CA Chartered Accountants of Canada

20 Questions
Directors Should Ask about
Codes of Conduct

Second Edition

WRITTEN BY
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Mark N. Wexler, PhD

20 QUESTIONS

How to use this publication

Each "20 Questions" publication is designed to be a concise, easy-to-read introduction to an issue of importance to directors. The question format reflects the oversight role of directors, which includes asking management — and themselves — tough questions.

The questions are not intended to be a precise checklist, but rather a way to provide insight and stimulate discussion on important topics. In some cases, boards will not want to ask the questions directly but they may wish to ask management to prepare briefings that address the points raised by the questions.

The comments that accompany the questions provide directors with a basis for critically assessing the answers they get and digging deeper if necessary. The comments summarize current thinking on the issues and the practices of leading organizations. They may not be the best answer for every organization.

Thus, although the questions apply to any organization, the answers will vary according to the size, complexity and sophistication of each individual organization.

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Preface

To help members of boards fulfill their respon-sibility for the oversight of an organization's eth-ical climate, the Risk Oversight and Governance Board (ROGB) of the Canadian Institute of Chartered Accountants (CICA) has commissioned this re-issue of its publication *20 Questions Directors Should Ask about Codes of Conduct*. This edition has been updated to reflect changes in the business and regulatory environments.

Directors' oversight role includes assuring them-selves that the organization's culture is character-ized by ethical practices and business behaviour. This briefing provides suggested questions for directors to ask the CEO, senior management, professional advisors—and themselves. Directors and CEOs will find it useful in assessing their present approach to formulating or revising Codes of Conduct and to overseeing the imple-mentation of these Codes throughout organiza-tions for which they are responsible. Reading this document may also prompt dialogue among directors and between boards and executives. That's exactly what an effective Code should do.

The ROGB thanks the authors, Michael Gunns and Mark Wexler, and acknowledges the contribution of the Directors Advisory Group. They identi-fied the need for research and guidance in this important area and have provided high level commentary and suggestions to the authors throughout the course of their work.

Giles Meikle, FCA
Interim Chair, Risk Oversight and Governance Board

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Introduction: Why directors should ask questions about Codes of Conduct

In parallel with boards' involvement in strategy and risk oversight, directors are recognizing that Codes of Conduct ("Codes") can enhance an organization's reputation and contribute to its success. Like strategy and risk management, the responsibilities associated with developing and implementing an effective Code are shared between the board and management—management usually designing materials and processes, and the board reviewing and approving them and overseeing the Code's effective implementation.

Accordingly, this document has been prepared in two principal sections:

A. Code context, development and revision; and

B. Code implementation and execution.

Where an organization has an existing Code, and where directors are generally confident in its relevance and content, boards may choose to focus primarily on the questions in section B—implementation and execution. Where a Code is being introduced for the first time, or where a major revision or re-launch of an existing Code is planned, directors may also wish to become more familiar with the questions in section A—context and development.

Many smaller organizations will not need to introduce the formality of structure or process described in several places in this document. The principles, however, remain the same and directors can use their intimate knowledge of the individual organizations they serve in tailoring their enquiries and assessing responses.

A Code is always a work in progress—it's better to make a start with an unsophisticated Code, developed or revised according to sound principles, than to lose the benefits of having one—or, worse, to promote a Code that is irrelevant or unrealistic.

"But we must remember that good laws, if they are not obeyed, do not constitute good government. Hence there are two parts of good government; one is the actual obedience of citizens to the laws, the other part is the goodness of the laws which they obey…"

Aristotle

Directors of public companies in Canada are obliged by regulation to ensure that certain obligations relating to Codes and business ethics are observed in those companies. The relevant regulations are reproduced in Appendix 1 of this document. Where appropriate, reference is made to these regulations in the text of this document. However, directors of public companies will also want to acquaint themselves in some detail with the content of the regulations. In addition, the increasing reach of legislation relating to bribery, corruption and related offences make a robust Code of Conduct more important than ever.

Section A
— Code Context, Development and Revision

When an organization is adopting a Code of Conduct for the first time or when a revised Code is being introduced, the board of directors has an important role to play. While the initial responsibility for designing and articulating the Code rests with management, the board is responsible for reviewing the Code to ensure that it is suitable in its tone and content, that it meshes well with the culture and objectives of the organization, and that it is capable of being implemented.

Some boards of directors may delegate the detailed review of the Code to one of the board committees (generally the governance committee, although some elements of the Code may be of particular interest to the audit committee), while in other organizations this may be undertaken by the full board. Regardless of how the board organizes itself, the final approval of the Code must come from the full board. The board should expect to receive information as the Code is developed, including drafts of proposed new or reissued Codes, along with information on how they were developed and plans for distribution and training. This culminates in the final Code being submitted to the board for its approval.

This section contains questions which boards of directors should consider when reviewing a new or substantially revised Code. The initial questions are more general and will assist directors in understanding the importance of Codes and the role they play. More specific questions follow, to help directors assess the particular Code which management has presented to them.

1. What are the objectives of a Code of Conduct?

A Code of Conduct is a key vehicle for:

- reducing the risk and associated costs of fraud, conflicts of interest and other ethical lapses;
- helping introduce new employees to the organization's standards;
- attracting and retaining high-calibre employees and business partners;
- setting the boundaries of acceptable behaviour;
- providing employees and others subject to the Code with comfort that they will not inadvertently stray offside;
- informing contractors, suppliers and others doing business with the organization of its expectations regarding acceptable behaviour;
- providing the basis for sanctions against those that deviate from the Code; and
- fulfilling the regulatory obligations of public companies (Appendix 1).

Organizations which walk the talk with regard to their Code develop a reputation for honesty, integrity and principled business behaviour. This can be a key element of a company's brand and can enhance its reputation. An effective Code also reinforces an organization's culture by emphasizing each individual's responsibility to observe its principles and requirements. Ultimately, it is this culture of shared responsibility that affords the greatest protection against the risks of unethical behaviour.

