Compliance Risk Assessment

Roman P. Bulyga¹, Lyudmila M. Kupriyanova²

¹Doctor of Economics, Professor, Chair of Department of Audit and Control, Vice-Rector for strategic Development the Financial University under the Government of the Russian Federation, Moscow.

²Candidate of Economic Sciences, Associate Professor, Associate Professor, Deputy Head of the Department "The Economics of Intellectual Property", Associate Professor of "Economic Analysis" Department the Financial University under the Government of the Russian Federation, Moscow.

Abstract

Importance/Subject. Compliance is an important component of economic entity’s corporate management. It starts at the top management level and is translated into all levels of business. The article describes the development of compliance system as an effective tool of risk minimization in modern risk management as well as the assessment of the realization of compliance functions. It also discusses the efficiency in applying compliance when creating an adequate control system including preventive procedures and those aimed at detecting breach as well as training programmes.

Objective. To research of international practice of compliance system development and prove that compliance control is necessary for all types of organizations as an obligatory part of internal control and risk minimization system in business.

Methods. The following concepts are studied: compliance, risk compliance, compliance control, compliance functions and topical problems of managing compliance risks, practical experience of creating effective compliance risk management systems, development of compliance as an instrument of generating profit and business growth and others. The main focus is put on solving the problems of effective management of a company in compliance with national and international legislation; the rules of market relations, contract obligations and international resolutions (sanctions, embargo) based on carrying out certain functions aimed at meeting the company’s obligations to stakeholders and pursuing their interests; effective management of financial losses risks, damaging business record and goodwill, restrictions imposed by the government and some others. The article proves the importance of effective functioning of a compliance system based on control, training, risk assessment, establishing key indicators to measure performance and efficiency and some others in accordance with the methodological requirements of structuring functions.

Conclusions and relevance. The review of methodical elaborations and the results obtained in the sphere of managing compliance risks made it possible to detect the problems and to justify their possible solutions targeted for effective development of business in particular for the elements of quality management system which is the methodology of lean production. The article recommends the effective model of compliance policy which is based on the following principles: intolerance to any form of corruption, unconditional law enforcement and imminence of punishment.

The research of areas of compliance operation results in assessing the compliance risks and the opportunity to avoid unfavorable consequences for the company and its management.

Keywords: business analysis, compliance, requirements, standards, compliance control, compliance risks, compliance management, monitoring, competence, stakeholders, internal audit function, functions of compliance, analysis of business processes, business process optimization.

“The more successful the business is, the more effective the risk management should be”

V. Balakin,
President of National Compliance Association, Russia, Moscow

International markets volatility stipulated the paramount importance of compliance risk management and ensuring stability of a business. Compliance or compliance control which characterizes the action made in accordance with a certain order or request is now considered to be a special type of professional activity. [1,2].

The term «compliance» has been the focus of significant interest in the USA and Great Britain for a long time. As far as Russia and the NIS countries are concerned, the word «compliance» appeared with the emergence of large international companies in their markets. Generally, «compliance» encompasses risks of implementing legal sanctions and the restrictions of regulating authorities as well as risks of financial loss, loss of social status as a result of incompliance with standards, business rules and regulations.

International and Russian companies gradually realize the relevance of compliance. Today, it is the major concept of effective business conduct that requires special competencies of the staff. The effectiveness of business development is dependent on staff’s competences and qualification.

There is a tendency to manage business development effectively in compliance with the national legislation and international laws, contract obligations and international regulations (sanctions, embargo).
All the above-mentioned rules and procedures are based on the accomplishment of some features such as company’s compliance with the stakeholder needs and demands, effective financial risk management, damages to goodwill, restrictions imposed by the State.

«Compliance» is impartially regarded as the foundation of company’s control processes and an obligatory component of management where the system of internal control is a major part. A strong incentive for compliance system development is the positive results of international practice of its development.

Professional communities have fierce discussions on how to organize the system of internal control and how to define its position within the whole system of internal control.

It is important to understand that compliance managers should participate and bear their part of responsibility for elaborating a company’s strategy, budget and business plans. A fundamental difference of a process-oriented approach is a focus on business processes and a causal chain between the units, while a traditional view of budgeting implies a solution of numerous organizational issues without considering any relations between units, therefore, causing inefficient allocation of funds.

