

CLAYTON UTZ

Compliance from Scratch  
Step by Step Design and Implementation



# Compliance from Scratch

## Step by Step Design and Implementation

The Clayton Utz contact for this document is  
**Randal Dennings on +61 7 3292 7017 / +61 2 9353 5979**

Clayton Utz  
Lawyers  
Level 28, Riparian Plaza 71 Eagle Street Brisbane QLD 4000 Australia  
GPO Box 55 Brisbane QLD 4001  
T +61 7 3292 7000 F +61 7 3221 9669

Level 34, 1 O'Connell Street Sydney NSW 2000  
+61 2 9353 5155 F +61 2 8220 6700

**[www.claytonutz.com](http://www.claytonutz.com)**

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## Introduction

The purpose of this paper is to provide an overview to assist compliance practitioners in the process of designing, implementing and then evaluating compliance systems having regard to the Australian standard on compliance (AS3806-2006).

I propose to briefly deal with these issues under the following headings:

1. Design of compliance systems;
2. Implementation of compliance systems; and
3. Evaluation of compliance systems.

### 1. Design of Compliance Systems

In my view, the task of designing a compliance system is essentially an “enlightened” management task. “Management”, since essentially compliance is a management skill. “Enlightened”, since the goals of compliance include long term sustainability and generally do not result in immediate significant benefits.

The object of a compliance system is to ensure that compliance is introduced throughout an organisation to ensure that management’s desired results can be achieved reliably and consistently throughout the organisation’s operations but within the parameters required by the law.

In order to design a system that can achieve this outcome it is important that measures are put in place "up front" to ensure that everyone inside the organisation knows what they should be doing. Further, those who are charged with the responsibility of operating the compliance system must be able to know what is going on, whether the desired results are being produced, and if not, where the problems are and how they are being attempted to be addressed. In summary, the compliance system needs to have a clear objective with clear targets and outcomes that are sought to be obtained.

The task of designing a compliance system must reflect the specific needs and challenges faced by each organisation. In my view, there is no one “off the shelf” or “one size fits all” solution.

What follows is a 3 step suggested methodology for your consideration.

**First**, the designer needs to determine what their organisation’s compliance system should contain and look like. In my view the essential elements are:

- A policy setting out the organisation’s view on compliance from the Board and setting organisational governance, compliance and risk tolerances and expectations;
- A comprehensive legal risk assessment review to ensure that a compliance system is dealing with the right legal risks;
- Appropriate documentation describing how the system works, who has the responsibility for what compliance obligations and controls applicable to the organisation and who is operating the compliance system and how the system is to be kept relevant and current;
- What control mechanisms are in place to ensure that people are acting in accordance with the compliance system, including reporting, monitoring and supervision;
- Operational processes and procedures assisting frontline staff on an operational basis;

- General training and back up education to assist all organisation members in understanding both the "how" and "why" of compliance; and
- Vitality, the structural relationship between compliance and the other key functions of the organisation such as governance, risk, audit, legal counsel and HR function and personnel / contractor incentive system. In my view, the structure and interaction between these key "control" areas of the business will ultimately determine the success of the business's compliance system and ultimately the culture of the organisation.

**The second step** is to ensure that all stakeholders are considered by the designer with a view to ensuring their potential reaction to and "buy in" into the system and to obtain the best results on the implementation of the system.

Usual stakeholders include:

- Directors;
- Senior management and staff;
- Shareholders;
- Linked third parties, for example, agents, contractors, distributors and alliance members;
- Customers;
- Suppliers;
- Insurers, especially professional indemnity and directors and officers insurers;
- Regulators;
- Consumer organisations; and
- the Public.

To the extent that is necessary, each organisation needs to take into account each of the above and an appropriate engagement and implementation strategy needs to be developed.

A useful way of doing this is to utilise "culture change" techniques so as to ascertain and, if necessary, thereafter modify the compliance culture of the organisation. A report should then be prepared by the compliance system designer as to how an appropriate compliance system can be implemented to address any deficiencies uncovered by internal or external reviews. The implementation plan should specifically also seek to address the organisational compliance risks. A key (but difficult) task is to negotiate, set and continue to focus on achieving tangible and measurable compliance targets. These targets will require ongoing monitoring for continuous improvement and must relate to and support the business goals of the organisation whilst achieving sustainable synergies and outcomes with other business, governance and risk goals.

**Thirdly**, this review and the implementation plan needs to be wholeheartedly endorsed and supported by the Board and by the senior management of the organisation and implemented via a compliance committee and compliance staff with real "clout".

This implementation plan should also have regard to all laws, codes or other rules that are perceived to be critical to the organisation and a review as to whether they are being dealt with appropriately at the time of preparation of the implementation plan.

Inherent in the plan will need to be an initial assessment of the key exposed areas that require immediate action and then a prioritisation of compliance attention and resources thereafter.

