compliance with the law within the meaning of subsection (a) minimally require the following:… The organization shall take reasonable steps…to evaluate periodically the effectiveness of the organization's compliance and ethics program."

Federal Sentencing Guidelines Manual Sect. 8B2.1(b)

The Ongoing Development of the Program Effectiveness Index

PEI

The evolution of the PEI is ongoing. This year's index rests on eight elements, as opposed to five last year. In addition, several new questions and potential answers were added to the survey specifically to address program impact. (Methodology is discussed in detail on page 33.)

The resulting data collection and analysis have opened up new opportunities for insight, though they have limited comparability with prior periods. For example, this year the mean PEI score is 0.60, while it was 0.71 last year, simply as a result of the new index calculation and certain other changes in the methodology. We believe the trade-off is worthwhile.

How to Read This Report

The Index

Broadly speaking, the PEI is built on eight data points reflecting the degree to which the particular program does the following:

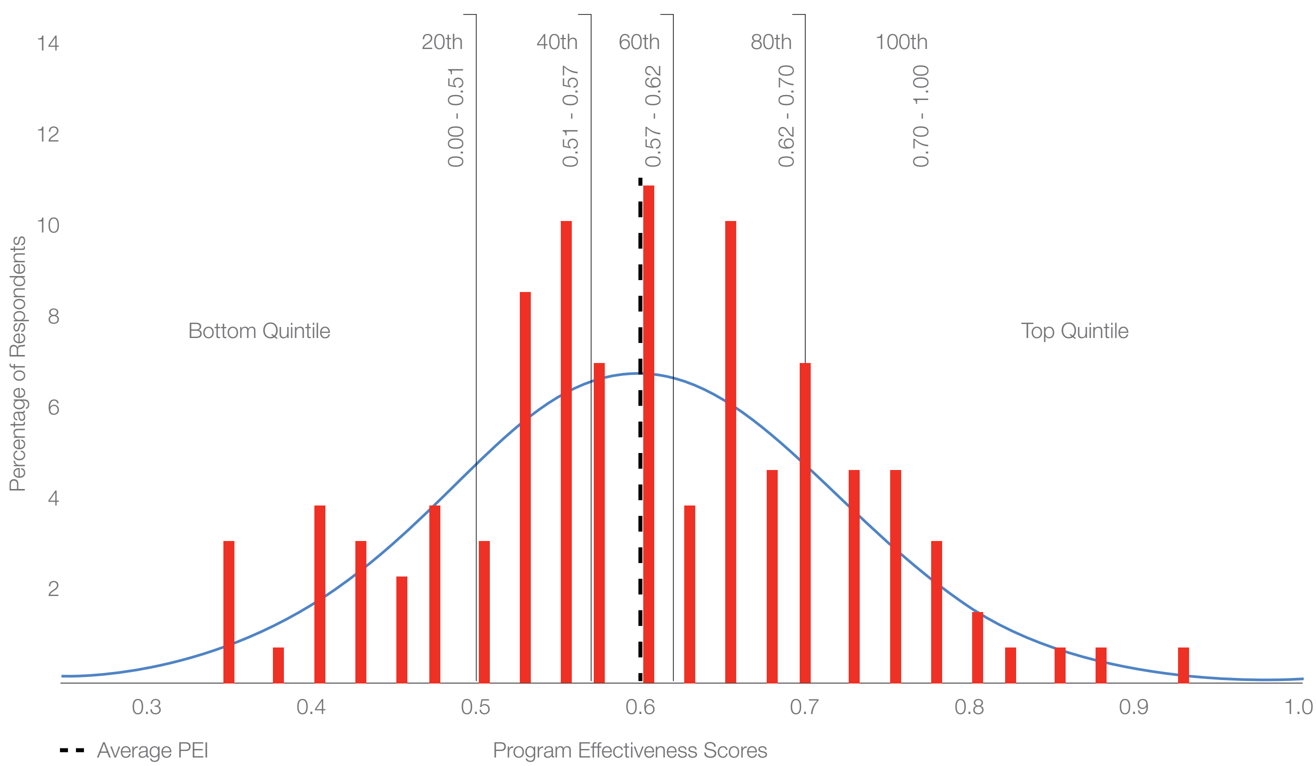
- Actively supports the achievement of business goals;
- promotes ethical culture and values-based behavior; and,
- provides and promotes a code of conduct and practical education that impact employee decision-making.

Individual programs are given an index score, between 0 and 1, from least impact to most, based on how well they accomplish these goals. They are ranked against one another accordingly.

Salient data is discussed in terms of "average PEI scores" of programs reporting a particular behavior and attribute—for example, programs that annually conduct a formal self-assessment have an average PEI score of 0.64. In doing this, we are not suggesting causation. Annual self-assessment by itself won't make a program effective. Rather, we are reporting correlation; whether or not, and to what degree, the presence or absence of a particular behavior or attribute is associated with more and less effective programs. In the example, because 0.64 is well above the mean (which is 0.60), we know that an annual, formal assessment is associated with high impact programs, especially when we also consider that programs that never conduct one have an average PEI score of 0.54, far below the mean.

Some program behaviors or attributes have no correlation of note to the PEI. We've only mentioned a couple of those, such as total spending and company size, because in those examples, the absence of correlation is interesting.

PEI Score Distribution



Among responding industries that are well represented, aerospace & defense has the highest mean PEI score (0.70), and chemicals has the lowest (0.49). This might reflect the long history of E&C in the aerospace & defense sector, which stretches back at least as far as the Defense Industry Initiative in the mid-1980s, and the relatively more recent and less multi-faceted regulatory requirements faced by the chemicals industry.

Comparing the Top 20 Percent to the Bottom 20 Percent

The correlations revealed by the many average PEI scores help point the way to program effectiveness. They do not, however, reveal much about best practices—or worst. For that, we compare the top quintile (the 20 percent of programs with the highest index scores, or "most effective" programs), against the bottom quintile (the 20 percent "least effective"). We compare what they report in relation to particular behavior and attributes. In our example, we see that 43 percent of programs in the top quintile conduct a formal assessment annually, while only 16 percent of those in the bottom quintile do so.

Statistical Significance

One other note about average PEI scores: Not all findings are equal. There are a number of statistical tests for the significance of a particular finding, and we have used two of them to determine which were worthy of particular attention. See the methodology section on page 33 for further detail. Each item reported on here was above the generally accepted threshold for statistical significance. Reported results without colored highlighting should be seen to have a statistical significance between 68.3 percent and 95.4. Results highlighted in yellow have a statistical significance between 95.5 percent and 99.7 percent. Highlighted in blue are results with statistical significance above 99.7 percent.

Returning to our program assessment example, the text of the discussion is highlighted as follows:

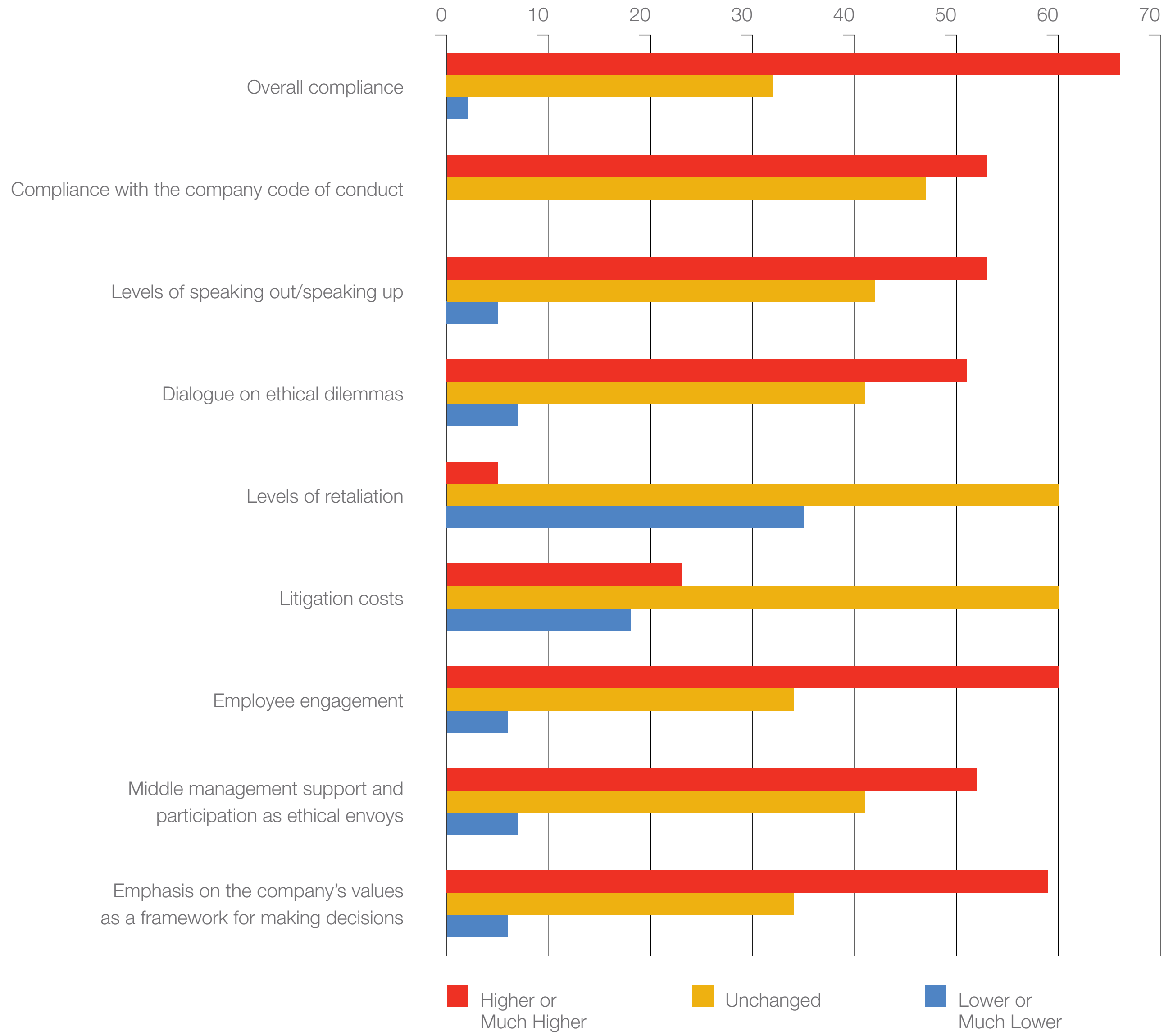
The first finding is highlighted in yellow, indicating that it has a very high statistical significance: *At an average PEI score of 0.64, those programs conducting such an assessment annually seem to have found a process that works.* The next finding is not highlighted, meaning that it has notable statistical significance: *Programs conducting assessments every other year have, on average, PEI scores above the norm, but average program effectiveness goes rapidly downhill for those assessing on an ad hoc basis (0.58), who never do (0.54) and…*While the last finding, highlighted in blue, has an even higher level of significance than the first:… *for those who don't seem to recognize the requirement ("don't know" at 0.47.)*

Benchmarking data, focused on what programs do and how they do it, is identified and discussed throughout the report, and the complete collection of information for 2014 is also available at **www.lrn.com/the-2014-ethics-and-compliance-program-effectiveness-report.**

YELLOW HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE BETWEEN 95.5 AND 99.7 PERCENT.

BLUE HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE ABOVE 99.7 PERCENT.

Figure 1. Changes Noted Over a Three Year Period for a Variety of Compliance-Related Outcomes



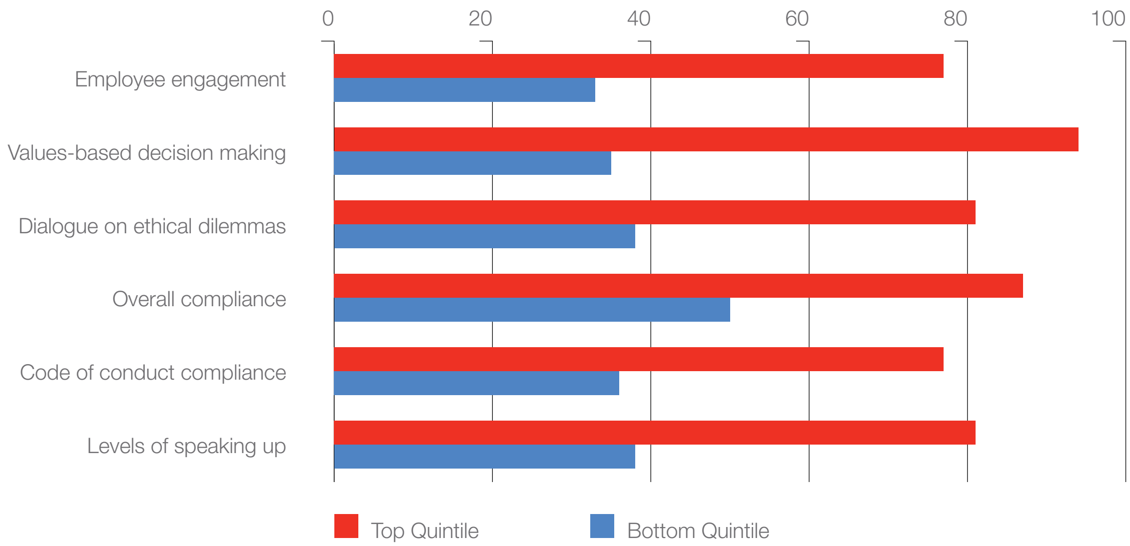
Of Effectiveness and Impact

For two thirds of respondents to our 2014 survey, overall compliance has improved over the last three years. Not surprisingly, the average PEI scores of those seeing overall improvement is above the average for the whole sample. Most respondents (53 percent) also report increased levels of code of conduct compliance, and average PEI scores vary widely between those who do (0.63) and those who report no gain (0.56).