On the other hand, merely issuing a Code does not assure an organization that it will be observed. Organizations that issue Codes simply to fulfill legal requirements or in response to stakeholder concerns, yet do little or nothing to embed the principles, invariably sow the seeds of cynicism.

2. What is the Code's relationship to the organization's mission, vision, values and culture?

Codes of Conduct are an integral part of organizational culture. In most organizations, Codes are introduced or revised within an existing context of explicit directional and behavioural expectations.

Whereas statements of mission, vision and values may be expected to inspire employees and other stakeholders in achieving organizational objectives, a Code has a different purpose. A Code sets boundaries of acceptable behavior. Positioned correctly, an appropriate Code completes the picture of an organization's aspirations and expectations.
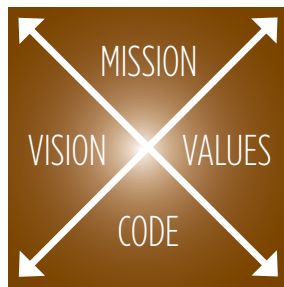
An organization's ethical climate is significantly influenced by its leadership. A term often used for this influence is "tone at the top". This climate creates the overall context in which all of the organization's directional statements (including the Code) are interpreted. Some factors that can influence the ethical climate of an organization include:

- the nature and influence of its shareholders;
- the regulatory environment (which may require specific standards);
- the country or countries in which it operates;
- its "ethical history"—good or bad;
- its short and long-term rewards structures;
- the behaviour of its contemporaries and competitors; and
- the perceived consequences of ethical breakdowns in terms of financial and reputational loss.

An organization's ethical climate also influences many key dynamics surrounding a Code and its effectiveness. If people feel free to raise issues, the likelihood of problems being hidden until they develop into major crises is significantly reduced. This right to dissent may vary according to the circumstances and the nature of the organization's business.

3. Who are the champions of the Code?

The role of the board of directors

Directors themselves should be subject to the Code and their obligations go further. The board has a key leadership and governance role in ensuring that the Code is appropriate to the organization and in overseeing its consistent application. This commitment is reinforced when directors individually sign off on the Code.

A board should study any new Code or revision before approving it to ensure that it is suitable and capable of being implemented. The board can also act as an invaluable resource and guide to the CEO. The varied perspectives and experiences of individual board members can generate wise counsel to the CEO as to the suitability of the Code to the organization and the potential risks in introducing or monitoring compliance with it.

Finally, directors are also responsible for ensuring that their own actions and those of the CEO (whether or not a member of the board) are consistent with the Code. As such, the board sets the tone at the top of the organization, from which all other behaviour follows.

> Directors often underestimate the significant individual and collective influence they can and should have over the organization by signaling to the CEO and the rest of the organization what is expected and acceptable behaviour.

The role of the CEO and executive team

Establishing, disseminating and supporting a Code are leadership activities. Typically, the CEO will appoint others (such as a respected executive or chief ethics officer) to create and maintain the Code and to monitor its application. The organizational relationship of this individual or individuals to the CEO, their personal credibility and the support and resources they are afforded can be seen as indicators of the CEO's personal commitment to the Code. One way or another, the CEO must be the ultimate champion of the Code, if it is to be taken seriously.

> *If ethics are poor at the top, that behaviour is copied down through the organization.*
>
> Robert Noyce—"Mayor" of Silicon Valley

The senior executive team also has a responsibility to ensure that the Code is embraced and followed by the rest of the organization. This team represents the first potential for a schism within the organization between espoused practices (the Code) and actual behaviour. An apparent lack of interest or cynicism on the part of the CEO's direct reports will immediately send a message to the rest of the organization that the Code is not to be taken seriously.

4. Who develops, administers and maintains the Code?

Although the CEO and the board of directors champion the Code, its development, periodic revision, administration and maintenance is usually delegated to another individual.

In large organizations, the individual assigned these responsibilities may be termed a "chief ethics officer" or the role may be assigned to an existing chief compliance officer. In somewhat smaller organizations, the responsibility may be assumed by the head of the Law Department, the Human Resources department, or by the Corporate Secretary. As noted above, it is extremely important that those assigned to develop, revise and administer the Code be viewed as credible and impartial.

> In all organizations, the CEO is the ultimate "chief ethics officer".

Organizations may also engage an external consultant on an as-needed basis to draft and revise Codes. External advisors can contribute valuable advice and perspective to organizations seeking to ensure that their Code represents best practice.

5. What is the process for developing the Code?

Stakeholder participation

Although the initiative for a new or revised Code usually emanates from the top of the organization, the timing and manner of inclusion of the representative views of other constituencies is a key factor in the Code being widely adopted and followed.

> *There can be no true agreement without the opportunity for discussion and negotiation.*
>
> Giles Meikle — Corporate Director

Principal stakeholders

Those having a strong ties to or in-depth involvement with an organization typically include the board of directors, employees, major suppliers and contractors. One best practice is to establish representative teams from each group subject to the Code and engage them in a participatory process of discussing alignment of business practices and behaviours. In the case of directors and employees, the organization will likely seek input on both content and wording.

Other stakeholders

Other stakeholder groups such as environmentalists, union representatives, regulators, or other special interest groups will legitimately have an interest in the content and application of the Code. Increasingly, institutional investors and other shareholder groups are also sensitive to the ethical practices of investee companies. Seeking input from these groups is not obligatory, however including them in the development process can help to build stronger relationships and trust with them.

Expert input

It is essential that those developing or revising the Code consult frequently with the organization's legal expert, whether an internal lawyer or outside counsel. Other technical specialists in areas covered by the Code (e.g., investment traders, environmental specialists, etc.) should also be consulted.

Supplementary Codes

At times material is relevant only to a particular part, or parts, of an organization. Examples would include detailed insider trading requirements for investment personnel, or supplier relationships for purchasing departments, etc. In these and similar cases, it is appropriate to have supplementary Codes. Those who are specifically affected by these supplementary Codes will likely have a significant role in developing them.