A board approval for a compliance budget should also be required in order that, inadvertently, compliance does not stumble through lack of allocated resources.

The implementation strategy to be utilised should:

- Link into the existing management systems and be designed to promote business improvement;
- The system should also ensure that the responsibility for compliance system lies with the existing management structure - not the compliance staff alone;
- Ongoing consultation and feedback with senior management, front line staff, third parties (including distributors and outsourcers) should also be a part of the implementation process;
- As well as articulating the organisation's commitment to compliance initially, the Board and senior management needs to also act consistently with these statements and regularly reiterate their commitment in this regard;
- The system itself should also be periodically reviewed so as to ensure that it is being effective (see 4 below);
- A report as to the effectiveness of the compliance system needs to be the feedback to the stakeholders and any necessary alterations made, reviewed and reissued. This feedback step is vital to ensure each stakeholder receives the necessary information. For example, staff need to know whether the metrics are being maintained, or their business unit senior management requirements both detailed business unit and "rolled up" organisational figures to monitor;
- It is essential that a compliance system specified the assessment criteria at the outset and continues collecting and reviewing data;
- Each activity should articulate the relevant objectives including performance objectives and key performance indicators (KPIs); and
- At the end of the day it is all a matter of continuous improvement and updating as a result of the changing requirements of the organisation, the marketplace and legislative structure in which the organisation finds itself.

## **2. Implementation of Compliance Systems**

Whilst every organisation has its own individual needs and requirements the following is a possible methodology of implementation:

- The board and/or CEO of an organisation appoints a person or small group to oversee the initial establishment of the compliance system (often it is the person who designed the system as described in 0 above) and a senior management "sponsor" to provide ongoing support ;
- This "compliance champion" and sponsor put together a proposal for the board's review of how a project can be established to determine the appropriate implementation plan;
- The "compliance champion" and sponsor by use of internal (and external resources, where warranted, e.g. focus groups), determines the suggested targets and outcomes required for the compliance culture of the organisation;
- The "compliance champion" and sponsor also makes discrete enquiries as a "reality check" from customers, suppliers, competitors and regulators as to their view of the compliance culture of the organisation.

- The “compliance champion” and sponsor do a quick review of the risk management documents for the organisation and of its legislation lists to check for their completeness and accuracy;
- The “compliance champion” then does a follow up presentation to the board of the revised suggested implementation plan which is focused on:
  - (a) Providing directors and senior management with a due diligence defence or at least evidences the compliance efforts of the board and organisation;
  - (b) Involving all management and staff and takes into account the appropriate culture changing principles as required;
  - (c) Involving all necessary external stakeholders including suppliers, customers and joint venturers and, where applicable, relevant regulators who have expressed adverse views; and
  - (d) Is focused upon strengthening the business and fulfilling corporate objectives having regard to draft compliance targets and legal obligations allocated on a business unit level.
- After discussion or amendment where necessary at board level, the implementation plan and the budget for its implementation is adopted;
- Using consultative processes the “compliance champion” and sponsor establishes a compliance committee involving some key influencers in the organisation identified during the legal risk assessment phase, with a view to overseeing the compliance roll out;
- The initial groundwork is then done whereby key senior management stakeholders are appraised with the aims and objectives of the compliance system and in particular the reason for selection of the compliance priorities as established in the implementation plan;
- The appropriate support from senior management is sought and emphasised together with “buy in” or amendment;
- Phase one commences with a “pilot program” in that area of the organisation which is identified as being both in need of compliance resources and as being receptive to their deployment;
- The detailed operational plans and compliance targets are agreed in advance with senior and middle management and then checked by the compliance committee as against the implementation plan;
- The compliance policy statement is issued by the board emanating from the chief executive officer and managing director;
- A full staff general education campaign is undertaken which leads into a detailed staff training system on those necessary areas that require amendment;
- Ongoing assessment of changes that occur is then made by the compliance committee;
- Alterations are made as required to the implementation plan by the compliance committee;
- As a result of review, the compliance committee notes lessons learnt;
- Phase two is then implemented in the next operating division and so on;

- Records are kept as to all necessary training and education and evaluation of changes against stated compliance targets objectives and budgets and appropriate reports are supplied via the compliance committee to the board;
- A general review of the implementation plan should be undertaken in regular intervals and issued to the board and senior management;
- Periodically, reviews should be considered during the implementation phase so as to ensure that the system is approaching the desired level of compliance outcome;
- Once the compliance system reaches a mature stage of development regard should be had as to whether it is advantageous for a significant external review to be undertaken; and
- Generally, compliance communication and feedback need to also be produced to all staff and key stakeholders to update them on progress.

Whilst this outline is aimed with a larger organisation in mind, the same steps can be used (with appropriate modification) when being considered by smaller organisations.