Many steps forward, just a few back, and still a long way to go: Most programs report progress on the outcomes they are intended to influence, but a good many do not. With just over half reporting increases in key areas like employees' willingness to speak up and the tone in the middle, there remains much work to be done.

The relationship between PEI score, our measure of program effectiveness, and outcomes is even more pronounced at either end of the scale. The top quintile—the most effective programs as measured by the PEI scores—are more likely to see higher or much higher levels of desired outcomes than the bottom quintile by wide margins:

Figure 2. The Percentage of Programs Reporting Higher or Much Higher Levels of Key Outcomes Over the Past Three Years, by 2014 Quintile



It is clear a strategic company focus on culture and highly effective programs go together.

Context Matters

Whether a strategic, corporate focus on culture is a prerequisite for a highly effective E&C program or vice versa is not clear. It is apparent, however, that they go together. The companies in which the top quintile of programs operate are far more likely to count as their key priorities, culture and business values (35 percent versus 15 percent, compared to the bottom quintile), risk mitigation (32 percent versus 12 percent), and innovation (42 percent versus 12 percent). Much higher than average PEI scores are typical of programs in companies prioritizing risk mitigation and leadership development (0.63), as well as those focused on culture and values (0.64) and innovation (0.66). By contrast, companies with cost reduction and cash management as key priorities—including 58 percent of the bottom quintile—have programs with PEI scores well below the mean (at 0.58, on average).

YELLOW HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE BETWEEN 95.5 AND 99.7 PERCENT.

BLUE HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE ABOVE 99.7 PERCENT.

Much higher than average PEI scores are typical of programs in companies prioritizing risk mitigation and leadership development, as well as those focused on culture and values and innovation.

Reporting Structures

Recent years have seen considerable discussion of whether or not the compliance function ought to report to the general counsel, which is true of just less than half of this year's sample. Most of the discussion hinges on avoiding the potential for conflict of interest between the two functions, but the PEI analysis suggests there may be more to it than that. Programs led by an individual reporting to either the CEO (22 percent of the total) or the board or one of its committees (16 percent of the total) have average PEIs of 0.63, substantially outperforming those reporting to the general counsel (average PEI scores of 0.58.) The point is made clearer with the comparison of quintiles. Among the more effective programs, far fewer report to the general counsel, and far more to the CEO or the board than at less effective programs.

It seems likely that a more prominent "seat at the table" for chief compliance officers reflects the greater importance accorded to their role and the issues in their organizations. Although many factors are likely at play, it is hard to overestimate the many benefits to the E&C program arising from proximity to the CEO; not the least of which is the message it sends to the organization as a whole.

Board oversight is an important indicator of the degree to which ethics and compliance are a matter of corporate focus, and ethics compliance officers need to enable this by regularly reporting to the board on E&C issues. The majority of compliance officers update their boards either two or four times a year, but the very small sample—4 percent—of respondents who said they don't update their boards at all, let alone report to them, has an average PEI of 0.48, among the lowest of any score in the analysis.

Reporting to:	More Effective Programs	Less Effective Programs
General Counsel	35 percent	65 percent
CEO	32 percent	12 percent
Board of Directors	29 percent	12 percent
Other	3 percent	12 percent

Programs led by an individual reporting to either the CEO or the board (or one of its committees) substantially outperform those reporting to the general counsel.

Tone v. Tone: What Matters Most

Regardless of reporting relationships, the "tone at the top—reflected in what the CEO does and says—is clearly associated with program effectiveness.

Does your CEO ever do the following:	Yes	Yes PEI	No PEI
Demonstrate ethical leadership by his/her words and actions	79%	0.62	0.55
Hold executives accountable for modeling expected behavior	64%	0.63	0.55
Reference the code of conduct in public without prodding or preparation from the General Counsel or E&C officer	48%	0.65	0.56
Reference the company's values as a framework for making decisions	73%	0.62	0.56
Be the first to complete ethics and compliance training	36%	0.64	0.58
Connect with the ethics and compliance officers on senior management performance and promotions	19%	0.69	0.58
Address ethics and compliance issues in staff meetings, operational reviews, and similar contexts	62%	0.63	0.56

There's a highly significant correlation between program effectiveness and CEOs who connect with E&C officers on senior management performance and promotions.

Though everything the CEO does seems impactful, the most significant correlation is seen where the CEO connects with E&C officers on senior management performance and promotions. It is another illustration of the impact associated with programs that are deeply embedded in the core operations, and are strategic concerns, of the companies they serve.

Active, consistent, and sincere board and CEO involvement in these matters make it clear throughout the organization that behaviors matter as much as outcomes—that culture matters more to long-term achievement than does quarterly performance. Programs in those organizations embracing the importance of culture as a competitive advantage have average PEI scores of 0.64, as opposed to the 0.54 average PEI score found within companies that do not appreciate the connection.

YELLOW HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE BETWEEN 95.5 AND 99.7 PERCENT.

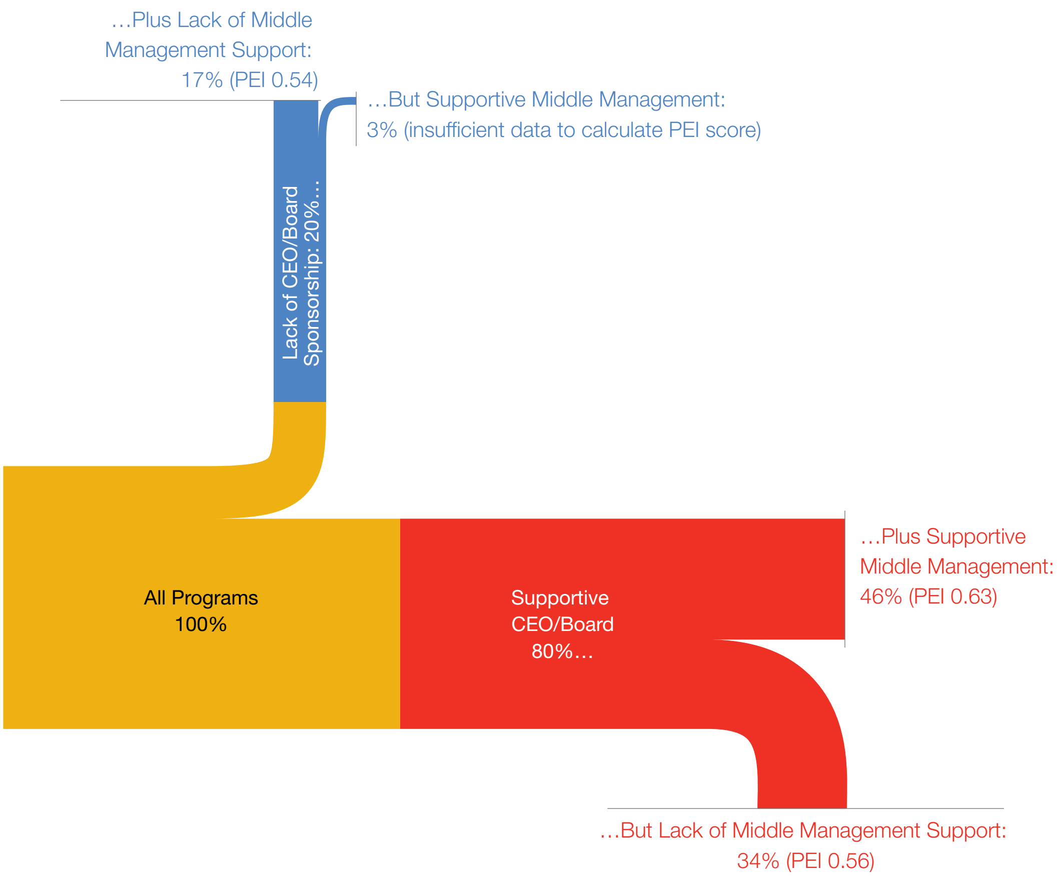
BLUE HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE ABOVE 99.7 PERCENT.

Tone vs. Tone: Whose Matters Most

Given the distance from which the tone at the top is generated, the "tone in the middle" should be of critical concern to E&C leaders. Few employees interact regularly with members of their organization's C-suite, and, as LRN research has previously identified, C-suite executives have a vastly different and more favorable view of their governance, culture, and leadership structures than do the employees they lead.* At every level, from team-lead to business unit head, management models behavior and decision-making, clearly identifying the company's actual values. In the event of a conflict between those actual values and the values being espoused by the E&C program, the program is unlikely to prevail.

The data reveal that a supportive tone in the middle is as closely associated with program effectiveness as is the tone at the top, if not more so. Programs in companies that have focused middle management attention on E&C issues have average PEI scores of 0.64, as do those in companies paying attention to senior management messaging on speaking up. However, companies without that middle management focus have programs that fare even worse (PEI average 0.49) than those not attending to the tone at the top (PEI average 0.52.) E&C officers face many obstacles to building ethical cultures, and a lack of support from either the top or the middle can be formidable. Programs whose efforts to build an ethical culture are hampered by a lack of CEO or board sponsorship have an average PEI score of 0.54, while the lack of support by middle management in this regard is associated with an average PEI score of 0.56. Programs with CEO/board support on culture are more common (80 percent), and have an average PEI score just above the mean (0.61), while those with supportive middle management sport an average of 0.63.

Figure 3. The Impact of Support: Tone vs. Tone



*For example, the more than 900 C-level employees surveyed were from three to eight times (depending on the country in which they were located) more likely to believe that their organizations were highly values-based than were the more than 35,000 less highly placed employees taking part in the study. The HOW Report, LRN Corporation, 2012, at p.23 ff. http://pages.lrn.com/how-report

While both seem necessary, it should be noted that 34 percent of all programs struggle with their middle management, despite CEO and board support. By contrast, fewer than 3 percent of respondents identified a setting in which tone in the middle was supportive while support at the top was lacking.

Celebration and Impact

Among the surprising findings of last year's PEI analysis was the clarity with which one set of behaviors, the celebration of ethical conduct, stood out as the most telling measure of program effectiveness.* This year the case is even clearer.

We asked how often respondents' companies celebrated acts of ethical leadership and in what ways. The percentage of the top quintile who said that they did so "often" or "very often" in each category is as follows:

- Awards, 55 percent;
- recognition in team meetings, 45 percent;
- recognition in company communications, 42 percent; and,
- job promotions, 23 percent.

By contrast, **not a single program in the bottom quintile reported that their companies "often" or "very often" celebrated acts of ethical leadership in any category.**

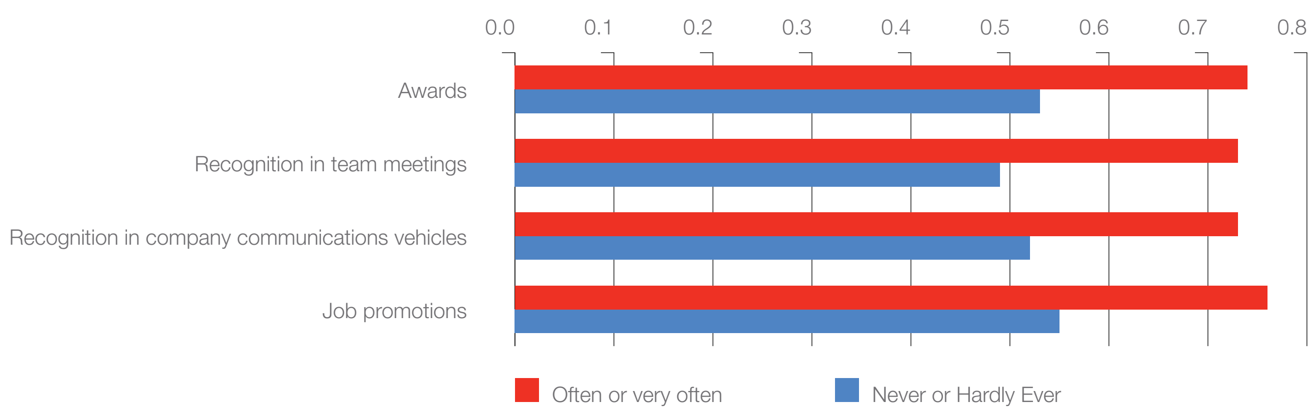
As seen in Figure 4, the frequent, public celebration of ethical leadership is characteristic of programs with extremely high average PEI scores, ranging from 0.73 associated with recognition in team meetings and company communications, to 0.74 for those giving public awards, to 0.76 where ethical leadership forms part of the reason for promotions. Each of these behaviors speaks plainly of the degree to which ethical leadership is valued not just by the E&C program but by the business itself. This is not E&C as a layer of additional controls against the risk of compliance failure, but as a strategic focus on building an ethical, values-based culture. The analysis makes clear which approach works best.

