

# *Research on the Compliance Third-Party Supervision and Evaluation Mechanism of the Involved Enterprises*

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**Abstract:** The third-party supervision and evaluation mechanism for compliance reform of enterprises involved in cases refers to the investigation, evaluation, supervision, and inspection of the compliance commitments of enterprises involved by a third party, and the use of the investigation results as an important basis for the procuratorial organs to handle cases in accordance with the law. This mechanism has problems in operation, such as the generalization of third-party mechanisms, a directory of third-party mechanism professionals, unclear cost burden of third-party mechanisms, unclear standards for determining compliance inspection periods, and insufficient supervision and restraint mechanisms. Therefore, it is necessary to limit the scope of application of third-party mechanisms, improve the selection method of the third-party mechanism professional personnel directory, improve the third-party mechanism funding guarantee mechanism, improve the compliance inspection period reference standards and review mechanism, and strengthen the supervision and restraint mechanism.

## **1. Introduction**

Since March 2020, the Supreme People's Procuratorate has conducted pilot projects for corporate compliance reform in some places. After two pilot projects, the "Guiding Opinions on Establishing a Compliance Third Party Supervision and Evaluation Mechanism for Involved Enterprises (Trial)" ("Guiding Opinions") was jointly issued by the Supreme People's Procuratorate, the Ministry of Justice, and the Ministry of Finance on June 3, 2021.[1]The third-party supervision and evaluation mechanism, that is, the procuratorial organs can entrust the third-party supervision and evaluation organization selected by the management committee of the third-party supervision and evaluation institution to inspect, supervise and evaluate criminal enterprises that meet the requirements of enterprise compliance reform. A third-party organization is a third party independent of the procuratorial organs and enterprises, and it is an objective and impartial supervisor. At the same time, the staff of third-party organizations are selected by the third-party mechanism management committee based on its established expert roster. They possess specialized knowledge and skills in compliance management, and are able to guide and supervise the compliance issues of enterprises. [2]Although the Supreme People's Procuratorate, the State Administration for Market Regulation and other nine departments have further jointly formulated supporting regulations such as the "Management Measures for the Selection of Professional Personnel for the Compliance Third Party

Supervision and Evaluation Mechanism of Involved Enterprises (Trial)", "Measures for the Compliance Construction, Evaluation and Review of Involved Enterprises" (hereinafter referred to as the "Measures"), and "Implementation Rules for the Guiding Opinions on Establishing the Compliance Third Party Supervision and Evaluation Mechanism of Involved Enterprises (Trial)" (hereinafter referred to as the "Implementation Rules"), the Supreme People's Procuratorate has also issued a batch of relevant guiding cases. However, so far, the third-party supervision and evaluation mechanism is still in the process of exploration, and the practices of procuratorial organs in various places are not the same in actual work. So, it is necessary to sort out the development status of third-party organization regulatory evaluation, in order to point out the direction of improvement for future work, so that it can better supervise enterprises to carry out effective compliance rectification.

## **2. Connotation and characteristics of the third party mechanism**

### **2.1 The connotation of third party mechanism**

The third-party mechanism, also known as the "third-party supervision and evaluation mechanism for compliance of involved enterprises", is led by the procuratorial organs in a multi-party linkage and collaborative manner to regulate the compliance of involved enterprises. Specifically, in the process of handling criminal cases involving enterprises, the procuratorial organs entrust eligible enterprises to personnel selected by the third-party mechanism management committee to be responsible for investigating, evaluating, supervising, and inspecting the involved enterprises based on their basic situation, compliance willingness, criminal situation, and compliance basis. The evaluation results formed by the third-party mechanism will become an important basis for the procuratorial organs to handle cases in accordance with the law.[3]

"Third party" refers to a compliance supervision group composed of externally selected professionals, which is the other party opposite to the enterprise or procuratorate, namely a third-party organization. There are three main reasons for choosing individuals outside of enterprises and prosecution departments to assume compliance supervision responsibilities. One is for enterprises to supervise and evaluate their own compliance behavior, which has some limitations in practice and results, requiring external parties to bear the responsibility of compliance supervision. Secondly, due to the strong specificity of corporate compliance, the procuratorial organs are limited by their professional abilities and find it difficult to meet the needs of their work. They need to rely on external forces to fill this gap. Thirdly, as the main body responsible for formulating laws and regulations, the procuratorial organs may face an awkward situation of dual identities as "judges" and "athletes" when evaluating their own supervisory actions and their consequences. Therefore, it is necessary to select entities that can take on this responsibility in the process of implementing compliance supervision.