Of crucial significance are the nature and characteristics of a compliance manager/"compliance champion", compliance sponsor and various compliance committee members.

Whilst the compliance committee leaders need to be perceived to be objective and fair, it is important that members of the committee also be representative of and report back to relevant line management within the organisation.

Some qualities that will be needed by the compliance manager/"compliance champion" include the following:

- Understanding of corporate management;
- An ability to recognise real rather than apparent results;
- An ability to audit, train, and interpret the law – or know where to go to access these skills;
- An ability to get the most out of people inside the organisation for compliance without being authoritarian or overly friendly;
- Being able to problem solve creatively with strong people skills, a capacity for planning, analysis, evaluation and project management; and
- Strength of character to stand up to senior personnel where necessary and to persevere in the face of criticism or unmerited personal attack.

Generally, I suggest consideration be given to the appointment of a small group rather than one "champion" or "sponsor". This is to remove a key person dependency and also to provide a wider range of views and experience to be brought to bear upon the project. From a practical perspective, it is also likely to be more sustainable in the long term (if well selected).

### **3. Evaluation of Compliance Systems**

The test of whether the system is doing its job effectively is a difficult issue. How can organisations be sure that their compliance system is really working? There are many ways of evaluating the effectiveness of a compliance system and no one way will suit all systems.

Essentially, a helpful evaluation technique is a "cocktail" of the following:

- Does an analysis by the complaints received by your organisation indicate:
  - (a) That nature and seriousness of complaints is decreasing?
  - (b) That the number of systemic complaints or repeat complaints is decreasing?
  - (c) That the same types of problems are being dealt with and are not recurring because you have fixed the system? or;
  - (d) That compliance and organisation's managers are actively going out and seeking complaints?
  
- Does an analysis of the corporate culture of the organisation indicate an improvement in the culture and so that it strengthens the organisation and promotes serving its customers? In other words, you can provide as much training as you wish but if the culture of the organisation is such so as to encourage deliberate or reckless actions in breach of compliance requirements then your compliance actions will come to naught;
  
- Will an impartial investigation into management's treatment of compliance breaches show:
  - (a) A ruthless prosecution of deliberate or reckless actions in breach of compliance requests;
  - (b) An encouragement and retraining emphasis for accidental errors;
  - (c) A continuous revision of the corporate system for areas of systemic complaint;
  - (d) Regular, practical reinforcement of commitment to compliance by those in authority;
  - (e) The equal emphasis for staff of the importance of compliance with the importance of achieving results; and
  - (f) The establishment of business and compliance recognition and incentive programs and awards?
  
- Do the operational plans for the implementation of the compliance system set fourth the key targeted results that are sought to be achieved in an objective fashion? Are they regularly monitored, reviewed and reported on by management?
  
- Are those measurements ever varied to reflect the maturation of the compliance system and are they linked to the operational procedures and corporate goals?
  
- Are the resources allocated to compliance sufficient to achieve the job and do the reports to the board or senior management stress both the positive and negative outcomes of the compliance system?
  
- Are there sufficient independent testing of the system and reviews by way of "mystery shoppers", undisclosed compliance activity and where necessary, external review?
  
- Are governance, risk and compliance issues considered synergistically and actions leveraged so as to minimise doubling up and maximising resource sharing (e.g. in incident escalation and risk assessment)?
  
- How often are full assessments and reviews of the compliance system undertaken? and;
  
- What and who has closed off / implemented on the outcomes of the review?

Of course, these are only some of the matters that can be examined.

## Conclusion and some helpful tips

I trust that the above will be of some assistance to those who are seeking to design, implement and evaluate compliance systems.

For a more comprehensive treatment of these and other issues I strongly recommend reading “The Official Guide to AS3806” by Brian Sharpe and myself and “Australian Legal Compliance – Making it Work”, the CCH loose-leaf service written by the Clayton Utz Compliance Team.

I have found over years of compliance practice a couple of specific helpful hints in this area that I find can greatly assist in the effectiveness of compliance systems.

The “Top 30” are:

1. Initially understate and over perform in your objectives and goals for the compliance system. This gets people into the habit of achieving compliance goals;
2. Establish a written commitment by an organisation to stand by those who innocently or accidentally breach the law but equally to abandon and if necessary assist in the prosecution of those who deliberately or recklessly breach the law, and stick to it;
3. Set up your systems so that the operational procedures must be followed or else the desired outcome can not happen. For example, by use of operational procedures in a step-by-step basis with compliance built in such that you cannot progress without having attended to the compliance step. Do not seek to explain the law relating to these operation instructions other than in a general way, but simply positively advise the way things are to be done in practice;
4. Look at creative ways to influence behaviour and seek to develop intrinsic motivations rather than "big brother" monitoring. For example, require line and middle managers to report upon their new compliance initiatives every month and overtly reward those who actively promote compliance;
5. Utilise the compliance committee and compliance staff as your talent pool from which promotees are selected;
6. Allow twice as much time as you initially think could ever reasonably be required for consultation with staff and senior management in the implementation plan (it always seems to take "twice as long" in practice as you think it should);
7. Never promote those that do not have sound compliance credentials;
8. Build compliance into the hiring criteria of your organisation (e.g. see HB 322-2007 on Reference Checking the Financial Services Industry);
9. Provide a significant dose of compliance induction upon hiring and have regular training updates. Further, provide specific compliance training prior to any change in job description to meet the new position requirements.
10. Undertake a corporate SWOT and cultural analysis prior to each regular review of the compliance system;
11. Implement whistleblower protection in a robust fashion inside your organisation permitting an anonymous method of providing feed back to whistleblowers;
12. Use focus groups on compliance regularly with a cross range of staff and invite a customer to keep the system results focused;

13. Use computer based compliance reporting systems to ensure the compliance system is working and that training is being undertaken. Require annually, in advance, planned compliance steps for compliance staff and managers;
14. Seek regular reviews with regulators to see if it is possible to benchmark your KPIs and to be advised of upcoming changes in the business environment;
15. If possible, align the compliance group with your marketing, business development, strategy and research and development groups thus ensuring that these three groups can evaluate opportunities at the one time (and increasingly be seen as improving the business);
16. Provide an appropriate compliance “help desk” and help numbers and intranet site;
17. First start by reviewing the organisation’s risk analysis documents and ascertain whether they need to be updated and determine whether the compliance system neatly fits into the risk and governance systems;
18. Regularly (at least 6 monthly) review the legislation lists built into the compliance system;
19. Always ask the person on the job what is the easiest way of achieving the desired compliance result and then assess whether this is an appropriate compliance outcome;
20. Apply the resource allocation for compliance where it will make the most difference in strict priority from a compliance perspective;
21. Be suspicious of compliance systems, which are “off the shelf”- especially if they rely upon manuals;
22. Convert your paper manual into a computer resource that can be automatically updated and reviewed from time to time; - when in doubt, and if relevant, put it on the compliance intranet!
23. Always have a mix of announced and unannounced audits but...only use unannounced audits strictly in accordance with the compliance system and then only audit on the published objectives and criteria’s contained in the compliance system – no "surprises" please;
24. Discuss your proposed compliance system for the year with your company secretary, insurance advisor, internal auditor, internal lawyer and the risk management team. It may well be that compliance can assist in obtaining information for the purposes of compiling the Annual Report or for other organisational purposes;
25. From the insurance perspective, it may well be that the compliance activity can be used to reduce insurance premiums or remove exclusions;
26. Auditing and other staff should also be used for assistance in any compliance audits and vice versa;
27. Compliance staff may well be able to provide feed back to the risk management team as to whether the risk assessment needs to be reviewed or whether a new risk has been uncovered.
28. Protect and reward line “compliance champions”;
29. Include a positive reinforcement to compliance in all key public/internal communication by the organisation’s CEO; and
30. Have members in your compliance committee join the ACI (the Australasian Compliance Institute) so as to keep up with compliance developments.

I trust that these “tips” will be of assistance by your organisations in their ongoing quest for continuous improvement.

**For further information please contact:**



**Randal Dennings**  
Partner

T +61 7 3292 7017  
T +61 2 9353 5155  
F + 61 7 3221 9669

[rdennings@claytonutz.com](mailto:rdennings@claytonutz.com)

Clayton Utz

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Sydney

Level 34  
No. 1 O'Connell Street  
Sydney NSW 2000  
T +61 2 9353 4000  
F +61 2 8220 6700

Melbourne

Level 18  
333 Collins Street  
Melbourne VIC 3000  
T +61 3 9286 6000  
F +61 3 9629 8488

Brisbane

Level 28  
Riparian Plaza  
71 Eagle Street  
Brisbane QLD 4000  
T +61 7 3292 7000  
F +61 7 3221 9669

Perth

Level 27  
QV1 Building  
250 St. George's Terrace  
Perth WA 6000  
T +61 8 9426 8000  
F +61 8 9481 3095

Canberra

Level 8  
Canberra House  
40 Marcus Clarke Street  
Canberra ACT 2601  
T +61 2 6279 4000  
F +61 2 6279 4099

Darwin

17–19 Lindsay Street  
Darwin NT 0800  
T +61 8 8943 2555  
F +61 8 8943 2500

Hong Kong

703 - 704  
The Hong Kong Club Building  
3A Chater Road  
Central Hong Kong  
T +852 3980 6868  
F + 852 3980 6820

[www.claytonutz.com](http://www.claytonutz.com)

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