Where a company operates an employer-sponsored pension plan, the plan will typically have its own Code. This is to recognize that providing and administering pensions is usually a fundamentally different activity than that of the company's core business, and operates in a different regulatory and stakeholder environment. As far as possible, however, the tone and substance of the two Codes should remain similar.

6. What is the process for the periodic review and revision of the Code?

A Code is always a work in progress. Regular review of the Code will help demonstrate the continuing commitment of the organization's leadership.

Key factors influencing the need to revise a Code include:

- changes in the organization's business, or the environment or locations in which it operates;
- changes in relevant laws and regulations;
- input from shareholder or other stakeholder groups;
- public opinion regarding acceptable business behaviour;
- experience gained from monitoring infractions, or difficulties in applying the Code; and
- input received from those subject to the Code (including the organization's leadership) regarding missing elements, unclear language or other weaknesses in the Code.

Language, examples and specifics will change as the business and regulatory environment changes. However, even with today's rapidly changing business environment, if appropriate effort is put into initially developing the Code, its fundamentals will change little over time.

Organizations may consider:

- reviewing the contents and applicability of the Code at least annually;
- reporting annually to the CEO and the board that the Code remains generally appropriate, and describing areas where revisions are contemplated; and
- having the organization's leadership fully revise reissue and formally re-endorse the Code every three to five years. This is also a suitable time frame for an organization-wide re-education in the Code, even if the content is not significantly changed.

The method for a comprehensive review, revision and reissue of the Code would correspond to that used for developing the Code. Interim changes or supplements to the Code would follow a less comprehensive process, particularly if they affect only one part of an organization or a relatively narrow aspect of its activities (e.g., new privacy regulations).

7. Is the Code at the right level for the organization?

When reviewing a new or revised Code of Conduct, the board should consider whether it is at the appropriate level for the organization. Three important elements that directors should consider are:

- how high the standards of the Code should be in relation to those established by the existing law;
- how the Code will deal with areas requiring individual discretion; and
- the timeframe for enhancing the organization's culture.

Appropriate but realistic standards

Organizations are required to follow the law. A Code only adds value if it establishes organizational standards where the law is silent, or sets standards above those legally required. A Code that merely repeats or summarizes existing legal requirements is likely to be seen as a token effort.

Setting high standards in the Code provides the maximum potential for organizations to enhance their reputation and build a high *esprit de corps*. Many feel that as a standard for Codes of Conduct, the requirements of the law are often

too little and frequently too late. However, Codes that establish unrealistically high standards of behaviour can result in the organization being offside from the outset. Unrealistically high standards could also reduce competitiveness and productivity.

Codes which cannot be complied with also expose the organization to vulnerability in terms of unwanted disclosure for public companies (see Appendix 1). If non-compliance is accepted or not addressed in some areas, the Code as a whole may lose credibility and management will find it harder to enforce compliance in other areas.

> Establishing a Code of Conduct in an organ-ization offers significant potential benefits. It also exposes the organization to risks.

Exercise of Individual Discretion

Some organizational activities are closely supervised and easily monitored. In other areas, expected behaviour is not self-evident and is capable of a wide range of reasonable interpreta-tion. Where individual discretion is inherent in the conduct of the organization's business, it will be necessary to decide how this should be considered and reflected in its Code.

Principles-based Codes allow for the use of individual discretion and articulate the principles which should guide the use of that discretion. Such Codes can support peak performance through appropriate empowerment, encourage organizational learning through discussion and assessment of alternatives, and can reinforce personal and organizational accountability. However, if principles are vague or their applica-tion is unclear, such Codes can also encourage ambiguity which limits their effectiveness.

A more rules-based Code which limits individual discretion may be easier to monitor and enforce, but it may also be seen as unduly detailed and restrictive—more an operational policy than a Code. In addition, a focus on following strict rules rather than internalizing and applying principles may be less effective in creating an ethical culture throughout the organization.

Time Frame

Finally, the time frame over which the Code is expected to influence the organization's culture should be considered. Successfully introducing and embedding a Code within an organization is itself an important change initiative. Most suc-cessful change initiatives take time and many are best approached as continuing processes, rather than quick fixes. On occasion, however, there is a need to make major changes in behaviour quickly to avoid exposure to legal or reputational risks.

The use of a longer time horizon demonstrates recognition that cultural change and building shared commitments are long-term processes. This can provide a better fit with the time horizons of companion mission, vision and values. However, a long time horizon can prolong organizational vulnerability if there are significant gaps between Code expectations and present performance. It may also encourage indefinite postponement of tough issues.

While a shorter time horizon can contribute to a quick revitalization of an organization, and may be necessary if there are significant gaps between actual and required performance, care should be taken as unrealistic expectations can undermine people's commitment to the Code and lead to widespread cynicism.

8. Is the content and tone of the Code appropriate for the organization?

When reviewing a Code, the board should con-sider whether it is appropriately balanced in its tone. There are three types of content in a Code:

- aspirational content;
- descriptive content; and
- proscriptive content.

The **aspirational** content of a Code is idealistic and can be related most clearly to the organiza-tion's mission, vision, values and long-term goals.

The **descriptive** content of a Code outlines the specific behaviour sought by the organization in areas such as conflicts of interest, the accept-ability of gifts from customers and suppliers, and other similar areas where the organization seeks to establish its particular position. The descriptive content is largely silent with regard to sanctions for specific Code violations.

The **proscriptive** content of a Code sets out what the organization prohibits. This "thou shall not" material increases the clarity of the Code and lends itself to forbidding behaviours that, although legally permissible, are unacceptable to the organization. If this content is dominant within a Code, it may impede proper risk-taking and limit innovation.

The overriding objective is to create a Code that appropriately balances aspirational, descriptive and proscriptive content. This will be different for each organization and will be affected by the organizational culture. Most organizations will be best served by a Code that is largely descriptive in nature and includes only the proscriptive content that is essential to its particular circumstances. The board should review the Code to determine whether the appropriate balance has been found and whether the Code is consistent with the culture of the organization.