The formal requirements to the creation and operation of Compliance Department are the following:

- to oversee and evaluate a compliance system;
- to detect, evaluate, monitor, control and advise on the risks that an organisation and its separate units face in professional business;
- to make recommendations to management and plans for effective control organization and implementation (rules, standards and practices applied in international companies);
- to design and introduce a system on compliance risks reporting, disclosing information on compliance risks in accordance with standards adopted;
- to educate the staff participating in compliance control;
- to provide management with reports, opinions and recommendations on reducing and eliminating the risks detected;
- to work out recommendations and commentary on framework, rules and procedures and to monitor if the company complies with them to decrease compliance risks;
- to lay down detailed guidance on application of the documentation that establish a standard of business conduct;
- to develop and implement activities that identify, analyze, evaluate and monitor conflicts of interest;
- to implement activities preventing violations of the established rules by the staff and to assess damage to business;
- to monitor if controls accord with adopted compliance rules and standards;
- to collaborate and coordinate efforts of the company’s units to reinforce risk compliance management.

Compliance Department, functioning as an independent body within the organization, is headed by a Compliance Officer/Manager who does not hold any other offices within the organization. A compliance manager acts as an independent review and evaluation body to ensure that compliance issues are being appropriately evaluated, investigated and resolved. Moreover, s/he reports directly to upper levels of management and may inspect and request any information from any department or company unit. Compliance Department is supervised by the Internal Audit Department [11].

This cooperation between Compliance Department and Internal Audit Department allows to develop, improve and implement principles of effective compliance management, based on the identified compliance-risks and breaches of the rules and recommendations.

Today, the list of job vacancies doesn’t encompass such positions as Compliance Managers/Officers and Compliance Controllers. But in practice they are already on the staff and are key figures in successful business development. A Compliance Manager has to be competent and professional taking into account the importance of compliance manager personal risks and risks of the whole organization.

The realization of the compliance function in an organization is a multistage process and can be implemented through:

- analysis of business activity and deals negotiated for compliance with legislation in force;
- analysis and assessment of the risks and economic, financial, and legal effects;
- recommendations on adjustments to comply with statutory regulations of the Russian Federation;
- identification of problem and critical areas likely to inflict financial losses;
- identification of compliance risks.

Small and medium-sized businesses need to determine the extent to which compliance is related to management and business process analysis.

Risk management is directly related to compliance and is part and parcel of the concept of lean production aimed to minimize financial risks. Well-targeted analysis of business processes is instrumental in determining the growth prospects for businesses and a number of improvements in their activity.
However, it should be noted that this mechanism is only effective when all employees are involved in documentation development and business processes description from the very start of their activity. The optimization process is based on the use of the centralized database which makes it possible to view all the sides of business processes. Nowadays, this management approach is gradually converging with the new functions of compliance.

ISO-certified organizations have major advantages of having a database in their corporate intranet with the business processes version downloaded, which allows the understanding of what is going on in the organization. Thus a foundation is laid for the optimization to be carried out and the business process chart to be constructed. Well-charted business processes can be useful in simulation modeling and optimization as well as in the assessment of complex corporate business processes and reducing the transition costs of compliance management. These days the modernization of the Russian economy is focused on reframing the concept of conducting business. The whole world’s production sector seeks the effective lean production methods and resource saving. A Congress on Lean Practices took place in the State University of St. Petersburg in October 2014. The participants of the Congress from Austria presented the concept of lean assessment of operational efficiency – a standardized quantitative assessment based on scoring and identifying ways to eliminate concealed losses.

Michael Wader, a US advisor on production system development, the author of “Lean Assessment Instruments” book (2004), a practicing consultant, a teacher of the Russian Lean Assessment School, has conducted hands-on training sessions for the executive staff of Oktyabrskaya Railway on the subject of “Lean Production: Leadership, Formation of Efficient Lean Teams”. V. Stepov, the head of Oktyabrskaya Railway, a speaker at the Lean Forum, said that “These days, our organization, as well as many others in the period of crisis, has proved the fact that only cost-efficiently managed organizations can survive. Nowadays, being an element of the quality management system the lean production method is the only way out of the crisis.”

Oktyabrskaya Railways started its strategic way for lean production as early as 2008. In 2011 this organization retrained 55 advisors on business goals achievement. Competition, competitiveness, types and the main causes of losses as well as other problems are the focal point of discussion at the lectures and seminars. The system of teaching lean production methods falls into three groups: teaching leaders, teaching innovators and advisors, and is based on project-making.

Lean Assessment is the objective appraisal of the current level of the process stability, of the process improvement of the degree of staff involvement in the related activities.

The first stage specifies the working place observation by the manager, the second one includes the interview with the key specialists of the working places. Experts submit the results of the assessment and the plan of the implementation of the recommended measures and activities concerning the key directions (inventory, processes, maintenance, logistics, suppliers, quality, planning).

The quality of strategic planning is the main condition for the achievement of short-term and long-term goals and objectives, specified in the plans and forecasts approved. Besides it is important to carry out an analysis for the effectiveness of making and implementing the planned tasks by the business entity. Home and foreign experience of the strategic planning appraisal is based on the use of the estimation procedure of the quality of plan making and application. The financial results and profit are considered to be the main performance indicators. The planning process starts with the drawing the plan of the financial results. The next step is the evaluating the total amount of assets and liabilities, assessing their structure and liquidity. Then the interest rate policy, the financial sustainability dependence, the profitability and stability of the business are worked out.

