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Compliance: Real or Illusory Support for Corporate Governance

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Abstract

The scientific literature treats compliance as a way of organising a company to ensure compliance with legal requirements. The effectiveness of the compliance system requires continuous improvement at each stage of the enterprise's operation, constant adaptation to changing business conditions and regulations, especially in the current crisis caused by the pandemic, which has affected the functioning of the organisation but also the escalation of specific risks. This time is a major challenge for compliance, allowing us to observe new realities as a matter of urgency, analysing needs in order to provide real and not illusory support for corporate governance.

Keywords: compliance, risk, crisis, corporate governance

JEL Classification Code: M14

Introduction

The purpose of this article is to answer the question whether or not compliance really plays an important role in supporting corporate governance. The pandemic and the resulting economic collapse are an opportunity to introduce a strengthened corporate governance, maintain the resulting coincidence in action and focus on transparency and competence. Support for corporate governance from compliance should be stronger than ever, especially as the current crisis has highlighted some weaknesses of compliance. The main purpose of the companies' activities is to generate profit for the owners of the invested capital. Compliance is designed to support corporate governance in achieving revenue and protect the organisation from the risk of the lack of compliance. Crisis situations are conducive to the risk of abuse, which is due, among other things, to the lack of the possibility of carrying out control activities, investigations or interacting with employees. External threats such as unfair competition and internal labour violations may increase. The misleading compliance functioning based only on formal implementation of internal procedures excludes a real and active impact on new risks and areas that may have a potential negative impact on the organisation. Such a long-term stagnation of the compliance system, which is measured by the number of procedures or other internal documents rather than their actual application, cannot provide real support for corporate governance.

The role of the crisis in the development of compliance

The words of Winston Churchill ('Never waste a good crisis') are appropriate to the current crisis situation. The crisis triggered by the pandemic may again focus attention on the strategic role of compliance both during and after the pandemic.

According to the research carried out by ACCA, published in mid-April, 80% of companies have limited their operations, and more than half of the companies are unable to make any forecasts for the future due to the enormous dynamics of change (ACCA, 2020). The organisation can only prepare itself for the day-to-day management of a crisis situation, but is not able to protect itself against it. There is also no proven strategy for the new, pandemic-induced nature of the crisis the economy is currently in. When a crisis situation passes, follow-up solutions are introduced in response to the crisis and its causes.

The development of compliance was brought about by the Federal Sentencing Guidelines (FSG), amended in 1991 in the USA, which were aimed at reducing

the so-called corporate crime. Thanks to the FSG, US judges have been given the opportunity to mitigate judgments in economic crime cases when certain mitigating factors are met. Mitigating a possible criminal conviction against an organisation is possible when the organisation demonstrates an effective compliance programme. The creation of incentives under the economic criminal law to build organisations and compliance programmes is found outside the USA as well. For example, criminal law in Australia, and after the recent reform also in Spain, makes it possible to mitigate the liability of corporate entities when they can demonstrate the existence of a corporate culture which will actively and preventively counteract illegal and unethical behaviour, or when the organisation will actively exercise control over the legality and ethics of its activities (precisely through compliance).

Compliance is a concept that has no legal definition. This medical term was introduced in economics in the 1980s by the American financial sector for areas with high risk of insider trading and areas at risk of money laundering or conflict of interest (Borowa, 2013).

Compliance is a state of conformity, a way of doing business in which the corporation is in compliance with all applicable laws, regulations and other standards. Practice has adopted the use of English compliance interchangeably with its equivalents in national languages. According to the definition adopted by Romanowski, compliance is a set of rules of conduct defining the way in which the employees of a company comply with the law, good practices in a given industry and internal regulations of the company (Braun, 2017). In the broad sense of the term, compliance is any solution that implements internal and external audit, day-to-day supervision, assistance in resolving doubts or interpreting regulations. In a narrower sense, compliance is an internal function within an organisation, whose tasks focus on managing the risk of non-compliance and implementing solutions to ensure compliance with laws and other regulations (Szpytka, 2019).

