

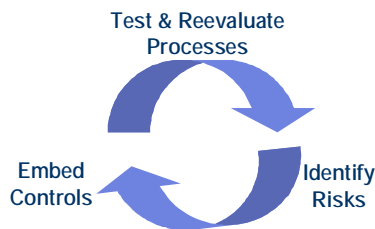


## COMPLIANCE IMPROVEMENT PROCESS

In early January 2005, 10 former WorldCom Inc. outside directors agreed to pay \$18 million of their own funds to settle pending shareholder and investor claims. Shortly after this announcement, a similar settlement arrangement was announced in which 10 former directors of Enron Corp. agreed to pay \$13 million of their own funds in a similar settlement with shareholders. What is unique about these two settlement arrangements is the requirement imposed by the lead plaintiffs that significant portions of the settlement amounts be paid from the directors' personal assets even though sufficient director and officer liability insurance was available. Directors generally avoid personal liability in shareholder suits by relying on charter limitations (such as those provided under Delaware corporate law), indemnification and director and officer liability insurance.

In light of the potential increased risk for personal liability following these two settlements, some directors are reconsidering their decision to serve as outside directors. But the vast majority are likely to continue to serve with an increased focus on their oversight duty and corporate governance best practices. Diligent directors are unlikely targets of litigation. The WorldCom and Enron settlements, in addition to the recent changes in the regulatory environment for public companies, should change governance and compliance focus to more of a prevention strategy rather than focusing primarily on "cure" techniques. Boards should seek to implement new governance and compliance tools and operating mechanisms and revisit the company's existing compliance program to ensure that the company is proactively doing the most that it can to prevent fraud and wrongdoing or other violations of law.

Many companies, both public and private, are looking beyond traditional elements of compliance programs (which are heavily focused on detailed policies and procedures coupled with intensive employee training) and are focusing in addition on a process-oriented methodology that includes undertaking multiple projects to design, implement and continually assess compliance controls.



**Compliance  
Improvement Process:  
SEVEN BASIC STEPS**

**STEP ONE:** Identify and fully understand the most significant legal requirements applicable to the company. Move from abstract to concrete requirements. Document these legal requirements.

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**STEP TWO:** Identify functions within the company that are affected by the legal requirements.

**STEP THREE:** Identify the relevant processes within these functions that are affected by the legal requirements.

**STEP FOUR:** Undertake process improvement. Simplify, standardize and remove duplicate processes. Employ process improvement methodologies such as Six Sigma.

**STEP FIVE:** Design controls, tailored to and embedded in the relevant processes, that will ensure that the legal requirements are met. Opt for software systems controls in lieu of manual controls where possible. The objectives for these controls should be to deliver improved financial reporting, operational efficiency and compliance.

**STEP SIX:** Implement monitoring mechanisms to track deviations from the legal requirements. Again, opt for software systems solutions in lieu of manual solutions where possible.

**STEP SEVEN:** Document all actions taken by the company in implementing this methodology. Test the controls and reevaluate effectiveness on a periodic basis.

Many companies are discovering that in order to implement an effective compliance program, including employing the methodology described above, significant cross-functional coordination is needed, with participation from senior leadership as well as key functions such as Legal, Finance, IT, Operations and Quality.

Companies that make this investment of time and resources should realize significant improvements in compliance, particularly in the areas of prevention and detection, and will reduce exposure for their outside directors.



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