Program Goals Matter, Too

By a ratio of three-to-two, more programs pursue as a primary mandate "ensuring ethical behaviors and alignment of decision making and conduct with core values" than pursue "ensuring compliance with rules and regulations." Those in the "values camp" have a higher average PEI (at 0.61) than those focused on rules (0.58). More telling is that more than two out of three of the most effective programs are values-based, which is true of fewer than half of the programs in the lower quintile.

Program goals appear to matter most when they reflect a positive integration with the entire company's operations and priorities. Thus, we see particularly low PEI scores for programs for which adapting to meet changing business needs is not high on the agenda (0.57), for those for which third party oversight isn't a priority (0.57), and even more so if risk management isn't a program priority (0.52). The poor performance of programs not focused on ethical leadership (0.55) or

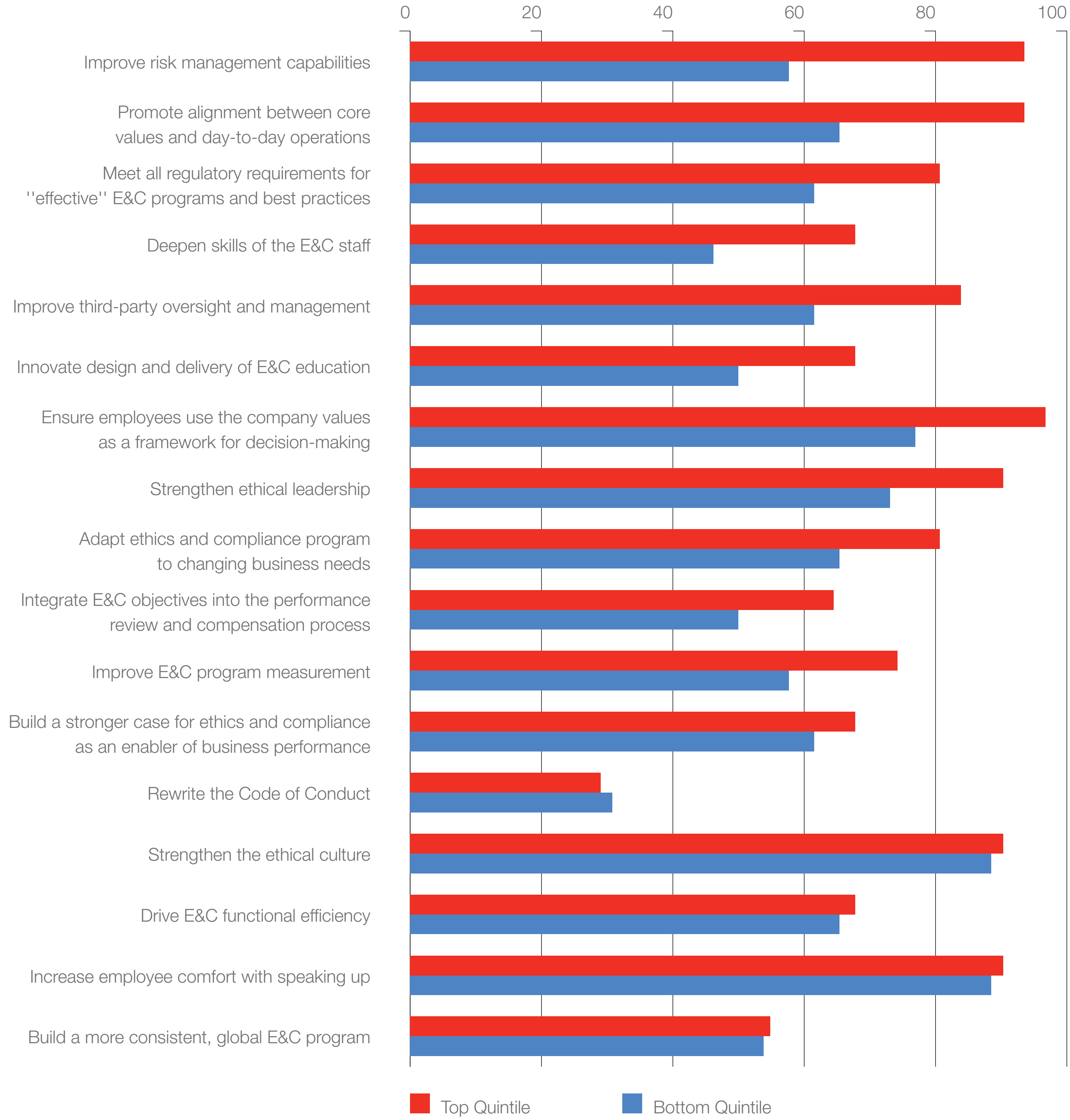
Figure 4. Average PEI Scores Based on Frequency of Celebrating Selected Acts of Ethical Leadership



*It is so telling, in fact, that this year's Program Effectiveness Index includes data from the celebration of ethical conduct set of questions. Because it is inappropriate to measure an index component against the index, the PEI scores used in this discussion of celebration were calculated using this year's data but applying the prior year's five-factor analysis.

YELLOW HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE BETWEEN 95.5 AND 99.7 PERCENT.
BLUE HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE ABOVE 99.7 PERCENT.

Figure 5. Program Goals: Highly Effective Programs Set More

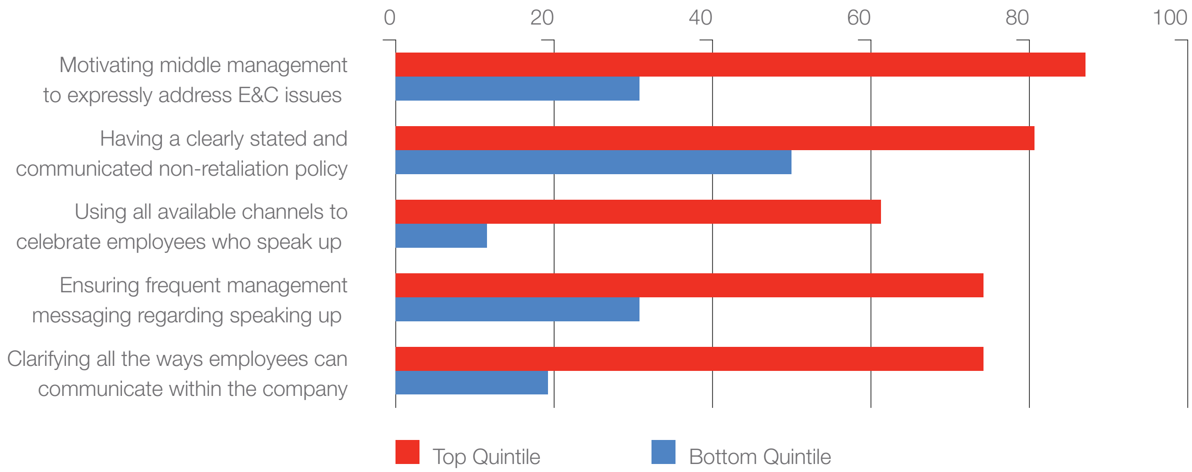


the use of company values as a framework for decision-making (0.54) likely also reflects both the importance of connecting the program to the essential elements of the company's operations, as well as the consequences of failing to do so.

Most practitioners would agree that meeting regulators' expectations for the design and implementation of effective programs and promoting alignment between the company's core values and its day-to-day operations are both fundamental. Programs with those tasks as express goals surpass the mean PEI score far more often than not. E&C programs that don't feature them on their to-do lists significantly underperform, each with PEIs of 0.55.

The most effective ethics and compliance programs don't "do" ethics and compliance. They enable and assist their business units to do so.

Figure 6. Program Goals Regarding Middle Management and Building a Culture of Speaking Up, by Quintile



Built-in Is Better Than Bolted-on

As seen in Figure 5, above, the most effective ethics and compliance programs don't "do" ethics and compliance. They enable and assist their business units to do so. Programs in the top quintile are far more likely than their less effective counterparts to be found in an organization at least moderately focused on certain elements.

The Hallmarks of an Effective Program

In November of 2012, the Securities and Exchange Commission and the Department of Justice issued their joint guidance on FCPA enforcement. The discussion of compliance programs it contains, though focused on anti-corruption efforts and firmly rooted in the approach previously taken in the *Sentencing Guidelines,* has been adopted as the definitive overall statement from the regulatory community of best practices for ethics and compliance programs.

The data discussed in this report make clear that there is more to creating impact than ensuring that the program as designed and implemented has hit the 11 "hallmarks" of an effective program the SEC and DOJ defined. Nevertheless, it is imperative that these marks be hit in order to meet both regulatory expectations and the demands of program stakeholders. Further, how far a program has progressed against the goals, and as to which goals, is closely associated with program effectiveness.

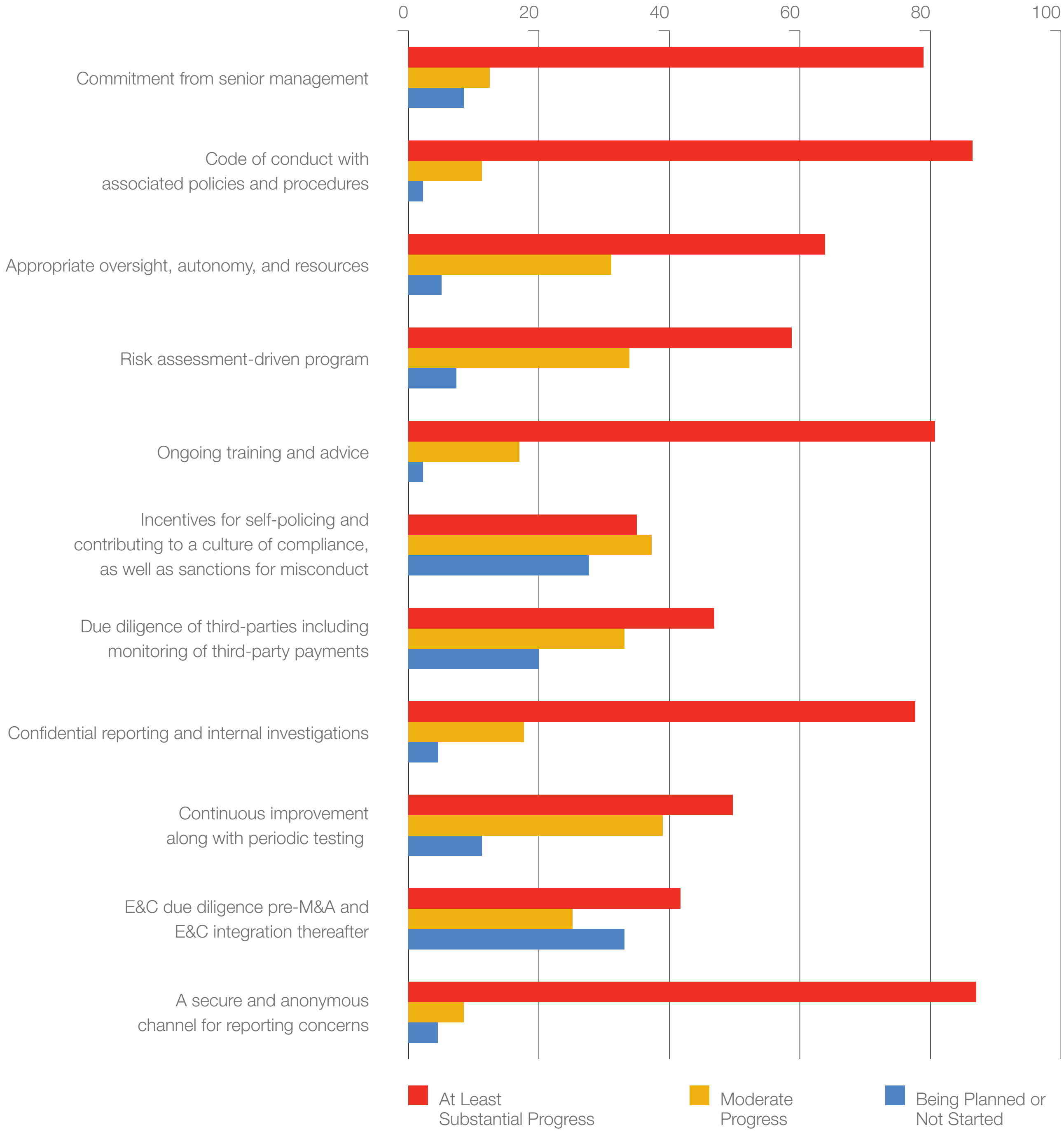
Not All Hallmarks Are Created Equal

Virtually all respondents have made at least sub-stantial progress on some of the hallmarks, while others have seen just moderate progress or are in the "planning" phase.

The "basics" are well and broadly under way. A hotline, code of conduct, training, tone at the top, and internal investigations have all been the subject of at least moderate progress for all but 20 percent of programs. By contrast, fewer than half of all programs have made at least substantial progress on continuous

Fewer than half of all programs average at least substantial progress on the critical hallmarks identified in the DOJ/SEC guidance on the Foreign Corrupt Practices Act.