The idea of compliance emerged in the United States on a wave of crimes detected in companies. The U.S. Supreme Court then ruled that every company should adhere to certain principles that will protect its authorities, employees and the company itself from liability to customers. Compliance has also spread outside the United States when companies with multiple branches, subsidiaries or entire groups were established. Procedures have become necessary to enable such companies to operate in a uniform manner. Compliance was also implemented in Poland. The Banking Law and the regulations concerning the functioning of brokerage houses or investment funds require a compliance officer and risk management system to be in place in a financial institution (Pajewska, 2011). Over time, the compliance function has become the domain of other sectors, where there is a risk of liability for the violation of certain standards.

Implementation of compliance policy, objectives, and functions

The implementation of the compliance management system prevents undesirable phenomena. A compliance officer plays a key role in introducing a compliance management system in the organisation, ensuring its ongoing effectiveness and developing and documenting compliance activities (Jagura, 2020).

The compliance function allows a company to reduce significantly its business risk, strengthen competitiveness and market position. A key role is played by the ISO 19600 Compliance Management System (CMS) standard issued in December 2014, which is understood as a set of standards and policies introduced by the organisation, as well as actions taken within the organisation to ensure compliance with ethical principles and legislation and thus to minimise the risk of non-compliance (Borowa, 2013). This concept clearly indicates the need to distinguish between compliance and the CMS. The main task of the CMS is to reduce the risk of irregularities that may adversely affect the company and its operations, and thus to strengthen the idea of compliance in the long term. Depending on factors such as the size of the company, area of operation or business risks, there are different models of systems and different means of compliance to achieve the indicated objectives. One of these basic measures are private internal investigations, i.e., investigative activities within the company which hold a number of functions. Their primary objective is to detect infringements of the law and other compliance obligations, which will enable the company to react appropriately depending on the nature of the infringement (Jagura & Makowicz, 2013).

In February 2018, a report¹ was published on the study of the state of compliance and compliance management systems as a whole, i.e., the extent to which they are disseminated in Polish companies, their essential elements and the manner in which they are implemented. The authors of the report wanted to examine what percentage of respondents had already introduced a CMS compliance management system and to find the reasons behind not implementing such systems. According to this report, the CMS or its elements function in as many as 65% of the surveyed companies. Compliance management systems are quite a new solution in Polish enterprises. The respondents were asked how long the CMS has been operating

¹ *Compliance in Poland* – Report on the research of the state of compliance and compliance management systems in enterprises operating in Poland, conducted by the Compliance Institute in cooperation with EY, Wolters Kluwer and Viadrina Compliance Centre operating at the European University Viadrina in Frankfurt (Oder). 110 companies participated in the survey. A vast majority (89%) were large companies with at least 50 employees, including very large companies with over 1,000 employees (46%). Nearly half (48%) of the analysed companies had a dominant Polish capital.

in their company and it turned out that in 17% of companies it has been operating for less than a year and in 47% of companies the CMS has been operating for one to six years. 28% of the companies declared to have the CMS for more than 6 years. Therefore, it can be concluded that the compliance trend is still very young in Poland (Compliance in Poland, 2018).

The reasons behind not implementing any CMS include mainly the lack of knowledge of the issue (28%) or belief that it is not necessary to have such a system due to the size or structure of the company or the nature of its business (38% in total). Only in 5% of the responses the lack of financial resources is the reason behind not implementing the CMS (Compliance in Poland, 2018).

Compliance is generally perceived as part of corporate governance, which is also understood as ownership supervision, which involves the existence of a network of relationships between the management of companies, supervisory bodies, partners or shareholders and other stakeholders understood as those interested in the company's operations (Mesjasz, 2011). As Makowicz points out, when speaking about governance, we find ourselves at the level of values, i.e., strategy and general planning, while the CMS level is the level of implementation of the strategy through appropriate management, i.e., a degree lower than governance (Makowicz, 2018). Moreover, the literature indicates that corporate governance principles cannot be fully universal and applied to all companies. At the centre of the international and interdisciplinary discussion on corporate governance one finds a joint stock company, or more precisely a public company ('open'), which raises funds through the issue of shares on the organised capital market and is characterised by a dispersed, anonymous shareholding (Oplustil, 2010).