### **2.2 Characteristics of third-party mechanisms**

The third-party mechanism includes the procuratorial organs, the third-party mechanism management committee, third-party organizations, and the involved enterprises. Among these types, procuratorial organs, third-party mechanism management committees, and third-party organizations are all supervisory entities with corresponding responsibilities for supervision, evaluation, and review. Its main features are:

- 1) Coordinated development led by prosecution and centered on diversity. The third party, centered around the procuratorial organs, collaborates with other parties to achieve the entire process of compliance management for the involved enterprises. The procuratorial organs are the statutory supervisory bodies of the national supervisory organs, and also the main supervisory objects in the

review and prosecution stage. They have comprehensive supervisory functions over the entire process of enterprise compliance supervision.

In third-party mechanisms, each agent achieves the goal of collaboration through division of labor, cooperation, and collaboration. The Guiding Opinions on Establishing a Compliance Third Party Supervision and Evaluation Mechanism for Enterprises Involved in Cases (Trial) and the Implementation Rules for Establishing a Compliance Third Party Supervision and Evaluation Mechanism for Enterprises Involved in Cases (Trial) reflect the spirit of collaboration among multiple parties in terms of specific content and procedural arrangements.[4] For example, to establish a daily communication mechanism to facilitate communication among all parties. Conduct a joint investigation to ensure that all regulatory agencies have the opportunity to directly understand the actual situation of the company, such as whether compliance conditions are met and whether compliance plans involve criminal offenses. By establishing mechanisms for information exchange and sharing, we can improve the efficiency of information utilization and enhance collaboration. The above aspects reflect the division of labor and cooperation among various departments.

2) The professional level of the target and regulatory content. Because the production and operation of the companies involved usually have some professional knowledge barriers. Therefore, members of compliance supervision must have specialized knowledge and skills. Generally speaking, members selected by the third-party mechanism management committee are composed of experts in auditing, legal, taxation, enterprise management, computer technology, and other fields. At the same time, it should be determined based on the characteristics of the illegal activities carried out by each enterprise, combined with their specific illegal activities and business situation. For example, when conducting compliance supervision on criminal cases of environmental pollution, appropriate selection should be made for environmental monitoring personnel and environmental assessment personnel. Overall, in the institutional design of compliance reform for the involved enterprises, third-party mechanisms can effectively supervise the compliance rectification of the involved enterprises under the guidance of the procuratorial organs and with the cooperation of multiple parties, to ensure the systematicity, comprehensiveness, and accuracy of compliance supervision.

### **3. The practical dilemma of the third-party supervision and evaluation mechanism**

#### **3.1 The scope of application of the third-party mechanism is generalized**

Third party mechanisms have advantages in compliance supervision models, but it is worth considering whether all corporate compliance cases require the application of third-party mechanisms? Article 4 of the Guiding Opinions stipulates that third-party mechanisms can be applied if the following conditions are met simultaneously: "The enterprise or individual involved in the case pleads guilty and accepts punishment; the enterprise involved is able to produce and operate normally, promises to establish or improve its compliance system, and has the basic conditions to activate the third-party mechanism; the enterprise involved voluntarily applies the third-party mechanism". Article 5 of the Guiding Opinions stipulates that enterprise compliance pilot programs and third-party mechanisms do not apply to individuals who establish companies or enterprises for illegal or criminal activities; companies or enterprises whose main activity after establishment is to commit crimes; company or enterprise personnel who use the name of the unit to commit crimes; suspected crimes that endanger national security or terrorist activities; and other situations that are not suitable for application. The fourth and fifth articles of the Guiding Opinions respectively provide clear provisions on the application and exclusion of compliance pilot programs and third-party mechanisms for enterprise related crimes.[5]

In the early stage of the compliance reform pilot work, in order to allow local procuratorial organs to explore more freely, and to enable more enterprises to "regain new life" and promote the

healthy development of enterprises and even the entire industry, relatively relaxed regulations were made on its scope of application. However, it is precisely because there are no specific and detailed regulations that third-party mechanisms are almost always adopted in judicial practice in various pilot areas. Many small and micro enterprises with smaller scales, simpler organizational structures, and suspected of minor crimes have adopted third-party mechanisms, resulting in unnecessary waste of resources. This often leads to a lack of resources when it is necessary for companies to initiate this mechanism for compliance review. In addition, these small and micro enterprises may not necessarily be able to hire specialized lawyers or accountants to help them with compliance governance, which not only brings great difficulties to third-party organizations, but also affects the implementation effect of enterprise compliance rectification.