Simple language

Each organization, industry, and region tends to have its own particular style of communicating. In reviewing the Code, directors should consider whether the language is appropriate to the organization and is sufficiently clear and specific to allow those subject to the Code to understand what conduct is expected of them.

To increase the probability of satisfying varied readers, the Code should:

- state general principles or policies as briefly as possible, followed by more explanatory text;

- use practical examples;

- use pictures and graphics to emphasize key points; and

- make reference to appendices or additional sources in technical areas (e.g., detailed insider trading policies).

9. How has the organization determined its actual ethical risks?

There is an important link between an organization's Code of Conduct and its identification, assessment and management of risk. Although many of the topics that will typically be covered in a Code are common across organizations, the practical exposure to ethical risk may vary considerably. Exposure to specific ethical risks may also vary widely across the different parts of an individual organization. Certain types of ethical risks (e.g., insider trading, corruption of foreign officials, etc.) will warrant enhanced focus in some companies or parts of companies. A list of topics which may be addressed in Codes of Conduct can be found in Appendix 2.

When reviewing a new or revised Code, boards should receive information on management's assessment of the organization's ethical risk exposure. Directors should consider whether they are comfortable with the assessment, and, if so, ensure that the Code is reflective of it.

A key input to the assessment will be the organization's awareness of previous breakdowns in ethical behaviour. Wider industry history or the experience of others with similar exposures may also prove to be invaluable in assessing risks.

As organizations adopt formal risk management processes, it is important to integrate the results of an ethics audit into the overall risk assessment process. Sometimes, it might seem that ethical lapses would typically have less impact than, say, overlooked strategic risks. However, there are numerous examples of high-profile corporate failures which demonstrate the very real consequences and costs of poor ethical behaviour.

We can afford to lose money, even a lot of money. We cannot afford to lose our reputation, not even a shred of it.

Warren Buffett

10. How does the Code apply to foreign operations?

Operations in countries other than an organization's home base can present many complications, not the least being the application of the organization's Code in other jurisdictions and cultures. Foreign operations may present challenges in terms of:

- additional or different exposures to ethical risk, and
- difficulties in implementation and monitoring compliance.

Directors of organizations with foreign operations should ensure that the assessment of ethical risks is undertaken as part of strategy development for those operations—both before entering the environment and regularly thereafter. These risks not only include exposures to loss or censure abroad but also the impact in the organization's home country of real or perceived ethical shortcomings in overseas operations.

Simply following a policy of "When in Rome, do as the Romans do" is unlikely to serve an organization well when it comes to ethics. Many organizations have paid dearly in terms of damaged reputations as a result of media attention to local child labour practices, weak environmental controls and the like in overseas operations. The arguments that "it's necessary to meet the local competition" or "it's expected locally" may be technically correct but are unlikely to convince today's public.

"Plausible deniability" is also unlikely to save a CEO or a board of directors if weaknesses or poor practices are highlighted, particularly if an organization is blamed for observing lower standards away from home.

When reviewing a new or revised Code of Conduct, directors should ensure that the Code takes into account the particular risks related to foreign operations and that management's plan for implementation and monitoring of compliance addresses the challenges involved.

Where organizations operate in different countries, it is vital to make sure that not only are the translations of the Code into different languages accurate but that they convey the intent and not just the actual written word. Different cultures place differing weights and interpretations on moral and ethical principles. It is essential to ensure that the Code's readership receives and understands the intended message.

Section B — Code Implementation and Execution

The board's responsibilities regarding the Code of Conduct don't end with the approval and adoption of a Code. Even the most well-thought out and drafted Code will have little impact on an organization if it is not effectively implemented.

Once a Code of Conduct is in place, both management and the board should turn their attention to its implementation and execution. This includes educating employees and others affected by the Code, monitoring compliance and addressing both criticisms and violations of the Code.

While management is responsible for the day to day implementation of the Code, the board must oversee this implementation as part of its responsibility for the overall culture of the organization. It is up to the individual board to determine how it will organize itself to discharge this responsibility.

11. What information should the board receive?

The board of directors has an ongoing responsibility to assess whether a Code is:

- relevant;
- properly developed, championed, administered and maintained;
- supported by suitable education;
- accompanied by appropriate processes to assure compliance; and
- accompanied by adequate channels for employees and others to express grievances or concerns.

Exactly how the board discharges its role and oversight duties in these areas will vary from organization to organization.

The board will likely receive reports on the Code on an annual basis. These may include:

- Code review, addressing continued applicability, any addenda or supplements issued, and the date of the next scheduled Code revision;
- briefing on responsibilities for maintaining and administering the Code;
- results of ongoing compliance and monitoring activities;
- report on annual sign-offs and the handling of exceptions; and
- reports from any ethics hotline provider.

As well, there are other issues about which the board should expect to be informed as they occur, such as:

- notification of significant criticism of the company's ethics;
- significant Code violations and related sanctions;
- Code waivers granted, or being considered; and
- results of any audits and their relationship to the organization's overall risk management activities.

Although oversight of the Code and the company's compliance with it is ultimately the responsibility of the whole board of directors, certain items may be brought first to the attention of one of the board's committees, such as the audit or governance committee and reported on by that committee to the whole board.

12. How is the Code communicated and how are people educated in it?

When overseeing the implementation of the Code, one of the issues upon which directors must satisfy themselves is that it is effectively communicated by management, and that those affected by it are educated about the Code.

Communication

In today's media-rich world, organizations have the opportunity to disseminate information in many different ways. The board should satisfy itself that the means of communication management uses are appropriate to make the information accessible to those affected.

The board should also seek assurances that publicly disclosed information regarding the organization's Code (on the website, in regulatory filings, etc.) is consistent with that which is disseminated internally.

Education

Without appropriate educational programs, the Code will not significantly influence organizational behaviour. Although management will determine the exact methods to educate employees (and others subject to the Code) in its principles and requirements, directors should assure themselves that educational support is robust and appropriate.

