

ETHICS AND COMPLIANCE “DUE DILIGENCE” AND “INTEGRATION” PROCESSES FOR NEW ACQUISITIONS

In 2004 the ERC Fellows Program undertook an effort to review what best practice companies were doing in the area of ethics and compliance when their company was considering a new acquisition. The Fellows recognized that there is well established practice by certain key functions within their companies to do critical due diligence when their company is targeting a new acquisition. The well established practices are usually found within the finance, legal, human resources and tax functions. What was not clear at the beginning of this effort was whether companies were conducting the same type of due diligence in the function of “ethics and compliance”. The review concluded that this is an emerging area and that there are few companies with well established practices in “ethics and compliance” due diligence.

Thus, the Fellows gathered existing best practices from both ERC and EOA selected member companies and created this “template”. The Fellows recommend that the Ethics and Compliance Officer have a seat at the table during the Due Diligence process. The questions in this template serve as guide, adapting this guide with questions specific to the industry and the circumstances under consideration.

The information gathered during the Due Diligence Process should drive action during the Integration phase of the acquisition, unless there is data found during Due Diligence which suggests that the acquisition should not go forward.

The Fellows also recognized that there could be circumstances when the Ethics and Compliance Officer may not have a seat at the table during Due Diligence or when the Due Diligence phase preclude a review such as this. In these situations, the Ethics and Compliance Officer should clearly have a seat at the table during the Integration phase and should proceed with all haste to do this review and to proceed with appropriate actions.

During this review, the Fellows program conducted a number of interviews with Ethics and Compliance Officers who had been involved in significant new acquisitions. The Fellows separately have documented the learnings from those interviews. We recommend that you read those learnings in conjunction with using this template.

As you use this document within your company, we would welcome your feedback and would encourage you to share your learnings with the Fellows.

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PURPOSE

Review “Target Company” ethics and compliance related policies and practices to determine compatibility with Acquiring Company’s policies and practices and the Acquiring Company’s Code of Conduct.

OBJECTIVES

- Identify areas of risk of non-compliance and incompatibility.
- Make recommendations to management concerning changes, adaptations, exceptions, warranties, and representations that would be required by the Target Company in order to successfully integrate/merge with Acquiring Company. Such recommendations shall include an assessment of the impact on the business of any changes/adaptations that would need to be made in order to meet Acquiring Company’s standards and requirements. Such recommendations should also consider if the Target Company has any practices that should be adopted by the Acquiring Company.
- Acquaint Target Company management during the pre-acquisition stage with Acquiring Company’s standards and requirements and Code of Conduct.

APPLICATION

This review shall be included as a routine element in the overall due diligence process in connection with all prospective mergers and acquisitions by Acquiring Company operating units, including joint ventures and minority partnerships.

The review shall be incorporated into the business's review, legal due diligence or conducted as a stand-alone review if deemed appropriate by Acquiring Company management. Every effort must be made to avoid duplication of questions if a separate review is conducted.

In addition, in some extreme situations, it might not be possible for this review to occur during the Due Diligence Process. If such review cannot be accomplished as a part of the Due Diligence Process, then such review will be fully conducted and action taken as a part of the Integration Process after the acquisition of the Target Company.

PROCESS OWNER

_____ (Indicate who is responsible in your company)

PROCEDURE

The review shall consist of face-to-face key management interviews of the target-operating unit. The people to be interviewed and the actual schedule shall be determined in consultation with an official representative of the Target Company.

The scope of the review shall be all activities that have occurred within the last five years.

The interviews shall be conducted using the attached Questionnaire as a guideline.

The interview shall be conducted by an Acquiring Company operating unit person who is familiar with the Acquiring Company's standards, requirements and Code of Conduct.

Copies of relevant Target Company policies, procedures, publications and documents shall be discussed and collected in connection with the review.