The Association of the German Automotive Industry, known as VDA, has a good record in German economy. In 1997 VDA created the Center for Quality Management (QVC), working on development of systems and methods for the formation of the future quality management system in the automotive industry, auditing standard of the business processes on the basis of the assessment and improvement of industrial enterprises management. In 2010 ISO9001 standard was comprehensively redrafted and changed according to the automotive industry customer requirements and it can be used by any organization for the internal audit and assessing production capacity. Nowadays the German automotive industry applies the strategy of the premium development of trade names, focuses on high labour productivity, high quality and production value of production, thus ensuring the global competitiveness.

Russia has formed the professional community of certified specialists in compliance development and implementation.
Experience exchange and development is realized in cooperation with the International Compliance Association (ICA), for example both the Association experts and representatives of the Russian and foreign leading companies took part in the international conference “The Compliance Risk Management, Internal Control and Sustainability”. Russian Agency of legal and judicial information (RAPS)/ infosud.ru, the press center of RIA Novosti, ICS and the International Compliance Association (ICA) were the coordinators of the conference. The conference made it possible for the participants to explore the latest methodological elaborations and achieved results in the field of the compliance risk management, to discuss problems and solutions associated with the coverage of challenges of compliance risk management, to exchange practical experience in creating effective systems for compliance risk management, developing compliance as a tool for profit and business growth, etc.

The compliance function as an effective tool of compliance risk minimization is the key one in the up-to-date business management, not only for the financial institutions but also for the real economy organizations.

There are several stages in creation of the competitive compliance system:

- before making a decision – the preparation of materials concerning the appropriateness of the compliance system adoption (Basel principles); advantages are the following - the positive impact on the corporate image, the opportunity to participate in the development of the compliance systems, the effective risk management, sharing responsibility in the sphere of compliance;
- making a decision – covering the main spheres of compliance. It implies the development of the internal normative documents, the development and adoption of the compliance program, the creation of the Compliance Department;
- system implementation implies the development of the policies and procedures in accordance with the compliance spheres (knowledge of the competitors, adherence to the confidentiality, theft control, sanctions and restrictive measures, the particular level of responsibility, data protection and storage, etc.), personnel’s awareness about compliance documents, personnel’s trainings in the sphere of compliance, the inclusion of the compliance matters into the personnel certification;
- compliance risk monitoring includes the compliance risk identification, the compliance risk estimation, level assignment to each compliance risk, the notification about the risk and provision of the appropriate measures and the development of the follow-up steps;
- presentation of results.

Basel principles in the compliance system are based on the top executives’ responsibility for organizing compliance, developing and implementing the compliance program and creating the independent effective compliance department. First the principles of organizing compliance were adopted in 2005 by Basel Bank Supervision Committee. The most common compliance model specified is “Three Protection Lines” including the following elements – Audit, Compliance, Business (8).

The success of compliance implementation depends on the cooperation between the three protection lines in matters of compliance, the aim of which is to protect shareholders, executives, employees and the contractors against compliance risks.

The effective implementation of the compliance system depends on the quality of the plan made.

The system approach to the construction of compliance function will allow to structure and create an effective function in order to ensure the compliance with regulatory and legislative requirements of the organization, in particular the one that includes process, technological and organizational elements of the structure. The main elements of compliance are the following:

- the organizational elements of the compliance system (organizational structure);
- the implementation of information systems and information technology in the field of compliance;
- reporting on Compliance (management of the organization);
- compliance-control types used in business processes;
- compliance policies and compliance procedures;
- the distribution of compliance functions and compliance risks on leadership and management levels;
- spheres of application of the compliance procedures and compliance regulation;
- training of compliance experts and supervisors of the business processes;
- monitoring of changes in regulations and compliance standards, and taking measures in order to ensure the improvement of business processes;
- the introduction of the compliance culture in the company’s performance by means of staff training (skills and competence development);
- conducting compliance auditing and self-assessment procedures;
- the development of compliance risks map, risk assessment, analysis of the possible impact on the company performance.
Russian Business Forum is the organizer of the annual conference “Compliance in Russia: the organization of an effective system of compliance control” [http://www.clj.ru/events/partners/244/].

The conference will address issues such as:
- the main directions of development of the compliance function in Russia;
- the construction of compliance function "from scratch"; the use of best practices as well as the lowest costs;
- the practice of compliance programs implementation in Russian companies;
- the key parameters of evaluation of the compliance services effectiveness;
- monitoring tools which ensure compliance with corporate standards;
- practical difficulties of working with regulatory authorities;
- compliance function outsourcing, etc.