Leading organizations use many approaches, and often a combination of them. These include:

- presentations by the organization's leaders and their availability for questions and dialogue;
- discussions between supervisors and their employees;
- videos and web-based educational materials; and
- briefings for suppliers and contractors.

To truly add value, ethics codes must extend beyond a compliance focus and strive to cultivate and maintain a collective spirit and culture throughout the organization that focuses on promoting positive moral behaviour while simultaneously striving to prevent ethical lapses.

K. M. Gilley and others—"*The bottom-line benefits of ethics code commitment.*" Business Horizons, 2010

Although some of these communication vehicles will be necessarily one way, interactive sessions are what really bring a Code to life. Participating in discussions gives those subject to the Code the opportunity to raise and discuss its practical application. It also (if an appropriate system is established) provides invaluable input to those responsible for Code revisions.

Education also has an important role with regard to new employees or other business partners. Many organizations provide orientation sessions for new hires and this is an appropriate vehicle for initial education in the organization's Code. Leading organizations, however, will cover this orientation before an offer is extended to a prospective employee, supplier or contractor. This provides far greater assurance that both the organization and those it engages are willingly committed to its Code from the outset.

13. How is criticism of the Code handled?

Regardless of the effort devoted to design and development, any Code will have its critics. Some will see the Code as unnecessary (believing appropriate behaviour is self-evident), others may feel the Code goes too far or fails to be completely precise.

Some criticism is to be expected. How the organization handles that criticism, however, demonstrates its true commitment to its principles and beliefs.

Statements in Codes of ethics are most likely to have an impact when they address new situations or when they take positions with which one mildly disagrees.

Bruce Gamatz and John Lere — Certified Planning Journal, 2003

Acknowledging and listening respectfully to critical feedback regarding the Code is of paramount importance. Undertaking to consider these opinions in subsequent revisions of the Code is also appropriate. However, bending to the expectations of vigorous critics, at the expense of the organization's well-thought out and purposefully developed principles, will quickly weaken everyone's commitment to the Code and can lead to widespread cynicism.

The board should be satisfied that management has established an explicit process for handling criticism of the Code. The board may receive a summary of this information on an annual basis. As well, there may be some types of criticism which, due to its nature or the credibility of the critic (e.g. a regulator), the board will wish to be made aware of immediately. Directors should ensure that management has a clear understanding of what types of criticism should be brought to the board.

14. How is compliance with the Code measured and monitored?

As part of the board's responsibility for overseeing the implementation of the Code, directors should receive information from management that satisfies them that compliance is being appropriately measured and monitored.

Actively monitoring the Code can enhance the culture of the organization by encouraging compliance as well as by reassuring those who are following the Code that their actions will be supported.

A further reason for monitoring compliance is to develop an ongoing understanding of where breakdowns in expected behaviour may be occurring in order to discern patterns of weakness — either in organizational culture or Code design. This information can serve as input to the established revision process, or, in the case of significant breakdowns, may lead to timely supplements to the Code or the introduction of measures to mitigate risks associated with non-adherence. Where monitoring reveals significant or pervasive weaknesses, this information can also influence the organization's overall risk management process.

In measuring and monitoring compliance, there is an important distinction to be drawn between investigating infractions and seeking assurance that the systems and processes surrounding the Code are effective.

Both of these types of review have their place. Almost all organizations realize the need to investigate infractions. Fewer organizations dedicate themselves to systemic learning from these investigations (rather than merely dealing with transgressors and plugging gaps). Boards should consider adopting a formal and comprehensive program of ongoing systemic review involving a variety of methods.

15. What measures does management take to reaffirm commitment to the Code?

The board should expect to receive information from management on steps taken to reaffirm commitment to the Code as part of the process of implementation and monitoring. Many organizations ask those subject to the Code to confirm in writing that they:

- received a copy of the Code,
- understand its contents, and
- commit to applying it.

Additionally, many organizations ask directors and employees (and others subject to the Code) to complete such a sign-off annually — reconfirming their continuing commitment and explicitly stating that they have followed the requirements of the Code throughout the previous year. Sign-off forms should make provision for disclosure of incidences of known or suspected non-compliance.

Legal requirements or the detailed proscriptive elements of a Code may require more detailed and specific sign-offs from those in senior positions or holding specific roles. Such detailed sign-offs should be tailored to the circumstances, as should sign-offs from contractors, suppliers or other parties subject to the Code.

Asking people to regularly sign off on a Code can keep the Code front of mind. It may also encourage individuals to come forward with real or perceived difficulties arising from past or anticipated actions or circumstances.

16. What procedures are in place regarding advice, issue resolution, or waivers of the Code's application?

A Code of Conduct is not "law" — at its best it represents a common agreement on behaviour between people working together.

If someone has a problem with the Code, it's better to hear about it and try to resolve it, than to ignore or suppress it.

Despite using best efforts to develop a clear Code, circumstances will invariably arise which were not contemplated by the Code, or in which the application of the Code is unclear. Directors should ensure that management has put in place mechanisms to allow individuals to seek advice and/or issue resolution.

An individual seeking guidance about the application of the Code would normally raise such issues with his or her immediate supervisor. Where this does not lead to satisfactory resolution, the issue may proceed higher up the reporting line.

The Code should offer explicit guidance to be followed in circumstances in which employees may be reluctant to raise concerns with their immediate supervisor. Typically the channels for such enquiries will include the chief ethics officer, the chief compliance officer or the head of the Law, Human Resources or Internal Audit functions.

Although it is usually most appropriate to seek advice on interpretation or application of the Code within the company, there may be circumstances in which an employee wishes to maintain anonymity. In such cases, the employee may wish to make use of any ethics "hotline" that the company may have established with an outside provider.

External stakeholders such as customers, suppliers and investors should also have an explicit point person within the organization to contact with questions regarding the organization's Code. This may be the chief ethics or compliance officer, if the organization has appointed one. Otherwise, questions might be directed to the Public Relations department or the Corporate Secretary.