Figure 7. Substantial Variation in the Degree of Progress in Addressing DOJ/SEC Hallmarks



improvement and self-assessment, third-party and pre-M&A third-party due diligence, or designing incentives and sanctions contributing to a culture of compliance.

The Hallmark Hallmark

Finishing the work on hallmarks is in and of itself a hallmark of an effective program. In the table on page 16, the average PEI score of respondents who identified each element as "completed" are shown, ranked in order of the element's correlation with program effectiveness. Since virtually every program does some training and has a helpline of some sort, the PEI scores are only somewhat above the mean. These values rise dramatically as the sophistication likely associated with a program at this stage of its maturity increases, from code of conduct to tone at the top to creating incentives for employee self-governance and reporting.

Pre-M&A due diligence of an ethics and compliance program with associated post-M&A integration	0.68
Continuous improvement along with periodic testing and review	0.68
Risk assessment-driven program	0.67
Incentives for self-policing, reporting of potential violations, and contributing to a culture of compliance, as well as appropriate and effective sanctions for compliance violations and lapses	0.67
Due diligence of third-parties including monitoring of third-party payments	0.66
Appropriate oversight, autonomy, and resources	0.66
Commitment from senior management	0.64
Confidential reporting and internal investigations	0.63
Code of Conduct with associated policies and procedures	0.63
Ongoing training and advice	0.62
A secure and anonymous channel for reporting concerns	0.62

YELLOW HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE BETWEEN 95.5 AND 99.7 PERCENT.

BLUE HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE ABOVE 99.7 PERCENT.

The "pre-M&A due diligence" measure first listed above is likely another marker for program integration into the business. Including it as part of program design and implementation likely requires an actual "seat at the table." The same is true, though to a less demanding degree, when it comes to the fourth hallmark on this list, which requires the participation of both business leaders and other corporate staff to develop and implement incentives and sanctions.

The items in the second and third positions, however, are matters in the sole control of the ethics and compliance officer. As has been seen earlier in this report, goals and metrics matter, and this data plainly illustrates the impact of program design and implementation based on risks regularly assessed and acted upon based on a continuous cycle of review and improvement.

Not All Programs Are Created Equal

Not surprisingly, highly effective programs are far closer to completing the hallmarks overall than are their underperforming counterparts. Figure 8 illustrates the percentage of all programs and of the top and bottom quintiles having completed or substantially completed each hallmark.

Seen in Figure 9, below, is the degree to which each of the programs in the top and bottom quintiles has, on average, made progress on hitting the regulatory marks. Only 8 percent of the bottom group is, on average, complete. None in the top quintile is, on average, less than substantially completed. And, once again, the relationship with PEI is clear.

The danger of looking at program effectiveness as a matter of design and implementation in accordance with the hallmarks is that it can be reduced to a "check the box" exercise. Properly approached, however, particularly by beginning with and maintaining a focus on risk assessment and continuous improvement, it appears to be able to generate significant impact.

Figure 8. Percentage of Programs Reporting At Least Substantial Completion of Each Hallmark

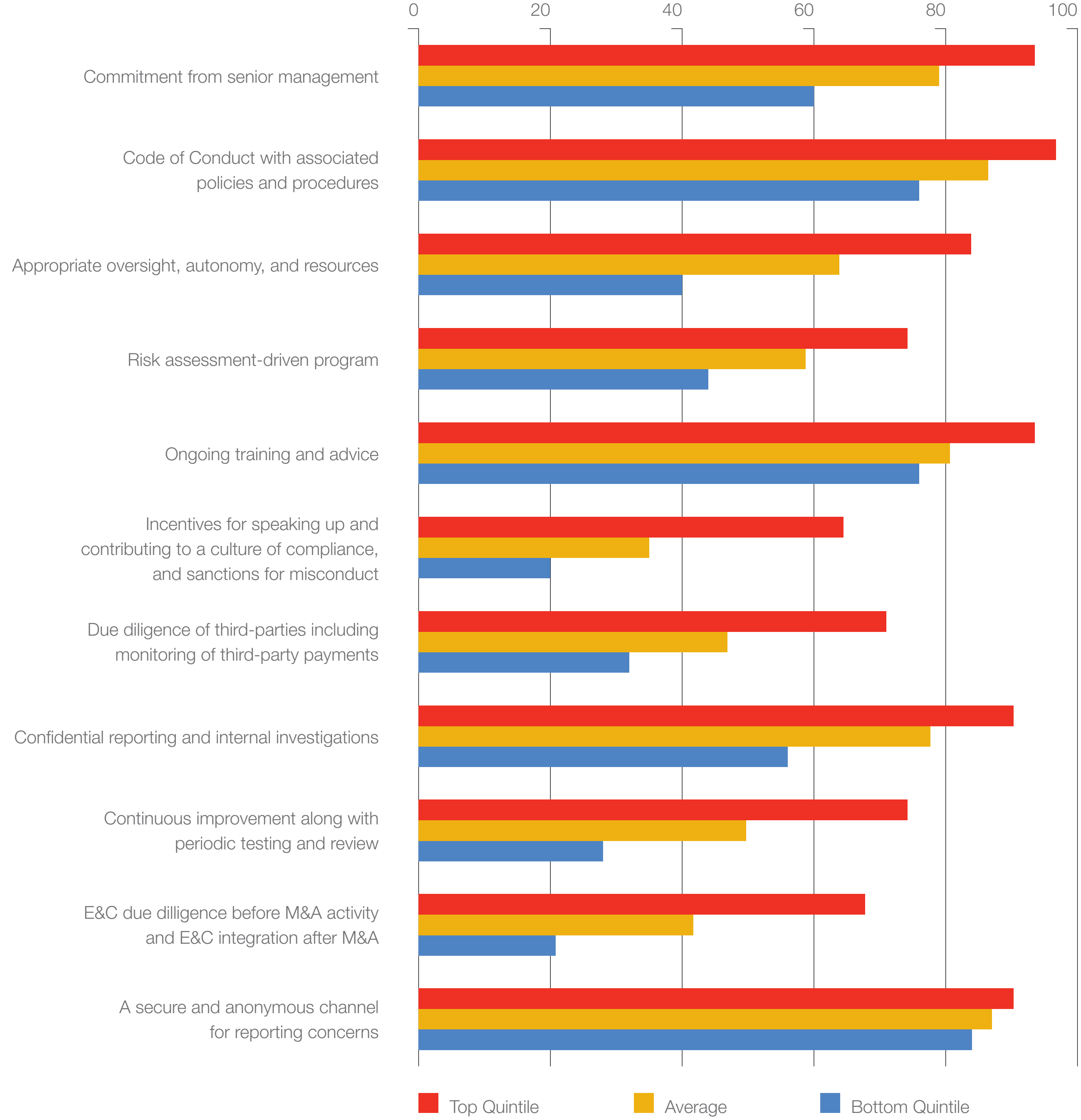
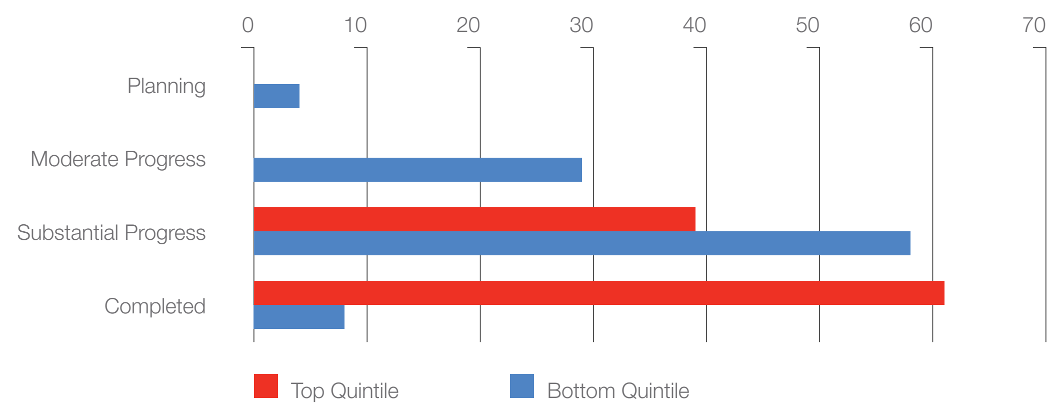
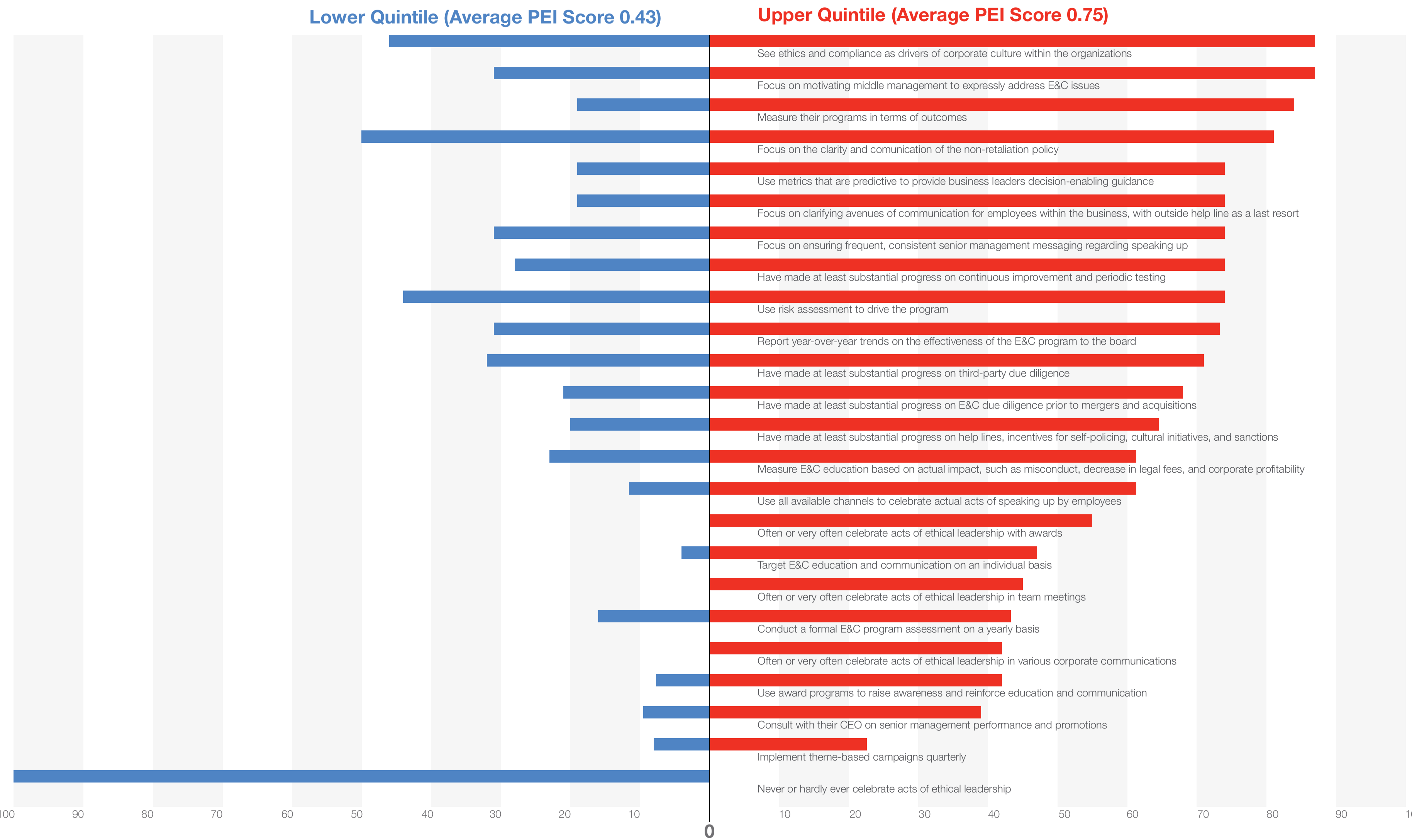


Figure 9. Average Hallmark Progress, by Quintile



Above and Beyond: Key Differentiators in Program Effectiveness

This table identifies those attributes that most clearly mark the difference between the less effective ethics and compliance programs that are found on one side of the Program Effectiveness Index distribution (PEI scores of 0.51 or less) and the highly effective programs found on the other (PEI score of 0.70 or more.) Those practices that are far more prevalent on the right side, taken together, give us a good sense of what separates high-impact programs from the rest.