Defining the areas which are relevant to compliance, we can identify the relationship with the employees, contractors, state officials as well as paying representation expenses (traveling and entertainment) by means of cash and other property. Thereby we should identify the major areas of compliance, in particular:

a) for socio-regulated organizations in selected areas of compliance:
- money laundry combating and foreign exchange control;
- anti-trust legislation;
- combating fraud;
- privacy, protection of personal data;
- consumer right protection;
- customs legislation;
- banking legislation;
- insurance legislation;
- the rules of professional associations;
- environmental standards;
- technical standards and regulations;
- safety regulations;

b) for any kind of organization:
- accounting and reporting, financial reporting (IAS, GAAP, RAS) and SOA;
- tax legislation;
- corporate law;
- employment and labor laws.

In this respect some experts include in the main areas of compliance internal rules and regulations of the organization; ethical code of conduct and local business practices.

The study of compliance coverage can be considered as an effective tool for managing compliance risks, which helps to avoid negative consequences for the company and the management.

Implementation of compliance functions is important both for top managers and owners. Therefore, elements such as follow-up control, training, risk assessment, establishment of key performance indicators, and the like, that is, all those activities that should be developed and implemented in accordance with the methodology of functions formation are important for the efficient operation of the compliance system [6 7].

Staff training is an essential function of the head of compliance department; his functions are similar to the functions of the head of risk management, and the development of compliance policy.

An effective compliance policy based on the following principles can be recommended:

intolerance to corruption of any form, i.e. strict prohibition for any persons acting on behalf of the Company or in its interests, directly or indirectly, in person or through a middleman, participate in corruption activities irrespective of business practices in this or that country;

the binding character: all employees are to abide by the requirements the corresponding legislation and internal normative and administrative regulations irrespective the job, work experience, position and other relations with the Company;

imminence of punishment: taking effort for quick and imminent lawsuit for corruptive activities and other breaches of international, Russian and foreign (in case the activity is performed outside Russia) applicable legislation and internal normative and regulating documents in the area of compliance irrespective the seriousness and form of the wrongdoing.

Therefore the Company can clearly define the basic elements of its compliance system, in particular:

1. relations with the personnel
   – the company expects that all employees share the company principles, abide by law requirements and the internal company norms and regulations;
   – the company aims at discovering and taking measures inside the company to those bona fide employees who report on possible corruptive activities;
   – the company guarantees that no punishment will be imposed on those employees who refuse to participate in corruptive activities that are qualified as such by the legislation;

2. relations with contractors (the company is duly prudent when selecting contractors, it informs them of its current policy, preference is given to those business partners, who exercise the same values as the company);
3. relations with public officials and state servants (it is considered unacceptable to pay or reimburse any public officials' or state servants' expenditures in order to gain any unlawful benefits in the course of performing one's duties);

4. hospitality expenses and presents (are acceptable on condition that they do not contradict international and Russian legislation as well as internal company regulations, in particular its compliance policy and Corporate Ethics Code);

5. participation in charity and sponsorship (the information on the charity and sponsorship expenditures must be open);

6. financial and managerial accounting (all operations are entered in the books, documented, available for examination according to the legal requirements; operations are not allowed unless they are recorded for accounting purposes, any distortion or falsification of managerial and any other types of accounting are strictly prohibited);

7. compliance system risks assessment (it is necessary to manage risk and monitor the business processes potentially vulnerable to risk of corruption).

Any entity functions in accordance with certain legal requirements and corporate regulations. The base for abiding by those regulations is formed by compliance, i.e. the conformity to the regulations examination procedure.

The research has revealed that international practice suggests compliance control of business processes which is exercised by compliance department officers in all areas of the business [5]. Modern businesses are after legal and civilized business practices so the management, understanding the importance and necessity of compliance divisions, supplies them with sufficient human resources and adequate access to information and documents.

In practice the necessity of compliance control is determined by corporate strategy. The highly qualified compliance structure provides a high level of perception of the company performance as well as its top management. Understanding by the company management of the compliance system sound and efficient functioning will help reduce the probability of profit loss risk, deliberate or casual loss and loss of goodwill [9, 10].

Compliance can be useful as a consultant on internal policy, strategy and tactics company business processes development. The interaction of the compliance control with business units allows to reveal, minimize or even eliminate compliance risks.

Compliance results in creating an adequate control system for a business including preventive procedures and those aimed at revealing breach as well as training programmes. Nowadays compliance is an important link on the system of corporate management as a whole starting from top management and conveyed downwards to all levels of the business.

REFERENCES


Stepov V., head of the October railway //
http://www.youtube.com/watch?v=2FY2CPZMNRw