### **3.2 Third-party mechanism professional directory database problem**

In China, the list of arbitrators is divided according to the expertise of the arbitrators so that the parties can choose from them, while the list of experts of third-party institutions is similar to the roster of arbitrators of arbitration commissions and is distinguished according to their expertise.

The Guiding Opinions also propose that third-party institutions shall be selected by the third-party institution management committee from the expert directory database in a category and random manner to form third-party institutions. When formulating this system, it is to ensure the professionalism and fairness of enterprise compliance work. However, in practical operation, although specialized talent directory databases have been established in various regions, only a small number of areas classify them according to their professional fields, and most of the expert directories in these regions do not classify them according to their professional fields. In cases involving corporate compliance, the compliance risks and institutional deficiencies of enterprises of different sizes and fields are unique, and the third-party mechanism management committee is randomly selected from all experts. Therefore, this point cannot be well matched to specific criminal fields, and therefore lacks specificity.

### **3.3 The third-party mechanism fee burden is unknown**

The investigation and evaluation of compliance rectification of the involved enterprises and the construction of compliance systems cannot be separated from the participation of third-party organizations. As a third-party organization with multiple entities, although it does not have an independent identity, it is also the supervisor, guide, and evaluator of the compliance rectification work of the involved enterprises.[6] Therefore, paying reasonable compensation and costs for the compliance work of third-party organizations is an important prerequisite for ensuring their effective operation. The Guiding Opinions do not provide clear provisions on this issue, and other relevant regulations only symbolically suggest diversified ways of financial support for various regions. Except for a few third-party management committees in Shenzhen that explicitly stipulate that regulatory costs should be borne by the relevant enterprises themselves, most other practices are borne by the government. Some are also considered to be free regulation or included in legal aid, requiring both symbolic fees and various constraints and restrictions. The Guiding Opinions point out that once intermediary agencies and practitioners engaged in legal, auditing and other professions enter the third-party mechanism, they cannot have any harmful relationship with the investigated object within 12 months after the expiration of their duties in the process of supervising and evaluating specific cases. Under such high-pressure constraints, if the reasonable compensation of compliance regulators cannot be guaranteed, it will inevitably dampen the enthusiasm of relevant professionals and professional institutions.[7]

At present, China's third-party regulatory evaluation system has just begun, with university

teachers, researchers, and other members as the main body. Their research enthusiasm is high, and their motivation to participate in regulatory evaluation may not necessarily be purely economic factors. However, in the long run, if third-party mechanisms want to achieve scale and long-term effectiveness, their economic motives must be considered.

### **3.4 The criteria for determining the compliance inspection period are not clear**

The length of the compliance inspection period largely affects whether the compliance plan formulated by the involved enterprise can be achieved and whether the rectification measures can be implemented. The "Guiding Opinions (Trial)" and "Implementation Rules" have made specific provisions on the determination of compliance inspection deadlines. Firstly, the ultimate review power of the procuratorial organs over compliance review deadlines has been established. In the compliance supervision mode where a third-party institution serves as the regulatory body, the third-party institution needs to consult the opinions of the procuratorial organs before determining the final compliance review deadline. Secondly, when determining the compliance inspection period, consideration should be given to the compliance plan of the involved enterprise, the specific circumstances of the case, and the deadline for fulfilling commitments.

Although the current legal provisions provide operational basis for the time limit of compliance inspections conducted by procuratorial organs and third-party organizations, there still exists the problem of unreasonable determination of compliance inspection time in the current legal provisions. One reason is that the considerations for compliance inspection time in the "Guiding Opinions (Trial)" and "Implementation Rules" are not consistent, which makes it difficult for the procuratorial organs and third-party institutions to grasp the key points of "compliance inspection" when determining the "compliance inspection" period. The Guiding Opinions (Trial) focus on the compliance plan of the involved enterprises, while the Implementation Rules are based on the time limit for fulfilling the commitments of the case and the involved enterprises, which has left practical operators at a loss. The second issue is that the consideration factors for determining the compliance inspection period are too vague. The "Guiding Opinions (Trial)" and "Implementation Rules" propose that the specific circumstances of the case and the deadline for fulfilling compliance commitments should be taken into account as evaluation factors, but neither provides clear reference standards. The lack of specific reference standards will be detrimental to the review and determination of reasonable compliance inspection periods by the procuratorial organs and third-party organizations. The ultimate consequence is that the determined compliance inspection period is too short to meet the actual needs of enterprise compliance rectification, or that the determined compliance inspection period is too long, resulting in compliance rectification exceeding the case handling deadline of the prosecution stage.