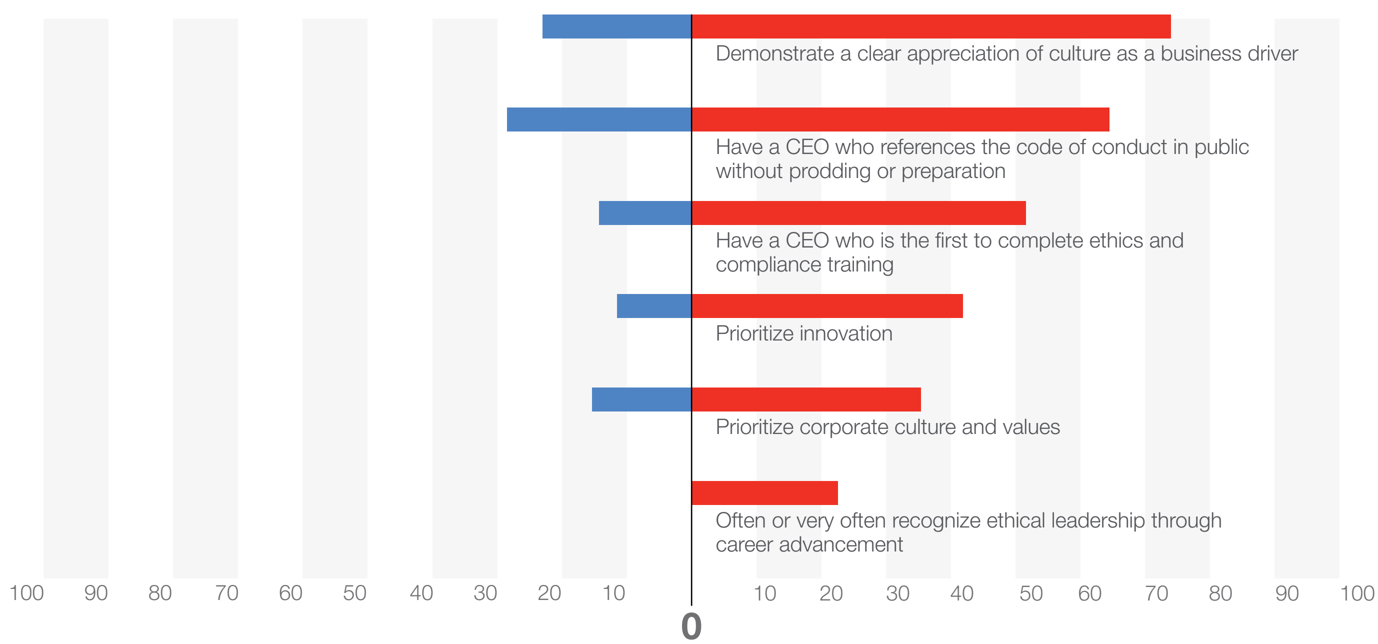
Most programs have much in common—a code of conduct, some manner of training, and a means to receive confidential employee communications. Most conduct internal investigations when necessary and provide information to their boards of directors on some sort of basis. Yet the differences between programs are many. Size, scope, and approach vary widely, as do resources, corporate salience and—most significantly—outcomes.

The table above illustrates what it is that high-impact programs do above and beyond the basics. None of those differentiators is a "check the box" exercise. None is necessary. They are about an intentional focus on culture. They are about middle management, and addressing the ethical dimension of management relationships. They are about predictive and outcome-focused metrics. They are about celebration.

Of course, wherever they are on the PEI distribution, E&C programs do not exist in a vacuum. The individual corporate contexts in which effective programs flourish or less effective programs languish are likely both cause and effect of program impact. The chart below identifies several of those corporate attributes and behaviors that most distinguish the companies within which the most and least effective programs are found. Here, too, the intentional focus on culture seems to drive the degree to which ethics is built in to an organization.

Above and Beyond: Corporate Differentiators

Lower Quintile 0.43 Upper Quintile 0.75



YELLOW HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE BETWEEN 95.5 AND 99.7 PERCENT.
BLUE HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE ABOVE 99.7 PERCENT.

Program Management

Budgets and Resources

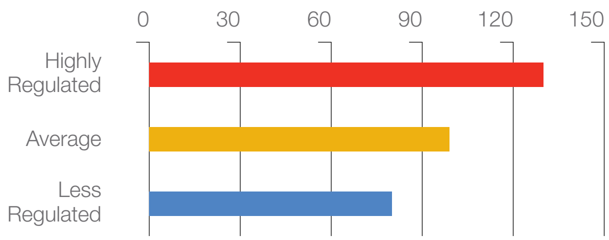
Cost of E&C Programs—Budget Per Employee

On average, our respondents spent nearly $100 per employee ($99,763 per thousand) on their programs.

With respect to E&C spend per employee, size matters, with larger programs recognizing significant economies of scale. The average annual spend-per employee at firms with fewer than 2,500 employees was $195, while the largest firms, those with more than 50,000 employees, spent just $22 on each one.

Not surprisingly, we found that the amount of money companies devote to their E&C functions is highly dependent on the extent to which their industries are regulated. On average, firms in highly regulated industries (healthcare, financial services, defense, energy, insurance, pharmaceuticals, and medical devices) spent $130 per employee ($130,279 for every thousand employees), 61% more than the amount ($80 per employee or $79,523 per thousand) spent by their less-regulated counterparts.

Figure 10. E&C Spend Per Employee



E&C 2014 Budget Adjustments

The growth of E&C spending we've seen over the last three years continues. Even though 40 percent of all programs surveyed planned no change in their budgets compared to 2013, those planning increases (47 percent of the total) far outnumbered the 13 percent planning budget decreases.

Once again, companies in highly regulated industries (of which more than half are planning increases) differ markedly from the average and from their less regulated counterparts, of which less than 40 percent are planning increases.

Figure 11. Planned Budget Changes for 2014

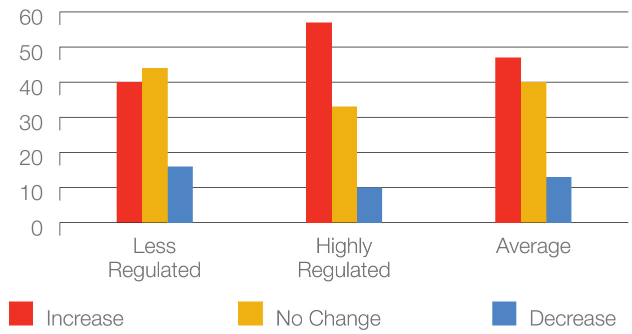
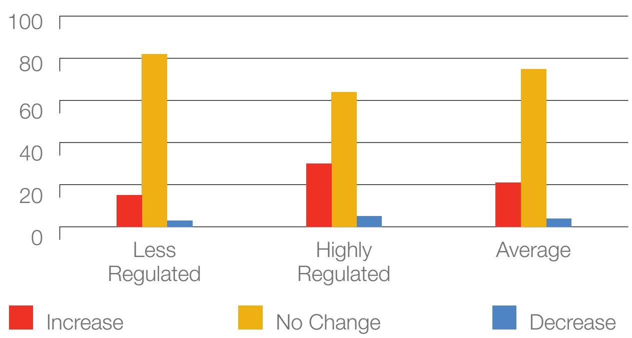


Figure 12. Planned Headcount Changes 2014



Regulation and Headcount

As with the overall spend, the number of people dedicated to the ethics and compliance function is generally modest, with our average respondent employing just 1.4 full-time-equivalent employees (FTEs) for every thousand employees in the organization. E&C functions in highly regulated industries employ nearly five times as many people per capita (2.3 FTE per 1,000 employees) as do those offices operating within the broad run of less regulated manufacturers, retailers, wholesalers, transportation companies, and others (.5 FTE per thousand).

While the majority of program leaders foresee holding head counts steady, among those planning changes in staffing levels, hiring outpaces layoffs by five to one. It's worth pointing out that nearly half of those doing the hiring anticipate adding just a single FTE.

Here, too, the broader average obscures the marked split between highly-regulated industries and "all others."

For the record, and as seen on the scatter plots below, there is no appreciable correlation between program budget, overall or on a per capita basis, and PEI.

Figure 13. E&C Annual Budget as a Function of PEI

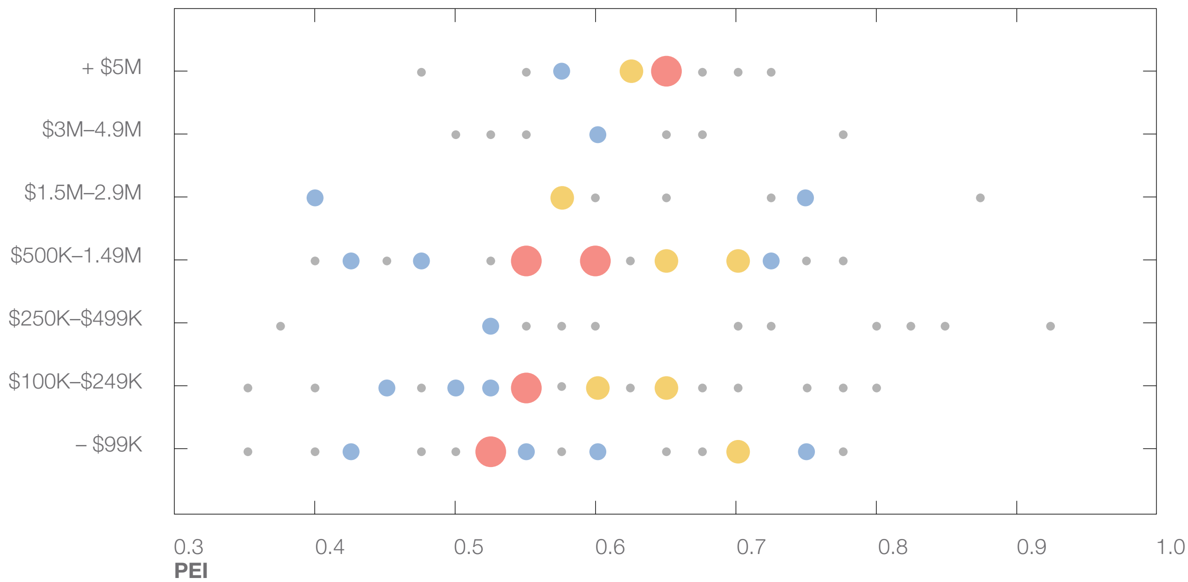
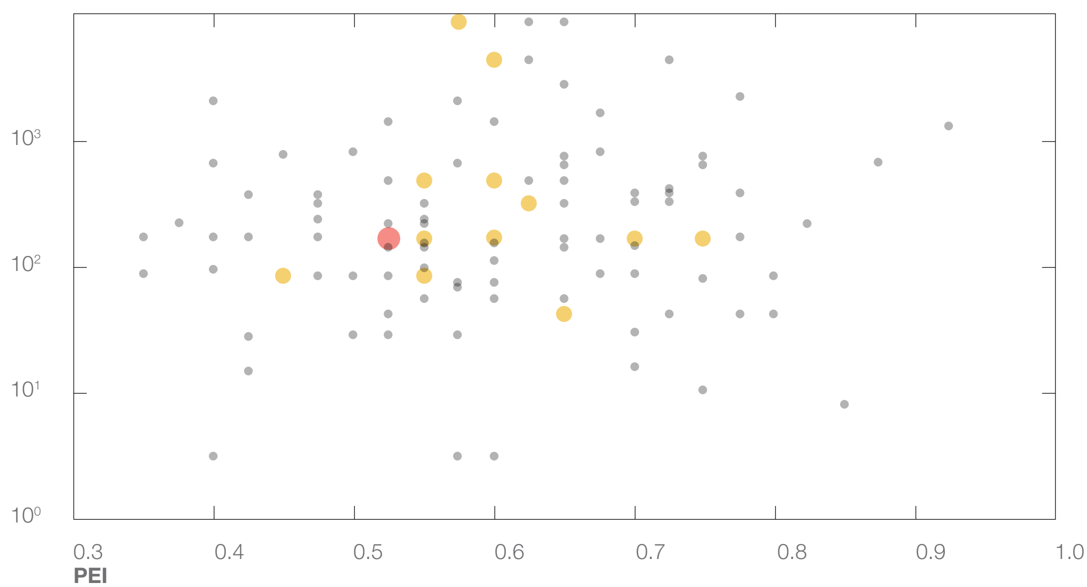


Figure 14. E&C Annual Spending per Employee as a Function of PEI (in Logarithmic Scale)



YELLOW HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE BETWEEN 95.5 AND 99.7 PERCENT.

BLUE HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE ABOVE 99.7 PERCENT.

Program Management Matters

The mechanics of E&C program management translate into impact in a variety of ways, and that translation illustrates two key themes emerging from the data. First, doing the hard work of paying close, thoughtful attention to the program pays off. Second, programs that are built into the very structure of the organization far out perform those that are bolted on as control mechanisms.