On occasions where employees or others subject to the Code seek to have its provisions waived there should be an explicit process for people to seek such waivers. To discourage people from seeking relief from what they perceive as inequitable treatment from the strict application of the Code ultimately acts as an incentive to cover up. However, such requests require deliberation at senior executive levels and, usually, at the board level. All waivers granted, regardless of significance, should be reported to the board of directors.

17. How does the Code relate to the rewards system and how are violations handled?

Perhaps the most difficult aspect of implementing a Code is linking it to rewards and sanctions. Some organizations specifically claim that sound ethical behaviour is a component of their rewards structure but, understandably, there is little publicly-available evidence in this regard.

In most organizations, however, there are opportunities to identify instances where difficult choices were made that respected the intent of the Code. Directors may wish to seek assurances from management that such choices are appropriately recognized and that the organization's operational policies facilitate such recognition. For example, employees who come forward with information regarding errors rather than attempting to cover them up should receive appropriate recognition for making the right decision.

The question of sanctions is more straightforward. That is not to say that the necessary actions will be easy or comfortable to take. However, an organization committed to its Code has no choice but to take seriously all alleged transgressions. To do otherwise is the fastest and most certain course to undermining all the efforts put into developing and implementing the Code.

There should be clear procedures in place to investigate alleged Code violations in order to make a determination as to the veracity of the allegation and the appropriate sanctions, should a breach of the Code be determined to have

occurred. These procedures should be impartial and should take into consideration the privacy of the parties involved.

Often, the exact circumstances surrounding the need for and nature of disciplinary measures cannot be made public. It is essential, however, that the organization is seen as having followed a fair and established process in examining all sides of a matter before imposing sanctions.

While the board of directors will not need to be advised immediately regarding every breach of the organization's Code, breaches committed by members of the management team, or others with the potential to seriously affect the company's reputation should be brought immediately to the attention of the board.

FOR MORE INFORMATION, SEE THE CICA PUBLICATION 20 QUESTIONS DIRECTORS SHOULD ASK ABOUT RESPONDING TO ALLEGATIONS OF CORPORATE WRONGDOING.

18. How does the Code deal with whistle blowing?

The board of directors should also expect to receive information from management regarding whistle blowing. Effective Codes accomplish two goals with regards to whistle blowing:

- Firstly, they help to create an organizational culture in which whistleblowers find it easier to raise actual or perceived wrongdoing within the organization, rather than turning to the media or other outsiders.

- Secondly, effective Codes provide explicit protection to the whistleblower from retaliation by those adversely impacted by the whistleblower's actions.

In most instances, whistleblowers go to outsiders because they feel that:

- their views have not been, or will not be, taken seriously;

- their concerns relate to someone to whom they report, or who has other significant influence over them; or

- the actual or perceived wrongdoing is harmful to others or to the public.

Effective Codes provide people who choose to blow the whistle with several options to speak candidly and confidentially about their concerns in order to improve the likelihood that individuals will first seek to resolve issues and concerns internally.

Wise organizations go out of their way to provide several internal avenues for raising concerns. They also provide an external whistle blowing hotline and encourage employees to use it when all other avenues have failed. The fairness and respect with which an organization treats whistleblowers is an acid test of its commitment to openness and transparency.

Increasingly, organizations are making use of specialist external "hotline" providers who operate under strict confidentiality and ethical guidelines. The Audit Committee of a Canadian public company is obliged by regulation (see Appendix 1) to establish procedures to safeguard complaints received regarding accounting, internal accounting controls, or auditing matters. That committee must also provide an avenue for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters. In practical terms, in the absence of robust internal mechanisms, this may necessitate the use of an external hotline provider.

One of the most difficult situations that an organization has to face is how to deal with anonymous complaints concerning ethical behaviour. Whether from employees or other sources, they cannot be ignored. Each instance must be weighed on its own merits, while carefully protecting the rights as well as the privacy of all those involved.

FOR MORE INFORMATION, SEE THE CICA PUBLICATION *20 QUESTIONS DIRECTORS SHOULD ASK ABOUT RESPONDING TO ALLEGATIONS OF CORPORATE WRONGDOING.*

19. What additional steps can directors take to satisfy themselves of the effective implementation of the Code?

In addition to reviewing written documents and asking intelligent questions, directors should consider taking some additional, practical steps to help ascertain whether the principles of the Code are actually being practiced throughout the organization.

You're on ethical thin ice when you hear these warning signs...

– *Well, maybe just this once*
– *No one will ever know*
– *It doesn't matter how it gets done, as long as it gets done*
– *It sounds too good to be true*
– *Everyone does it*
– *What's in it for me?*
– *We didn't have this conversation.*

Mark Wexler — Confronting Moral Worlds

Directors should use their instincts and experience to assess the behaviour of the CEO and other members of the senior management team and should be prepared to discuss it openly amongst themselves and, if necessary, directly with the CEO. If this feels too uncomfortable, either within the board or with the CEO, it's probably an indication that something is wrong.

Directors should also take advantage of opportunities to observe what is actually happening in the organization and to listen to what others say about it.

Many directors find that "field" visits, when they chat informally with management and front line employees, are invaluable — not only to understanding the business but to assessing the organization's ethical climate. They factor this assessment into their confidence in everything from the organization's sustainability to the probable accuracy of its results and reporting. Again, if directors feel uncomfortable raising the subject of field visits, or feel that there's no opportunity, it's probably a cause for concern.

At their root, Codes are concerned with behaviour — both organizational and individual. Directors' years of experience inform their instincts and observations. However, directors may be reluctant to act on their instincts or voice concerns. It is important that they feel free to do so, as discussing concerns openly is a key part of their contribution to the tone at the top.

20. How does an organization's Code contribute to its long-term sustainability?

Over time, organizations—all organizations—are tested. They are tested by whistle-blowing incidents, product recalls, indiscretions by leaders, accidents that injure innocent third parties and the like. Codes cannot prevent all such events from occurring.