Subsequent to the on-site review, a report with recommendations shall be provided to appropriate Acquiring Company management for inclusion in the acquisition evaluation process. The report shall include an assessment of the impact to the business that would likely result from the need to correct any questionable or improper business practices that were identified in the course of the review. This assessment is to be done in consultation with Acquiring Company's finance and legal departments.

Assessments should be made of:

- Reputation of Target Company in the community.
- Reputation relative to competitors.
- Support for 3rd party codes, OECD Guidelines for Multinational Enterprises, ILO (Declaration of the Fundamental Principles and Rights at work), International Model Principles.
- Support for a Values Based program versus a Rules only based program.

The acquisition agreement is to include representations, warranties and indemnities based on the findings in the Ethics and Compliance Due Diligence.

ETHICS AND COMPLIANCE DUE DILIGENCE AND INTEGRATION QUESTIONNAIRE

I. CODE OF CONDUCT (“CODE”) AND/OR POLICIES AND PROCEDURES (“P&P”)/PROGRAM

- Does the company have a written Code and/or P&P? Is the document available in both the local language and English? If so, please provide a copy of each.
- What is covered by the Code and/or P&P?
- Is the Code and/or P&P distributed to all employees? How is it distributed?
- How is it enforced? Examples.
- Do employees sign a declaration that they will not engage in any activity which is not in compliance with the Code? Which which could be considered a conflict of interest with the company? Explain.
- Are audits/reviews of compliance conducted? When was last instance and what was covered?
- What is the procedure for reporting wrongdoing¹ or suspected wrongdoing?
- What is the process for handling allegations/claims of wrongdoing¹? Who is normally responsible for managing that process?
- How are Code allegations actually tracked?
- Is there a system for receiving complaints from employees and others?
- Does the system protect confidentiality? How? Is confidentiality still protected in third party lawsuits?
- Does the system allow a person to report anonymously?
- How is the system for complaints communicated to employees and others?
- Is there a policy of no retribution for employees who report wrongdoing¹ or suspected wrongdoing¹? Describe.
- Is there a means of reporting wrongdoing¹ or suspected wrongdoing¹ in which the person is assured their name will be kept confidential? Describe.

¹ For purposes of these questions, “wrongdoing” or “misconduct” means breach or violation of (a) the Code, (b) its P&P, (c) any other standards of conduct related to any of the topics listed in §II, or (d) any applicable law or regulation.

- Is the Company's Code communicated to its suppliers? How?
- Is training done on the Code? If so, when was it done, who was trained and what was the material? What is the frequency? What types are performed – web, video, classroom, other?
- Is training done on any Policies or Procedures within the Code? If so, when was it done, who was trained and what was the material? What is the frequency? What types are performed – web, video, classroom, other?
- Any other forms of legal training being performed? What were the reasons for initiating the training
- Is there ethics and compliance training for leadership? Management? Supervisors?
- Is there a formal, written disciplinary process? If so, may we have a copy? How often has it been used in the last 5 years?
- What is the integration process to ensure ethics and compliance in operations?
- What areas of the business are considered to be the highest risk of non-compliance with policies, standards, laws or regulations? Why? Has there been any special action to address the risk areas?
- What is the culture? Is there a high level of support in action and words for ethics and compliance?
- What is the oversight mechanism? Board of Directors? Ethics and Compliance Committee?

II. ARE ANY OF THE FOLLOWING SPECIFIC SUBJECTS COVERED BY THE TARGET COMPANY'S CODE OF CONDUCT OR POLICIES & PROCEDURES?

CHECK APPROPRIATE BOX	YES	NO
• Kickbacks	<input type="checkbox"/>	<input type="checkbox"/>
• Misappropriation/embezzlement	<input type="checkbox"/>	<input type="checkbox"/>