Program Assessment

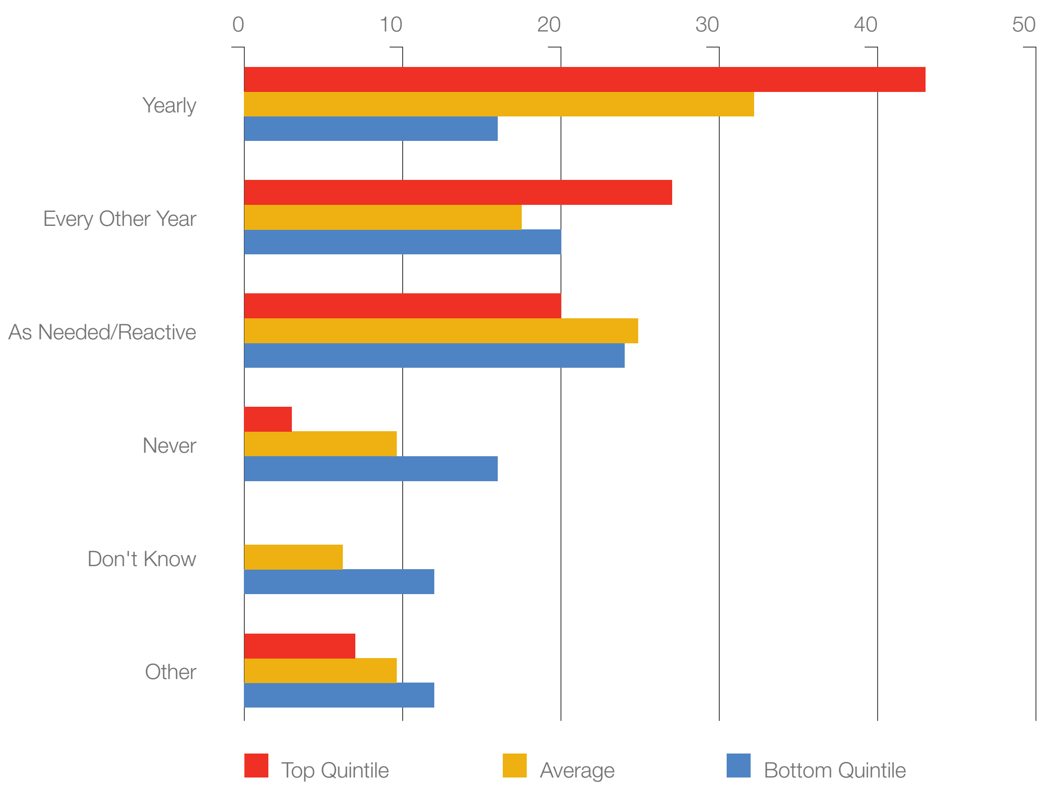
The use of ethics and compliance program assessment to ensure effectiveness and facilitate the continuous improvement of program design and implementation is a prominent hallmark of an effective program, according to both regulators and practitioners. Not surprisingly, then, every one of the programs in the top quintile conducted formal program assessments, with more than 70 percent of them doing so on a regular schedule, either annually (43 percent) or every other year (27 percent). Only 36 percent of less effective programs adhere to any particular schedule, and fully a quarter of them report that they do not conduct a formal program assessment at all.

> Programs that are built into the very structure of the organization far out-perform those that are bolted on as control mechanisms

> Every program in the top quintile conducts a formal program assessment, with 70 percent doing so on a regular schedule, either annually or every other year.

At an average PEI score of 0.64, those programs conducting such an assessment annually seem to have found a process that works. Programs conducting assessments every other year have, on average, PEI scores above the norm, but average program effectiveness goes rapidly downhill for those assessing on an ad hoc basis (0.58), those who never do (0.54), and those who don't seem to recognize the requirement ("don't know" at 0.47.)

Figure 15. Formal Program Assessment



Risk Assessment

Risk assessment is the starting point of any effective program. It is one of the hallmarks identified by regulators, and it is on every inside, outside, and regulatory auditor's checklist.

Obstacles: Those with less effective programs cite resource constraints and a conflation with enterprise risk assessment as obstacles to conducting risk assessment about twice as often as do those with more effective programs. A lack of cooperation from business units is more common among the less effective programs by a striking ratio of nearly four to one, which is yet another key data point pointing to the importance of building the ethics and compliance program into the business, rather than trying to layer it on as a control from above. Meanwhile, 35 percent of programs in the top quintile say they have no obstacles at all in conducting risk assessment, an answer given by none in the bottom quintile. And the average PEI score of the programs not encountering obstacles in the risk assessment process comes in at 0.70.

The impact of the presence or absence of constraints is not limited to risk assessment. A similar pattern is seen in terms of PEI and quintile differentials as programs address obstacles to the fundamental task of promoting ethical cultures within their organizations, as seen on the table below.

	Average PEI where not an obstacle	Average PEI where a significant obstacle	Top quintile with this as a significant obstacle	Bottom quintile with this as a significant obstacle
Inability to identify which initiatives enhance culture	0.62	0.53	6%	31%
Lack of appreciation of culture as a business driver	0.64	0.54	13%	46%
Lack of CEO/Board sponsorship	0.61	0.56	3%	8%
Lack of clear accountability	0.62	0.54	10%	38%
Lack of a clear statement of ethical standards	0.62	0.55	3%	12%
Lack of clearly stated corporate values	0.61	0.54	6%	15%
Lack of clearly stated mission/purpose statement	0.62	0.60	3%	4%
Lack of support by middle management	0.63	0.55	19%	46%
Organizational complexity (e.g., global, functional silos)	0.62	0.58	32%	46%

YELLOW HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE BETWEEN 95.5 AND 99.7 PERCENT.

BLUE HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE ABOVE 99.7 PERCENT.

Those who run “highly effective” programs are two-to-three times more likely than their counterparts with less effective programs to believe that the metrics they are using rest firmly on principles of validity, impact, practicality, and value

Metrics: As with their overall use of metrics, more effective programs use many more inputs in their risk assessments than do less effective programs, and of these, several stand out. Just one in three program leaders considers financial pressures, such as company sales and profit goals and individual targets, as countervailing forces when it comes to employee conduct. Those that do, however, have average PEI scores of 0.65. The limited group who also consider customer feedback average 0.66 on the PEI. The clear implication, once again, is that ethics and compliance programs work best when they closely focus on the operations and realities of the enterprises of which they are a part.

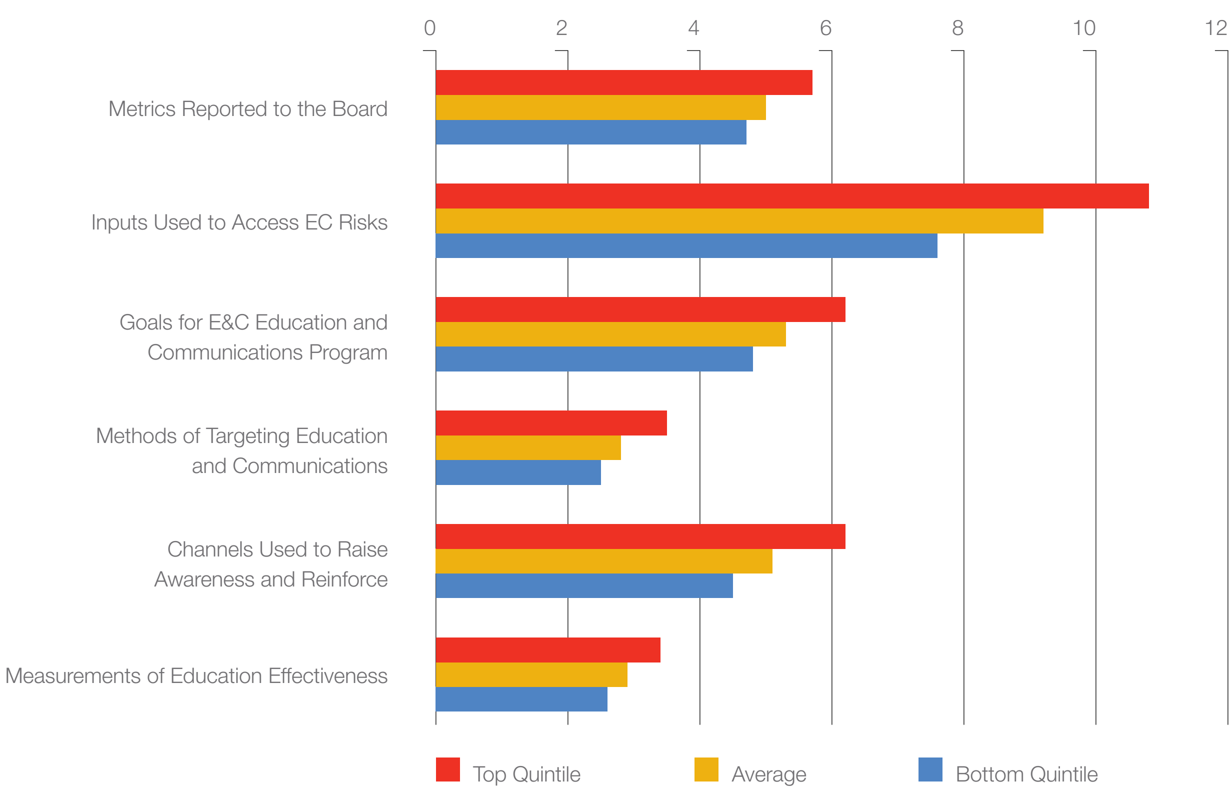
What is more, those who run highly effective programs are two-to-four times more likely than their counterparts at less effective programs to believe that the metrics they are using rest firmly on principles of validity, impact, practicality, and value. More to the point, by a ratio of nearly four to one, leaders at high impact programs believe they can use their metrics for predictive purposes.

Goals, Metrics, and Tools: More Matters

As Figure 16 makes abundantly clear, highly effective programs set out to accomplish more. They measure more, and they use more tools than their less effective counterparts. It is not likely a coincidence.

The lesson might be simple, and familiar to many in the profession. It is hard work to impact the behavior of thousands of employees. The effort has many facets, and they require a great deal of attention. But it seems to pay off.

Figure 16. Metrics, Goals, and Tools and the Number of Each: More Matters



Education and Communication

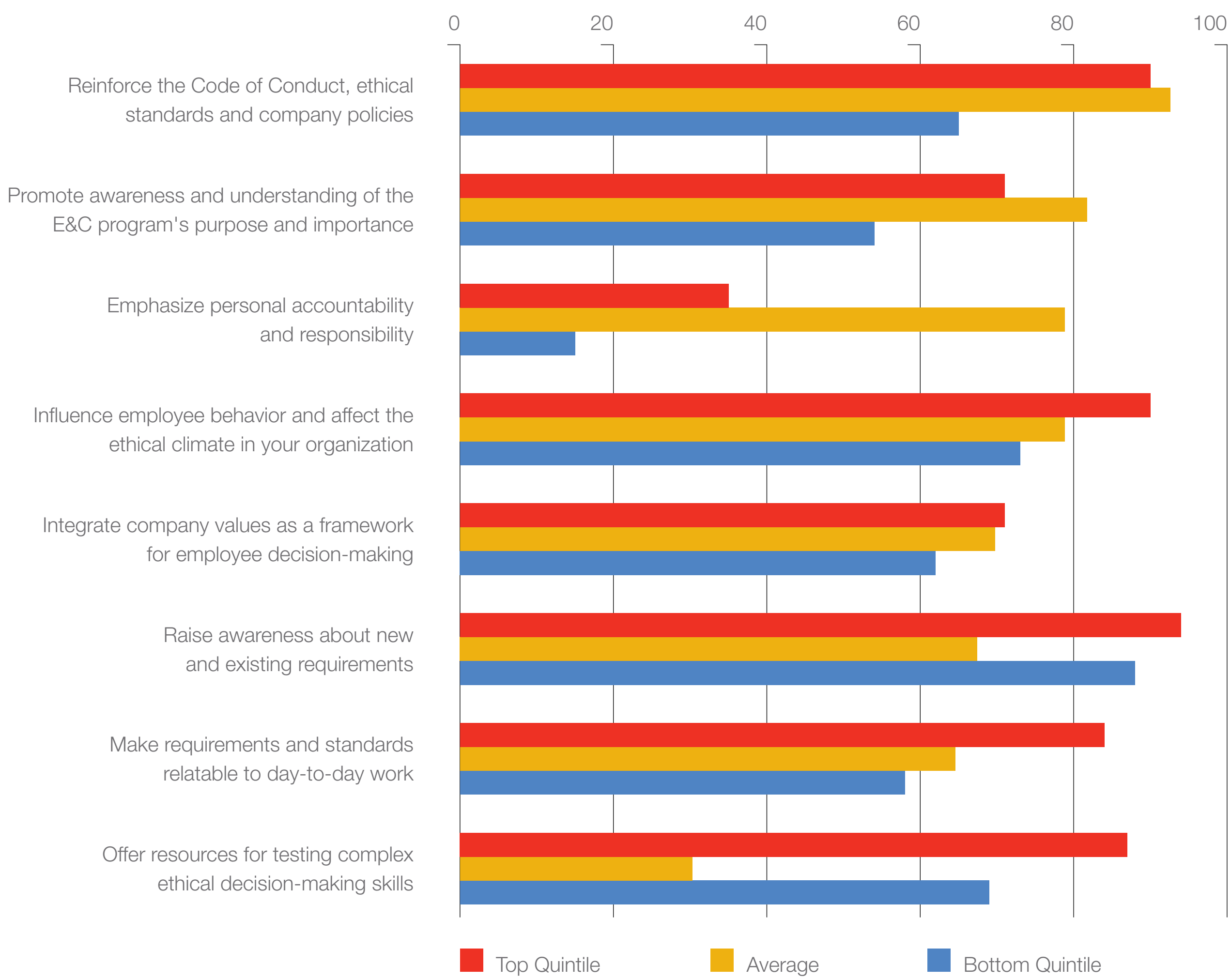
What's the Point?

As we have seen in examining the impact of E&C program goals and the importance of their alignment with the company's goals, what leaders set out to do greatly influences their overall impact. The same holds true in education and communication, as evidenced by the much larger number of goals identified by those running more effective programs. See Figure 17.