Compliance is of particular importance if a given business activity is subject to separate regulations, i.e., it must comply with the procedures, processes and product standards set out in sectoral regulations, as well as with the various guidelines and recommendations issued at the European and national level. The effectiveness of a compliance policy depends on its content and the extent to which it is tailored to the specifics of the company. Then we can say that compliance is an effective instrument for limiting the risk of violation of laws and regulations in the company. Compliance is intended to reduce the risk of sanctions that may be incurred by an entrepreneur due to non-compliance with the law. The lack of implemented compliance policy may result in image losses, i.e., loss of credibility for customers, contractors, shareholders, investors and the public, to which the organisation is exposed as a result of failure to comply with legal regulations, recommendations and guidelines of supervisory authorities, internal regulations of the entity and standards of conduct it adopted. Moreover, in the case of companies, significant financial penalties are often involved, the obligation to return received public aid

and paying tax arrears, liability for damage, the risk of invalidation of concluded contracts, civil and criminal liability, penal and fiscal liability – both of the entity as a whole and the persons managing the company.

An important role of compliance in corporate governance is underlined by the objectives it is supposed to achieve and its functions within the company.

The compliance objectives can be divided into overarching and subordinate objectives. Regardless of the definition adopted, in all cases compliance will focus on the achievement of a number of essential subordinate objectives. First of all, it is about preventing legal risks, which can result in sanctions and damage to the organisation's reputation. Secondly, transparent structures of the organisation should be created by ensuring that management bodies, shareholders and employees are effectively informed. Thirdly, it is necessary to carry out effective control and observation of the organisation and to document it accordingly (Makowicz, 2011).

Formulating precise objectives of compliance allows for the definition of its functions, two of which are essential, namely preventive and repressive ones (Makowicz, 2011). The preventive function is designed to identify potential risks quickly enough, before they materialise. Its aim is to counteract any attempt of improper action and minimise reputation or regulatory risk. In turn, as part of the repressive function compliance detects and identifies the irregularities committed and introduces corrective actions to improve internal procedures and image in the media after the irregularities in the company are detected and publicised. To this end, it is necessary to establish appropriate internal procedures of an investigative nature, e.g., searches, interviews of employees, data security (Mrozowska-Bartkiewicz & Wnęk, 2016).

In addition to the above-mentioned essential compliance functions, detailed functions such as corrective, promotional, protective, evidentiary, organisational, advisory and informational, quality assurance, innovation and observation functions also play an important role (Makowicz, 2011).

The corrective function focuses on repairing organisations embroiled in scandals such as corruption, trafficking with terrorist organisations and other incidents. The common factor in all these cases is usually a situation in which the organisations in question do not have a compliance system at all or the system functions incorrectly because it has design errors. Therefore, most organisations decide to create a new compliance system from scratch, or to improve the existing system, which is connected with hiring a new person responsible for compliance (Makowicz, 2011).

Another detailed compliance function is the promotional function (Makowicz, 2011). This function consists in publishing information about the compliance system in order to convince third parties, including business partners, consumers and investors, that the company uses the most modern standards in its operations.

The protective function of compliance is to avoid sanctions or the risk of being held liable for damage, as well as to protect the reputation of the company, which could be damaged as a result of media coverage of the irregularities. The implementation of the CMS makes it possible to control legal risks related to the activity of a given entity. This system works preventively, by applying compliance measures, and limits the occurrence of infringements and acts as a repressive response to irregularities. Furthermore, the fact of having the CMS can be taken into account as a mitigating circumstance (Jagura, 2017).

Another important compliance function is the evidentiary function, the essence of which is to collect relevant documentation, which may have evidentiary value in various types of proceedings (Makowicz, 2011). For example, the company will be able to apply for a leniency programme in relation to leniency, or a board member will be able to prove that he has taken the due care required of him (Jagura, 2017).