• FCPA/bribery/improper payments (Either official or commercial)	<input type="checkbox"/>	<input type="checkbox"/>
• Conflicts of interest	<input type="checkbox"/>	<input type="checkbox"/>
• Sexual harassment	<input type="checkbox"/>	<input type="checkbox"/>
• Keeping accurate books & records	<input type="checkbox"/>	<input type="checkbox"/>
• Intellectual property protection	<input type="checkbox"/>	<input type="checkbox"/>
• Copyrights/trademarks	<input type="checkbox"/>	<input type="checkbox"/>
• Software copying	<input type="checkbox"/>	<input type="checkbox"/>
• Giving and receiving of business gifts	<input type="checkbox"/>	<input type="checkbox"/>
• Antitrust/competition laws	<input type="checkbox"/>	<input type="checkbox"/>
• Export controls	<input type="checkbox"/>	<input type="checkbox"/>
• Trade sanctions	<input type="checkbox"/>	<input type="checkbox"/>
• Anti-boycott regulations	<input type="checkbox"/>	<input type="checkbox"/>
• Political contributions	<input type="checkbox"/>	<input type="checkbox"/>
• Receiving/gathering competitive information	<input type="checkbox"/>	<input type="checkbox"/>
• Compliance with applicable law	<input type="checkbox"/>	<input type="checkbox"/>
• Health, Safety and Environmental protection	<input type="checkbox"/>	<input type="checkbox"/>
• Fraud, misrepresentation	<input type="checkbox"/>	<input type="checkbox"/>
• Employment issues (e.g. EEOC, age and other types of discrimination)	<input type="checkbox"/>	<input type="checkbox"/>
• Tax inquiries (allegations of fraud, insufficient payment of taxes, etc.)	<input type="checkbox"/>	<input type="checkbox"/>
• Privacy	<input type="checkbox"/>	<input type="checkbox"/>
• Other topics (such as Government Affairs, Insider Trading)	<input type="checkbox"/>	<input type="checkbox"/>
• Other Workplace Conflicts	<input type="checkbox"/>	<input type="checkbox"/>

- What Policy changes have accrued in the past 2 years?
- Review target's web site. Search Internet, Better Business Bureau, Purchasing-Supply, Management, Lexis/Nexis, Credit Reporting and Dunn & Bradstreet.
- What is the extent of related individuals or companies doing business.
- What are the practices related to employees- setting of compensation, EEO activity, Diversity activity, Child Labor, Prison Labor?
- Is there any evidence of company assets being used for personal purposes?
- What is the company doing to comply with Sarbanes Oxley?
- What is the budget for IT tools for ethics and compliance?
- What is the past record for Enviromental,Health and Safety?

- Does the company issue a Sustainability Report?
- Does the company have a procedure to approve and review consultants?
- Does the company have a procedure for paying finder fees?
- Does the company do business with the US Federal Government? Foreign Government?, US State and local Governments?
- Who are the company's major customers? Who ultimately pays for the work?
- Review Invoices vs. actual payments.
- Is the special treatment for certain customers (most favored treatment, launch customer)? Large customer discounts?
- What is the extent of promotional activity?
- Does the company have a system for documenting customer and vendor gifts?
- Does the company have a system for documenting gifts to customers?

III. HAS THE TARGET COMPANY OR ANY OF ITS EMPLOYEES BEEN THE SUBJECT OF ANY OF THE FOLLOWING TYPES OF ETHICAL, COMPLIANCE OR LEGAL ISSUES? REFERENCE IN PARTICULAR THE LIST OF TOPICS IN SECTION II.

[NOTE: THE QUESTIONS IN THIS SECTION MAY BE COVERED IN OTHER PHASES OF THE DUE DILIGENCE PROCESS. PLEASE CHECK BEFORE PROCEEDING WITH THIS SECTION.]

- Any government investigation into alleged civil or criminal wrongdoing or misconduct?
- Any government civil lawsuit or criminal prosecution?
- Any stock exchange or quasi-public body investigation, allegation or litigation into wrongdoing or misconduct?
- Has any shareholder filed a claim or suit against the company or its directors for breach of fiduciary duty or other wrongdoing or misconduct?
- Any allegations/claims of wrongdoing or misconduct by private parties (including other employees, suppliers, customers, competitors)?
- Is there a litigation tracking system used?
- Any civil litigation involving wrongdoing or misconduct?