Also noteworthy, goal by goal, is the difference between the average PEI of those who have identified a goal and those who haven't, as seen in Figure 18. By that measure, reinforcing the code, an emphasis on personal accountability, and relating requirements and standards to daily activities have the clearest association with program effectiveness.

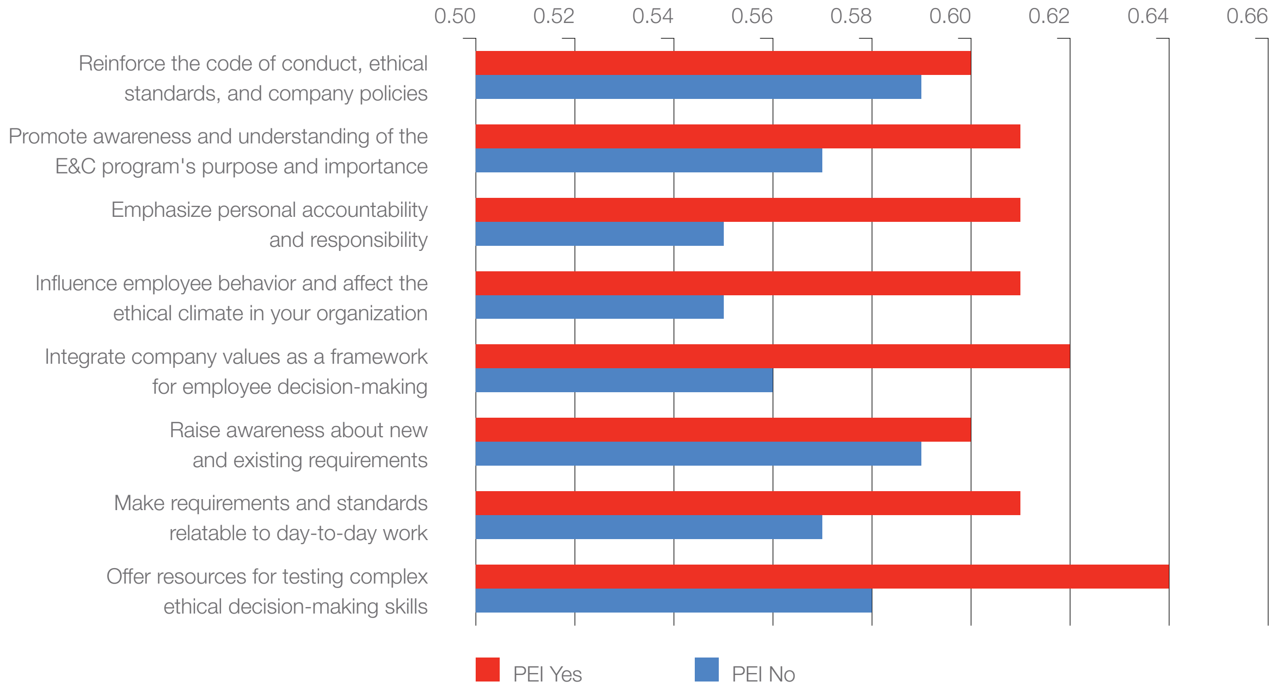
Here, too, metrics matter. While most every program measures completion rates, programs taking account of employee feedback are above par (average PEI scores of 0.62), as are those that capture the ratio of requests for advice to allegations of misconduct (PEI of 0.63). In a finding very much in keeping with the importance of a focus on actually changing behavior, programs capturing data on changes in measures of employee misconduct and speaking up, as well as organizational impact such as legal spend and profitability, tend to be among the more effective, with PEI averages of 0.63 and 0.64, respectively.

Figure 17. Education and Communication Goals



YELLOW HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE BETWEEN 95.5 AND 99.7 PERCENT.
BLUE HIGHLIGHTED TEXT: FINDING HAS A STATISTICAL SIGNIFICANCE ABOVE 99.7 PERCENT.

Figure 18. PEI Impact of Specific Education and Communication Goals



From this perspective, both the year-on-year *decrease* in the use of completion rates (7 percent) and the *increased* use of organizational impact (10 percent) and the ratio of requests for advice to reports or allegations (11 percent), as well as the three-year increase in the measurement of impact on employee behaviors, are positive signals that ethics and compliance officers are paying more attention to outcomes and less to “check-the-box” metrics. The three-year increase in informal education might well speak to greater corporate commitment to fostering dialogue on ethics and compliance topics.

E&C Program Metrics: Frequency of Use	2013	2012	2011
Employee feedback	71%	72%	75%
Completion rates	71%	78%	77%
Impact on employee behaviors (e.g., decline in misconduct, increase of speaking up, etc.)	56%	54%	49%
Organizational impact (e.g., fewer reported issues, decrease in legal fees, corporate profitability)	42%	32%	33%
Ratio of requests for advice to reports or allegations	31%	20%	—
Test results	25%	32%	21%
Increase in informal education	12%	9%	5%

Who Gets What and How Much

The vast majority of programs (88 percent) target at least some part of their education and communication at the entire enterprise. Marginal improvement is observed in average PEI scores when education and communication are functionally targeted, and more still when targeting is activity-based. But the 23 percent of respondents who reported individual targeting had the highest average PEI; an impressive 0.68. Just about half of the most highly effective programs use activity-based targeting of education, compared to fewer than one in five of those in the bottom quintile. And while half of the top quintile also assign education on an individual employee basis, virtually no program among those in the bottom quintile does so.

With so many programs painting with a broad brush, it is not surprising that online education fatigue remains a major hurdle for many programs to overcome, troubling nearly half of them "moderately" or worse (PEI 0.57). Insufficient resources, lack of dedicated personnel to drive campaigns, and disinterest among senior leadership are all issues associated with sub-par impact, with PEI averages of 0.55, 0.56, and 0.58, respectively. As we have seen, these factors are fundamental to program impact in virtually every aspect of the E&C endeavor.

Online education continues to be the content delivery vehicle of choice, deployed by 82 percent of programs to, on average, 76 percent of their employees, for, on average, just about three hours a year. Nearly two out of three companies also use classroom training, but they do so with far fewer of their employees (25 percent, on average.) Significant increases in average PEI scores accrue to that small number of programs that add mobile devices to the mix (at 0.68), as well as to those which add facilitated group discussions to the mix (at 0.66.)

Figure 19. Modes of Education In Use and for How Many Employees

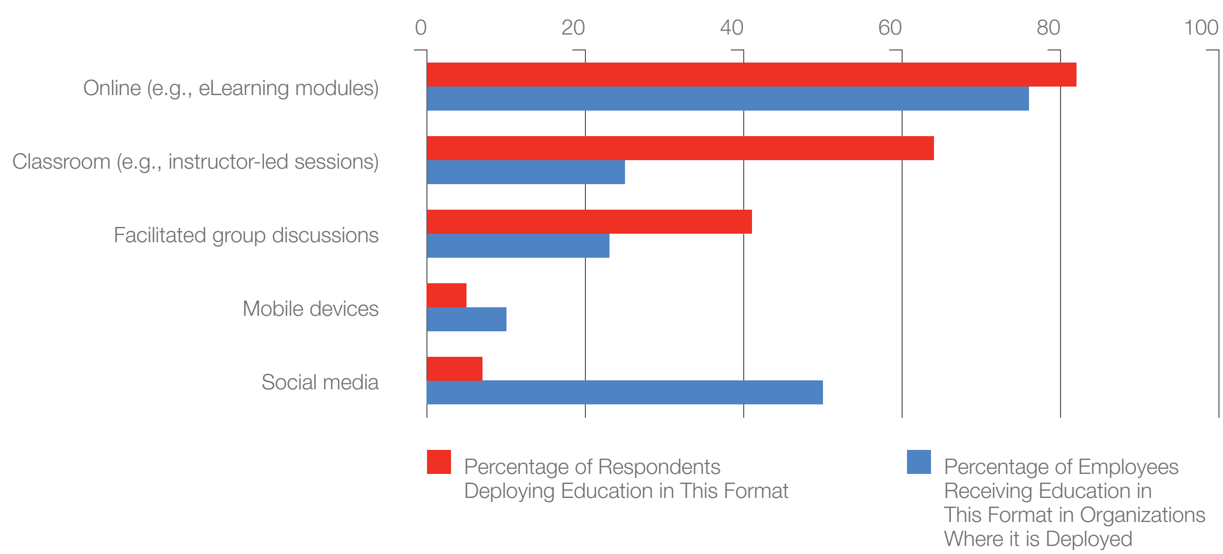
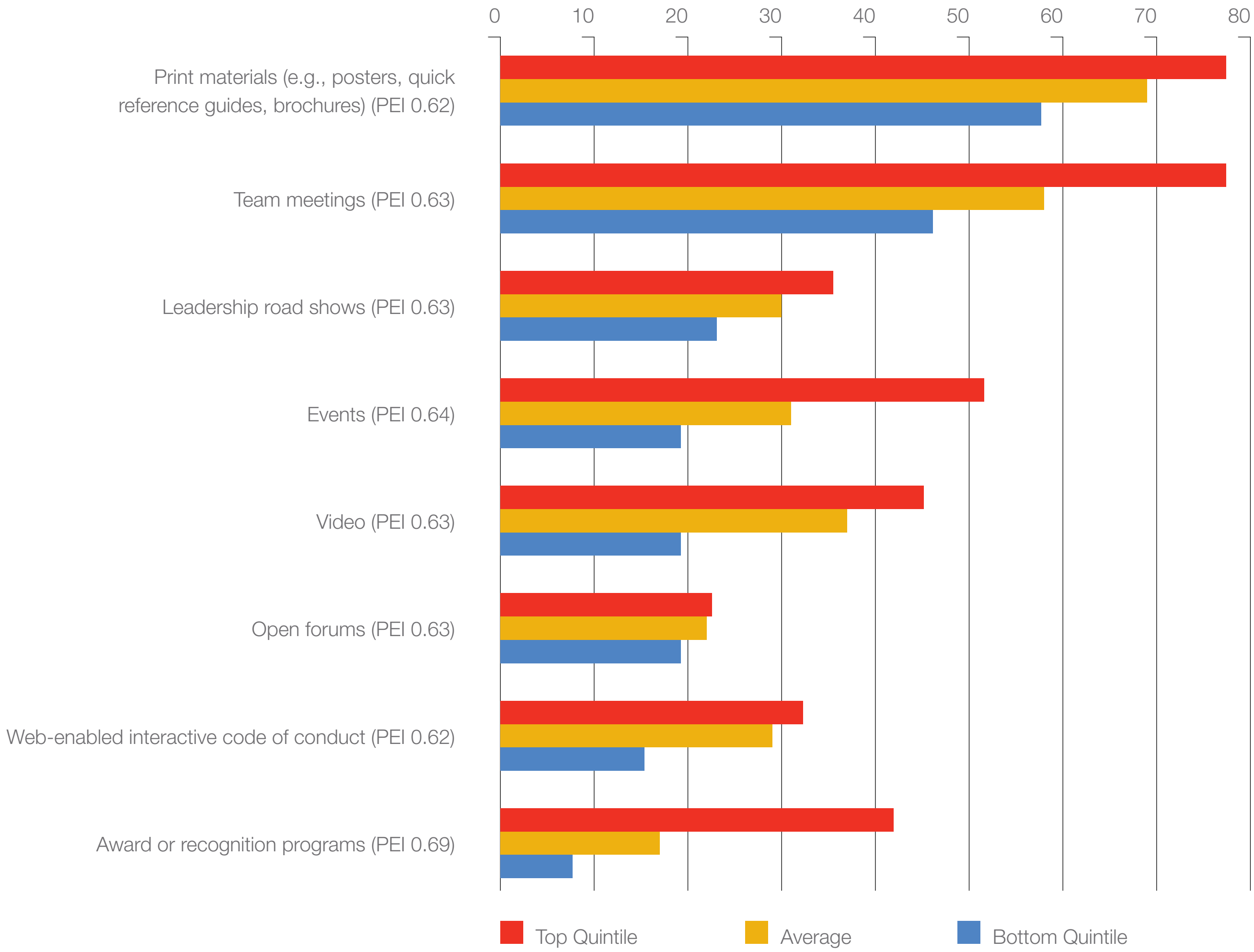


Figure 20. Building Awareness: Who Does What



Impact is measured in terms of effect on behavior, and it seems unlikely that anyone intending to have such impact would look for it in a single, annual approach to a topic of any salience. That said, a surprising number of programs (15 percent) never roll out theme-based campaigns at all, and they have an average PEI score of 0.53. By contrast, the 20 percent of programs that do so on a quarterly basis have average PEIs of 0.63. Every program in the top quintile conducts theme-based campaigns on some basis, while more than one in four among the bottom quintile never do at all.

There is no end to options for raising awareness of E&C issues for employees. Some are quite common. Fully 87 percent of programs use email, and 72 percent use their intranets for this purpose. Among the less common, it appears that the degree of association with impact increases with the degree to which they express the focus of the business unit or company, rather than the E&C program as such. Team meetings (average PEI score 0.63) and other public events (at 0.64) make a difference. Official corporate award and recognition programs reflect a company's focus and culture, and are closely associated with highly effective (0.69) programs.

The 20 Things Most Everyone Does

The bulk of this report focuses on more and less effective practices and programs in terms of their impact on the organizations they serve. Accordingly, little attention has been paid to the body of attributes and behaviors most notable by virtue of their ubiquity.