### **3.5 The supervision and restriction mechanism is insufficient**

The Guiding Opinions and relevant third-party mechanism management committees have issued procedural provisions, such as responsibility, avoidance, evaluation, exemption, etc. However, in terms of the mechanism itself, it mainly targets the investigated enterprises, rather than the relevant departments such as the leading prosecutorial agency.<sup>[8]</sup> In addition, in some places, when choosing third-party regulators, the pursuit of formal justice ultimately leads to formalism, resulting in designated regulators being unable to fulfill their duties. At present, there is still a problem of insufficient supply of regulatory constraints on third-party mechanisms, and the introduction of external supervision through judicial review by the court. Due to the lack of corresponding institutional foundations, the risk of "rent-seeking" and third-party regulatory negligence in the execution process has increased. Therefore, further improvement and standardization are needed in

the supervision and constraint of third-party mechanisms.

## **4. How to improve the third party supervision and evaluation mechanism**

### **4.1 Limitations of third-party mechanisms apply**

In the current reform process, the procuratorial organs must strictly control the initiation of third-party mechanisms, and comprehensively consider factors such as the size of the enterprise, suspected charges, and degree of harm when initiating necessity reviews. Generally speaking, the production capacity of small and micro enterprises is relatively weak, their ability to resist risks is relatively low, and the damage caused by suspected crimes is also relatively small. Therefore, for small and micro enterprises suspected of minor crimes, the procuratorial organs guide the involved enterprises to conduct risk self-examination and provide feasible and effective compliance plans. At the same time, based on the compliance risk points discovered during the case, prosecutorial suggestions will be issued to provide guidance on the criminal reasons and compliance system construction of the involved enterprises, urging them to establish compliance management systems. Finally, the procuratorial organs invited experts from relevant parties to comprehensively review and evaluate the compliance rectification based on the compliance rectification report submitted by the enterprise. Ensure that enterprises can truly fulfill their compliance commitments and plans, and achieve effective compliance rectification. In this case, due to the prosecutor's deep understanding of the case, the pressure of supervision is also relatively small. Therefore, simple compliance supervision by the procuratorial organs can be more effective and convenient, without the need to activate third-party mechanisms.

### **4.2 Third party mechanism professional personnel directory database selection and appointment improvement**

Firstly, referring to the list of arbitrators of arbitration committees nationwide, they are classified into different categories such as taxation, environmental protection, food and drug by industry. Ensure that the institution can select third-party institutions based on suspected charges, industry sectors, etc., to ensure the professionalism and effectiveness of compliance case handling. Secondly, it is necessary to strengthen the training and evaluation of members in the directory database, and make it a regular training system. Through lectures, exchanges, and seminars by experts and scholars, a detailed introduction will be given, and combined with the actual situation in various regions, the professional ethics of the members of the directory database will be improved.

The company involved in the case may be given the right of initial screening of members of third-party organizations at its discretion. Firstly, the involved companies can select a group of professional talents from the directory database, and then have their qualifications reviewed by the third-party mechanism management committee. Secondly, based on specific circumstances, a substantive and targeted review will be conducted on the nominated person's business capabilities in compliance with a particular industry, as well as their interests and relationships with the parties involved in the case. Finally, a comprehensive assessment will be conducted on the workload, health status, and other aspects of the pre selected candidates to ensure the high-quality implementation of compliance supervision work.

In fact, the expert directory database of various regions and levels should be a complete whole. The directory database between superiors and subordinates, as well as between the same level and different regions, should achieve the sharing and mutual assistance of talent resources. If the third-party mechanism management committee finds that the local expert roster cannot select experts who meet compliance requirements during the selection process of third-party organizations,

it can consult with the third-party mechanism management committee at the higher level or other regions at the same level to select suitable experts to form the third-party organization.