Codes are a means of creating resilience in organizations. They are always a work in progress. It is only through ongoing dialogue among all the organization's stakeholders that the shared commitment of superior organizational behaviour is maintained.

By building a culture of integrity, an organization may protect itself from some of the damage that can result from deliberate wrongdoing. By building and maintaining a culture of openness and mutual respect, an organization can protect itself from being blindsided—being the last to know.

> *Ethics is an area where "practice makes perspective."*
>
> John Dalla Costa
> From: The Ethical Imperative —Why Moral Leadership is Good Business

The board of directors possesses one of the greatest funds of knowledge, experience and wisdom available to the organization it serves. Through its own contribution and by the example it sets to the CEO and the rest of the organization, the board can encourage a culture of openness, healthy introspection and the pursuit of organizational excellence.

Appendix 1:
Regulations relating to Codes of Conduct for Canadian public companies

The **Canadian Securities Administrators** are responsible for the securities regulations of all Canadian provinces and territories. CSA members work closely in the development of new policy initiatives and the continuous improvement of the regulatory framework for securities. Investigation and enforcement are also core CSA activities.

There are three pieces of regulation that address the need for Codes of Conduct and sound ethical practices of Canadian public companies. The relevant excerpts from these regulations are reproduced hereunder.

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NATIONAL POLICY 58-201

CORPORATE GOVERNANCE GUIDELINES

Effective June 30, 2005

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Board Mandate

3.4 The board should adopt a written mandate in which it explicitly acknowledges responsibility for the stewardship of the issuer, including responsibility for:

    (a) to the extent feasible, satisfying itself as to the integrity of the chief executive officer (the CEO) and other executive officers and that the CEO and other executive officers create a culture of integrity throughout the organization;

Code of Business Conduct and Ethics

3.8 The board should adopt a written code of business conduct and ethics (a code). The code should be applicable to directors, officers and employees of the issuer. The code should constitute written standards that are reasonably designed to promote integrity and to deter wrongdoing. In particular, it should address the following issues:

    (a) conflicts of interest, including transactions and agreements in respect of which a director or executive officer has a material interest;

    (b) protection and proper use of corporate assets and opportunities;

    (c) confidentiality of corporate information;

    (d) fair dealing with the issuer's security holders, customers, suppliers, competitors and employees;

    (e) compliance with laws, rules and regulations; and

    (f) reporting of any illegal or unethical behaviour.

3.9 The board should be responsible for monitoring compliance with the code. Any waivers from the code that are granted for the benefit of the issuer's directors or executive officers should be granted by the board (or a board committee) only.

Although issuers must exercise their own judgement in making materiality determinations, the Canadian securities regulatory authorities consider that conduct by a director or executive officer which constitutes a material departure from the code will likely constitute a "material change" within the meaning of National Instrument 51-102 *Continuous Disclosure Obligations*. National Instrument

51-102 requires every material change report to include a full description of the material change. Where a material departure from the code constitutes a material change to the issuer, we expect that the material change report will disclose, among other things:

- the date of the departure(s),

- the party(ies) involved in the departure(s),

- the reason why the board has or has not sanctioned the departure(s), and

- any measures the board has taken to address or remedy the departure(s).

NATIONAL INSTRUMENT 58-101
DISCLOSURE OF CORPORATE GOVERNANCE PRACTICES
Effective June 30, 2005

Part 1 Definitions and Application

"venture issuer" means an issuer that, at the end of its most recently completed financial year, does not have any of its securities listed or quoted on the Toronto Stock Exchange, a U.S. marketplace, or a marketplace outside of Canada and the United States of America.

Part 2 Disclosure and Filing Requirements

2.1 Required Disclosure—

(1) If management of an issuer, other than a venture issuer, solicits a proxy from a security holder of the issuer for the purpose of electing directors to the issuer's board of directors, the issuer must include in its management information circular the disclosure required by Form 58-101F1.

(2) An issuer, other than a venture issuer, that does not send a management information circular to its security holders must provide the disclosure required by Form 58-101F1 in its AIF.

2.2 Venture Issuers—

(1) If management of a venture issuer solicits a proxy from a security holder of the venture issuer for the purpose of electing directors to the issuer's board of directors, the venture issuer must include in its management information circular the disclosure required by Form 58-101F2.

(2) A venture issuer that does not send a management information circular to its security holders must provide the disclosure required by Form 58-101F2 in its AIF or annual MD&A.

2.3 Filing of Code—

If an issuer has adopted or amended a written code, the issuer must file a copy of the code or amendment on SEDAR no later than the date on which the issuer's next financial statements must be filed, unless a copy of the code or amendment has been previously filed.

FORM 58-101F1
CORPORATE GOVERNANCE DISCLOSURE

5. Ethical Business Conduct —

(a) Disclose whether or not the board has adopted a written code for the directors, officers and employees. If the board has adopted a written code:

   (i) disclose how a person or company may obtain a copy of the code;

   (ii) describe how the board monitors compliance with its code, or if the board does not monitor compliance, explain whether and how the board satisfies itself regarding compliance with its code; and

   (iii) provide a cross-reference to any material change report filed since the beginning of the issuer's most recently completed financial year that pertains to any conduct of a director or executive officer that constitutes a departure from the code.

(b) Describe any steps the board takes to ensure directors exercise independent judgement in considering transactions and agreements in respect of which a director or executive officer has a material interest.

(c) Describe any other steps the board takes to encourage and promote a culture of ethical business conduct.

FORM 58-101F2
CORPORATE GOVERNANCE DISCLOSURE
(VENTURE ISSUERS)

4. Ethical Business Conduct —

Describe what steps, if any, the board takes to encourage and promote a culture of ethical business conduct.

MULTILATERAL INSTRUMENT 52-110
AUDIT COMMITTEES
Effective March 30, 2004

2.3 Audit Committee Responsibilities —

(7) An audit committee must establish procedures for:

(a) the receipt, retention and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and

(b) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.