The main compliance function is also the organisational function, which is based on creating a transparent and well-functioning organisational structure of the company (Makowicz, 2011). An effective compliance function requires the involvement of people at all levels of this structure (Szczytka, 2019).

Other noteworthy functions include advisory and informational functions, which are based on the functional aspect of compliance, consisting of the compliance officer and his or her employees providing information and guidance to the rest of the organisation's employees about their behaviour in accordance with the compliance objectives. The compliance department provides advice and information on the company's operations. Every employee and member of the authorities should be able to approach the compliance officer and obtain information to eliminate the risk of inappropriate behaviour (Jagura, 2017).

As regards the quality assurance function, it mainly concerns organisational aspects. The compliance officer is not able to predict potential irregularities. The compliance system should be flexible, prone to adapting quickly to new challenges and situations. Thus, we can speak of the innovation compliance function. The observation function boils down to constant observation and monitoring (Makowicz, 2011).

A key role in the compliance function is played by the management board as an obligatory body performing management and representation functions and the supervisory board permanently watching over the company's activities – if it is established in a limited liability company, as it is an optional body in this type of companies. The company's management board decides whether it is necessary to implement a CMS in a specific factual situation, and if so, shapes the system and adapts it to the company's needs, based on the business judgement of the situation. The management board is also responsible for detecting and sanctioning situations of non-compliance. Responsibility for compliance lies with the entire

board as a corporate body (Jagura, 2017). It is undisputed that only the cooperation between the management board and the supervisory board guarantees the effective performance of the compliance function.

When analysing the role of compliance in corporate governance, it should be noted that the implementation of compliance principles is based on the individual situation of a given company and the circumstances pertaining to it, such as its business profile, size, the markets in which it operates, the scope of regulations applicable to it, and the fact of previous irregularities (Jagura, 2017). The implementation of the CMS should be seen as part of a carefully conducted business. Not every company will need to undertake separate organisational activities in the form of creating a compliance structure or appointing a compliance officer.

From the risk management practice, it can be seen that the compliance function includes: monitoring of changes in regulations and identification of new regulated areas, protection of confidential information, advisory role, prevention of conflict of interests, analysis of reliability and correctness of marketing materials.

An effective compliance management system may constitute an exculpatory circumstance, which will be invoked by a member of the management board who is held liable pursuant to Article 293 or Article 483 of the Commercial Companies Code for damage caused to the company. In order to be exempted from liability for damage, it is necessary for a member of the management board to demonstrate that the conduct of the company's affairs and its representation were performed in a professional and diligent manner. A member of the management board could argue that the implementation of the compliance management system meant that care was taken in the professional nature of the activity and, therefore, there is no basis to hold him liable. Such an approach is intended to support the functioning of the management board as a whole in the implementation of its duties of carefulness (Jagura, 2017).

Compliance systems increase the transparency of companies' operations, build the trust of customers and business partners, lead to an improved reputation, as well as shape a culture of compliance with the law and ethical standards (Weber-Elzanowska, 2018). The company's management board should take into account the function of ensuring compliance within the organisation's strategic plans. This function should be seen as an essential element in the implementation of the business strategy. In turn, the supervisory authority should expect a detailed declaration from the board of directors on the approach to ensuring compliance in the organisation (Szczytko, 2019).

Conclusion

In conclusion, compliance consists of all means of ensuring that the organisation's activities comply with the law, internal regulations and accepted standards of conduct. Every area of the company's activity is burdened with the risk of non-compliance, hence the actions taken within the framework of compliance are aimed at preventing legal, financial or image losses. The role of compliance is to provide advice, information, protection, control, and evidence.

The implementation of the management system is part of the imperative of responsible management of the organisation. An effective compliance programme allows for an adequate minimisation of risk while avoiding high costs associated with reputational damage or economic sanctions and damages imposed on organisations and their management bodies in the event of compliance violations. A compliance management system provides a real support for corporate governance if its components form a coherent whole, are compatible and integrated. It aims to identify, analyse, evaluate and eliminate all compliance risks, present or future (Janecki, 2020).

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