Regulators and other concerned parties recognize that there is no ideal—that each program and company is unique. That said, there are minimum regulatory standards, as well as a developing consensus around the fundamental requirements for ethics and compliance programs, generally. (See the discussion of hallmarks at page, 14.) For this reason, it is not surprising to see code of conduct, helplines, training, and other basics high on the list. Other items might be less obvious, but all are sufficiently prevalent to suggest that practitioners should attend to them or consider something substantively similar.

To the degree indicated, ethics and compliance programs:

90% Use audit findings to inform their E&C risk assessment

89% Deploy online learning modules for at least some of their employees

88% Target at least some of their education and communication at their entire enterprise

87% Have made at least substantial progress on providing employees with a secure and anonymous channel for reporting concerns

87% Use employee email to raise awareness on E&C issues

86% Have made at least substantial progress towards the deployment of their codes of conduct with associated policies and procedures

86% Report helpline and investigations data and trends to their boards

84% Have as "very important" program goals to increase employee comfort with speaking up and to ensure employees use the company values as a framework for decision-making*

82% Use data about reported misconduct (e.g., from the helpline) and code of conduct violations to inform their E&C risk assessment

78% Have completed building capacity for confidential reporting and internal investigations

76% Plan to keep their staff the same size this year

75% Report key risk assessment and mitigation plans to their boards

74% See themselves as drivers of culture in their organizations

72% Use company intranets to raise awareness on E&C issues

72% Report education completion and certification rates to their boards

70% Measure the effectiveness of their education using completion rates and employee feedback

70% Use regulatory enforcement trends to inform their E&C risk assessment

70% Report code of conduct violations to their boards

69% Use print materials (e.g., posters, quick reference guides, brochures) to raise awareness on E&C issues

---

*Many compliance officers share a variety of goals for their programs overall as well as their education and communication efforts. Most common among program goals are the following:

- Increase employee comfort with speaking up (84 percent);
- ensure employees use the company values as a framework for decision making (83 percent);
- strengthen the ethical culture (82 percent);
- improve risk management capabilities (80 percent);
- strengthen ethical leadership (79 percent);
- meet all regulatory requirements for effective E&C programs and best practices (79 percent); and,
- improve third-party oversight and management (73 percent).

Most common among education and communication goals are:

- Reinforce the code of conduct, ethical standards and company policy (93 percent);
- promote awareness and understanding of the E&C programs purpose and importance (82 percent);
- emphasize personal accountability and responsibility (79 percent);
- influence employee behavior and the ethical climate in the organization (79 percent);
- promote alignment between core values and day-to-day operations (73 percent); and,
- integrate company values as a framework for company decision-making (70 percent).

Conclusion

Broadly speaking, commitment, resources, and compliance-related outcomes are on the upswing. This suggests that the ethics and compliance community, the corporate world of which it is a part, our regulators, and other stakeholders are all beginning to see the fruits of this decades-long effort to improve how we do what we do.

As we have seen, however, both the effort and the impact have been uneven. Certainly, those who have set out to address little and accomplish less seem to have done exactly that, while those who have set out to change culture and elevate behavior have marked significant gains. Still, the relationship between effort and impact has itself been uneven, with some investments yielding consistently higher returns than others.

The first of the high-yield investments is an intentional focus on culture. Values drive culture, because values drive behaviors, and behaviors—how things are really done in an organization—*are* culture. Behaviors, in turn, drive outcomes. The analysis makes clear that businesses focused on culture, on values, on risk management, and on innovation have very effective compliance programs. And such programs have very effective businesses.

Secondly, the most effective ethics and compliance programs don't "do" ethics and compliance. They enable and assist their business units to do so, or—more precisely—to "do" culture and "get" compliance as an outcome. These programs are more likely than not to have a seat at the CEO's or the board's table. And those CEOs and compliance officers have built ethics and compliance into their organizations, not bolted it on as a layer of controls. These programs echo the clear tone at the top and help reinforce the even more important tone in the middle. These people celebrate the ethical leadership that they embody. They outbehave, and they outperform.

Finally, high-impact ethics and compliance leaders have the ambition and determination to set more goals, seek more inputs, generate more outputs, and use more rigorous metrics in the difficult endeavor of inspiring change and elevating behavior. Less effective programs are led by those who check their boxes and turn away. They paper a program in hopes of mitigating some inevitable penalty. More effective programs are led by those who hit their marks and lean in. They weave their programs through their organizations in hopes of multiplying the benefit of the impact those organizations can have in their worlds.

We hope that this study and the rest of our analytic work will provide our partners and colleagues throughout the impact business with a little more insight and some more capable tools for moving our collective work forward and demonstrating its value to our business leaders, the regulatory community, and concerned members of civil society.

Please feel free to contact us at: **www.lrn.com/the-2014-ethics-and-compliance-program-effectiveness-report.** There, you will also find complete survey and benchmarking data and other useful materials.

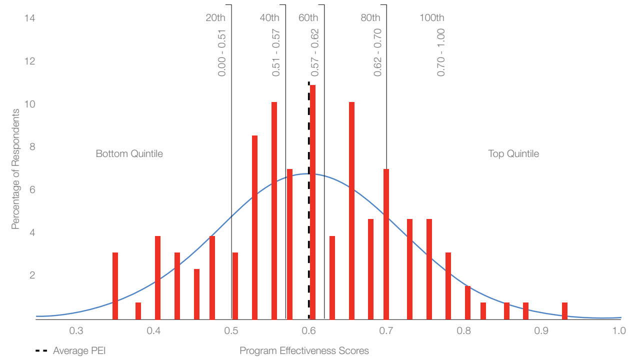
Methodology

The Program Effectiveness Index (PEI) is designed to measure the degree to which each respondent program has had impact on the organization of which it is a part. The PEI is built on eight separate data points reflecting program impact:

- As a business enabler (e.g., providing advice/ counsel, enabling better decision making);
- as a corporate conscience (e.g., promoting an ethical culture and values-based behavior);
- in the celebration of acts of ethical leadership;
- in the frequency of employee application of the company code of conduct; and,
- in the perceived effect of E&C education on employee behavior and decision making.

Each index element has been tested to ensure high degrees of internal consistency and reliability. Data were collected from approximately 200 programs (see the Demographics section, below), though not all respondents completed all questions, and only those completing all index questions were used to calculate the PEI.

Programs are ranked on a scale of zero to one. Programs are ranked relative to one another, and the specific PEI scores identify their relative locations on the continuum.



The “average PEI score” reported with respect to a particular behavior or attribute is the average of the individual PEI scores of all of the indexed respondents who report that behavior or attribute. This measure is intended to reflect correlation and not causation. The degree of correlation of each PEI finding has also been tested.

No PEI result reported here (other than those listed without comment or those noted for an absence of correlation) has a statistical significance below 68.3 percent, and all are “color coded.” Reported results without colored highlighting should be seen to have a statistical significance between 68.3 percent and 95.4. Results highlighted in yellow have a statistical significance between 95.4 percent and 99.7 percent. Highlighted in blue are results with statistical significance above 99.7 percent.

The comparison of quintiles with respect to particular attributes or behaviors is, unless otherwise noted in the text, the percentage of indexed respondents among those in the top 20 percent ranked by PEI score (i.e., with PEI scores at or above 0.70) who report that behavior or attribute compared with such respondents in the bottom quintile (i.e., with PEI scores at or below 0.51).

Appendix

Demographics

Figure 21. Seniority in Role

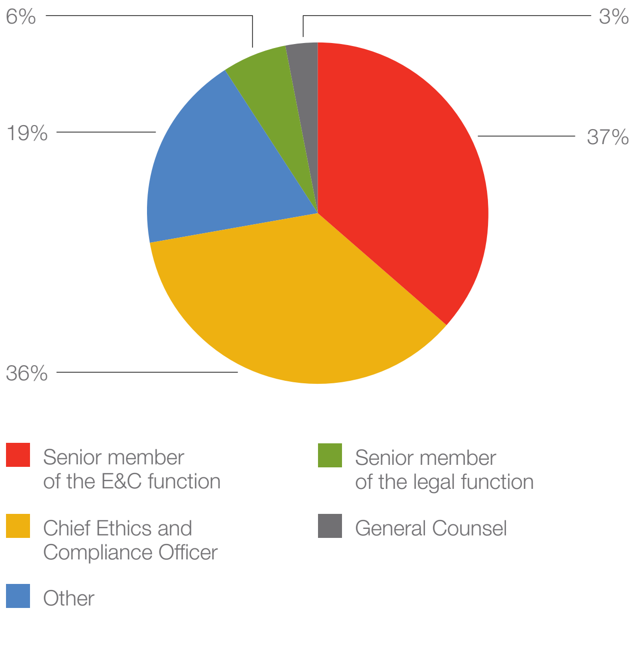
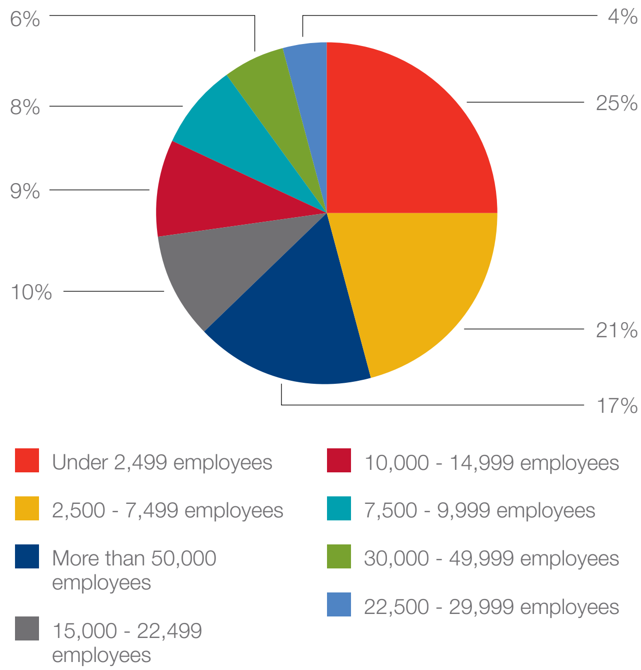


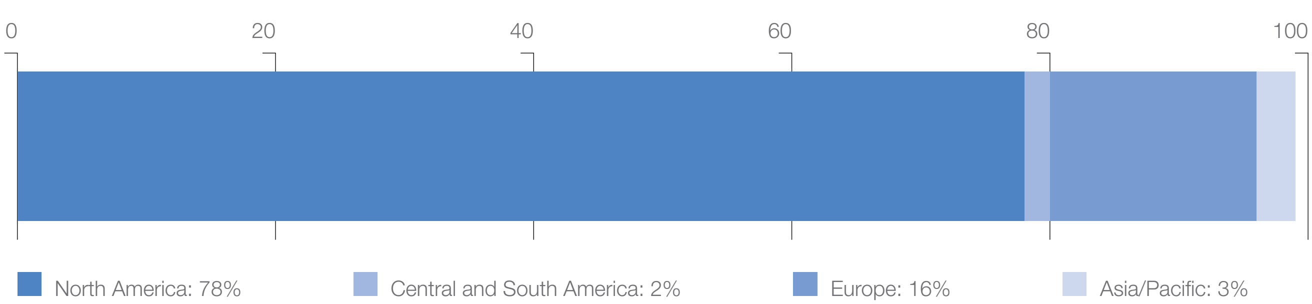
Figure 22. Number of Fulltime Employees



Respondents by Industry

Primary Industry	Percent	Primary Industry	Percent
Manufacturing	14	Computers	2
Other (Please Specify)	13	Consumer Products & Services	2
Insurance	13	Travel, Leisure & Hospitality	2
Energy (Oil & Gas, Renewables)	8	Media, Music, Publishing & Broadcasting	2
Pharmaceuticals, Medical Devices & Biotechnology	7	Telecommunications	2
Chemicals	6	Business Services	1
Financial Services	6	Electronics	1
Aerospace & Defense	5	Retail	1
Automotive & Transportation	4	Construction & Real Estate	1
Food, Beverage, Tobacco & Agriculture	3	Security	1
Health Care	3	Wholesale/Distribution	0
Utilities	3		

Figure 23. Headquarters Locations



About LRN

Since 1994, LRN has helped over 20 million people at more than 700 companies working in over 100 countries simultaneously navigate complex legal and regulatory environments, foster ethical, winning cultures, and inspire principled performance in their operations. LRN's combination of practical tools, education, and strategic advice helps companies translate their values into concrete corporate practices and leadership behaviors that create sustainable competitive advantage. In partnership with LRN, companies need not choose between living principles and maximizing profits, or between enhancing reputation and growing revenue: all are a product of principled performance. LRN works with organizations in more than 100 countries and has offices in New York, Los Angeles, London, Mumbai, and Paris.

Please visit www.lrn.com/the-2014-ethics-and-compliance-program-effectiveness-report to explore the 2014 Ethics and Compliance Program Effectiveness Survey data and findings in more detail.

For more information about LRN visit LRN.com, or call: 800 529 6366 or 646 862 2040.

© 2014 LRN Corporation. All rights reserved.

Inspiring Principled Performance℠

LRN.com