Appendix 2:
Topics that may be included in Codes of Conduct

The following topics (listed in alphabetical order) are typical of those found in Codes of Conduct. This is not intended to be an exhaustive list but may be helpful when reviewing the content of a Code. Except in the largest organizations, Codes will rarely cover such an extensive number of topics.

1. Bribery of government officials or others
2. Charitable contributions
3. Computer security
4. Confidentiality
5. Conflicts of interest
6. Confirming compliance with the Code
7. Consequences of contravening the Code
8. Customer complaint handling
9. Discrimination
10. Drug use
11. Employment of spouses or other family members
12. Environmental policies
13. External directorships
14. Fair competition
15. Fair employment practices
16. Gifts and entertainment from suppliers and others
17. Gifts and entertainment to customers and others
18. Insider trading
19. Intellectual property and other propriety information
20. Maintaining accurate records
21. Media relations
22. Outside employment
23. Personal use of computer systems
24. Political activity
25. Privacy of employee, customer and other records
26. Product safety
27. Purchasing policies
28. Record-keeping
29. Reporting violations and suspected violations
30. Responding to shareholder activists or other organizational critics
31. Regulatory enquiries
32. Safeguarding assets and responding to thefts or misappropriation
33. Seeking a waiver from the Code's provisions
34. Supplementary Codes
35. Truth in advertising
36. Use of organization's assets
37. Whistle blowing procedures
38. Workplace harassment
39. Workplace safety

Where to Find More Information

CICA PUBLICATIONS ON GOVERNANCE*

THE DIRECTOR SERIES

THE 20 QUESTIONS SERIES

20 Questions Directors and Audit Committees Should Ask about IFRS Conversions

20 Questions Directors Should Ask about Building a Board

20 Questions Directors Should Ask about CEO Succession

20 Questions Directors Should Ask about Codes of Conduct

20 Questions Directors Should Ask about Crisis Management

20 Questions Directors Should Ask about Crown Corporation Governance

20 Questions Directors Should Ask about Director Compensation

20 Questions Directors Should Ask about Directors' and Officers' Liability Indemnification and Insurance

20 Questions Directors Should Ask about Executive Compensation (2nd ed)

20 Questions Directors Should Ask about Governance Assessments

20 Questions Directors Should Ask about Governance Committees

20 Questions Directors Should Ask about Internal Audit (2nd ed)

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20 Questions Directors Should Ask about Management's Discussion and Analysis (2nd ed)

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20 Questions Directors Should Ask about Risk (2nd ed)

20 Questions Directors Should Ask about the Role of the Human Resources and Compensation Committee

20 Questions Directors Should Ask about their Role in Pension Governance

20 Questions Directors Should Ask about Special Committees

20 Questions Directors Should Ask about Strategy (2nd ed)

DIRECTOR BRIEFINGS

Climate Change Briefing—Questions for Directors to Ask

Controlled Companies Briefing—Questions for Directors to Ask

Diversity Briefing—Questions for Directors to Ask

Long-term Performance Briefing—Questions for Directors to Ask

DIRECTOR ALERTS

New Canadian Audit Standards—questions for directors to ask (Dec 2010)

Fraud Risk in Difficult Economic Times—questions for directors to ask (July 2009)

Human Resource and Compensation Issues during the Financial Crisis—questions for directors to ask (July 2009)

The Global Financial Meltdown—questions for directors to ask (Oct 2008)

Executive Compensation Disclosure—questions directors should ask (Feb 2008)

The ABCP Liquidity Crunch—questions directors should ask (Oct 2007)

*Available at www.rogb.ca.

THE NOT-FOR-PROFIT DIRECTORS SERIES

NPO 20 QUESTIONS SERIES

20 Questions Directors of Not-for-profit Organizations Should Ask about Board Recruitment, Development and Assessment

20 Questions Directors of Not-for-profit Organizations Should Ask about Fiduciary Duty

20 Questions Directors of Not-for-profit Organizations Should Ask about Governance

20 Questions Directors of Not-for-profit Organizations Should Ask about Risk

20 Questions Directors of Not-for-profit Organizations Should Ask about Strategy and Planning

Liability Indemnification and Insurance for Directors of Not-for-Profit Organizations

NPO DIRECTOR ALERTS

New rules for Charities' Fundraising Expenses and Program Spending—questions for directors to ask (Sept 2010)

Increasing Public Scrutiny of Not-for-Profit Organizations—questions for directors to ask

Pandemic Preparation and Response—questions for directors to ask

THE CFO SERIES*

Deciding to Go Public: What CFOs Need to Know

Financial Aspects of Governance: What Boards Should Expect from CFOs

How CFOs are Adapting to Today's Realities

IFRS Conversions: What CFOs Need to Know and Do

Risk Management: What Boards Should Expect from CFOs
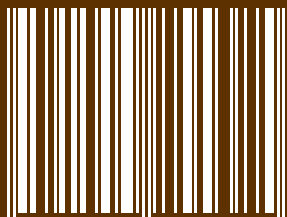
Strategic Planning: What Boards Should Expect from CFOs

Available at www.rogb.ca.

About the Authors

Michael Gunns is Managing Principal of the Gunns Group, which provides consulting services in corporate governance, strategy and risk management to a wide range of clients. He is a former Chair of the Risk Oversight and Governance Board of the Canadian Institute of Chartered Accountants and also chaired a CICA task force of prominent Canadian CFOs in advancing the role of CFOs in Risk Management and Corporate Governance. He was a judge for the Canadian Institute of Chartered Accountants' 2002 and 2006 Corporate Governance Awards and was elected a Fellow of the Ontario Institute of Chartered Accountants in 2006. He regularly presents one-day public courses for the Ontario Institute in each of Corporate Governance and Risk Management. Michael is a graduate of Harvard Business School's Advanced Management Program and has previously held executive positions at Zurich Canada and Sun Life.

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20 Questions
Directors Should Ask about
Codes of Conduct

Second Edition