- Has an internal audit group uncovered any wrongdoing or misconduct?
- Has any officer or employee of the company been terminated, separated or otherwise disciplined (including financial sanctions) for wrongdoing or misconduct?
- Have there been any internal investigations conducted into employee wrongdoing or misconduct?
- What process is used to monitor investigations?
- Has the company ever sued an employee or made a criminal referral/complaint to an employee for wrongdoing or misconduct?
- Has the company been the subject of any adverse publicity in the media (print or electronic)?
- If the answer to any question in this section is yes, please provide comment for each matter:
 - (i) description of matter
 - (ii) final result (e.g., fines or damages paid, whether by verdict or settlement)
 - (iii) whether still pending
 - (iv) corrective action taken by the company to avoid recurrence
 - (v) disciplinary actions taken or to be taken

IV. CUSTOMER PRACTICES (BOTH NEW EQUIPMENT AND SERVICE)

- Describe the process for securing a business contract with a customer. Note the specific steps involved, the documents associated with each step and the individuals within the company who must sign/approve the transactions.
- Are intermediaries, such as sales agents or 3rd party representatives, ever used to help identify/secure business opportunities? If yes, describe the conditions or circumstances under which such an intermediary would be used.
- Is there a written agreement between the company and the intermediary that describes the scope and nature of the services to be provided, the type and amount of compensation to be paid and the restrictions/limitations that will apply to both parties in the conduct of the service? Describe in detail and provide a copy of all existing agreements with intermediaries.
- Are all remittances to 3rd parties documented with invoices and receipts?
- What steps are taken to ensure the intermediary will adhere to company policies and observe all legal requirements in representing you?
- Are all sales fully recorded on the company's books? If not, explain the specific instances and circumstances.

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- Have any commissions ever been paid to any public officer? Provide detail of the specific instances and circumstances.
- Review correspondence, legal opinions, relationships with customers, doctors, and medical practitioners.
- Review copies of contracts with anyone who receives compensation for services to arrange or obtain business.
- Review top customers (10) in each country and detail expenses related to customer or its employees.

V. SUPPLIER / SUBCONTRACTOR PRACTICES

- Describe your process for identifying and using suppliers and subcontractors, i.e. when and why are they used, the person(s) responsible for making the decisions, the documentation associated with the business arrangement and the approvals required.
- Describe the process for managing the suppliers/subcontractors once an order has been placed, i.e. who is responsible for managing them, how is their performance measured, is there an open contract or a separate contract for each purchase, how are they paid (cash, check, other), etc?
- Are there any written procedures that govern the company's practices on awarding business to and dealing with suppliers/subcontractors? If a written procedure exists, provide a copy in English.
- In the judgment of the person being interviewed, how strongly are those procedures communicated and enforced internally and externally? What changes would that person like to see in order to improve the dealings with suppliers and subcontractors?
- Have gifts and/or commissions ever been offered by suppliers/subcontractors in return for awarding them the company's business? If yes, provide details of the specific instances and circumstances.
- Has an internal audit covering the company's supply management program been carried out during the past 5 years? If yes, what were the results of that audit? Is a copy of the audit report available?
- Is there any law which applies to/regulates the arrangements with suppliers/ Subcontractors? Describe the law and its implications for the business.

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VI. OTHER PRACTICES

- How is the company portrayed in external sources? Fortune? FTSE4GOOD?

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- What topics are discussed at association meetings? What are the important achievements/contributions of the association?
- Customer/competitor information?
- Process control? Quality control?Project change process.
- Invoice & billing?.
- Identification of potential conflicts of interest -company, team members, competitors, suppliers?
- Identification of Community Practices - involvement, charity, complaints?