#### **4.3 We will improve the funding guarantee mechanism for third-party mechanisms**

There are currently three different models in China's reform practice regarding how to bear the costs involved in third-party mechanisms. One approach is similar to foreign conventions, where the relevant companies bear the responsibility themselves and adopt a fully commercialized charging method to punish the companies in a "preemptive" manner.<sup>[9]</sup> Starting from the motive of 'counter evidence', it is reasonable for the involved enterprise to bear the cost of supervision and evaluation. However, from a Chinese perspective, this model does not match the identity characteristics of China's third organization "quasi judiciary" and is highly prone to corruption. Under market-oriented conditions, in order to pursue profits, it is necessary for institutional designers to consider whether third-party personnel will collude with the involved enterprises. Secondly, based on the fiscal budget, local governments or procuratorates pay for compliance supervision costs, which not only increases the burden on local finances but also does not align with their functional positioning. The third is to adopt a combination of the first two methods, which is generally borne by the enterprise itself, but if it cannot be borne by law, it shall be borne by the national finance. There are more uncertainties in this model, which also implies possible operational confusion. The burden of compliance costs directly affects the effectiveness of corporate compliance work. Only when the cost of compliance is lower than the benefits of compliance, will enterprises take the initiative to carry out compliance construction and cooperate with relevant departments.

From the current pilot situation, it can be seen that the supervision cost is not high enough to effectively motivate third-party supervision agencies to seriously formulate governance plans for enterprises. On the other hand, there are currently a large number of private small and medium-sized enterprises in China, and they do not have sufficient funds to pay management fees. Therefore, a standardized and clear audit fee system should be developed as soon as possible to achieve diversified sources of compliance management costs. It is possible to consider establishing a special fund, with local industry associations, local chambers of commerce, and related enterprises as the main body. If financial resources permit, a certain proportion of subsidies can be provided within the budget. The cost of third-party evaluation in districts and counties is actually not high, usually reaching 200000 yuan per year. Moreover, local chambers of commerce and associations usually have training and insurance fees ranging from tens of thousands to hundreds of thousands. With the approval of the board of directors, they can allocate a significant portion to assist the investigated enterprises in rectification. This is not only a mutual assistance between enterprises, but also a function of chambers of commerce and associations, as well as to avoid private small and medium-sized enterprises being unable to operate or even go bankrupt due to high compliance costs. In addition, it is suggested that the procuratorial organs, together with the Federation of Industry and Commerce and industry regulatory departments, establish a long-term mechanism. Establish a standard document for the use of third-party mechanism funds and manage fund expenditures in accordance with the work budget standards for people's supervisors and people's jurors. This measure can establish a unified payment method and establish payment isolation to prevent corruption.

#### **4.4 Improve the compliance inspection period reference standards and review mechanisms**

The compliance inspection period should be based on the time required for the construction of the enterprise's compliance system, and scientifically set the necessary time limit for the

implementation of the regulatory review system. Excessive compliance inspection time not only increases the cost of compliance inspection, but also greatly weakens the autonomy of the involved enterprises in compliance construction, and even weakens their compliance enthusiasm.[10] If the prescribed compliance inspection period is too short, it will limit the compliance construction work arrangements of the involved enterprises, resulting in low compliance construction quality. Therefore, in order to ensure the smooth progress of compliance supervision, third-party organizations should establish a reasonable review time limit to ensure the width and appropriate time interval of compliance review. In order to solve the problem of inconsistent application criteria in the process of reviewing and determining compliance inspection deadlines in judicial practice, it is necessary to consider the compliance inspection deadlines in a unified, reasonable, and detailed manner.

When determining the compliance inspection period, the specific case of the involved enterprise should be the focus of the review, and the complexity and degree of harm of the criminal circumstances should be the overall guiding principle. Secondly, taking into account the number of criminal subjects, duration, severity of harmful consequences, and severity of statutory penalties, the focus is on identifying risks in the production, operation, and management behavior, management organizational system, internal decision-making methods, and other aspects of the enterprise. Finally, a targeted compliance improvement plan will be formulated, specifying the deadline for fulfilling compliance commitments and carrying out compliance rectification work. So, for companies with complex situations and serious consequences, the rectification period for "critical illnesses" will be longer, and the time for compliance inspections will also be longer. In the case of simple criminal facts and minimal harmful consequences, the content of compliance rectification is simple and the difficulty is low, so a relatively short compliance observation period can be set.

#### **4.5 We will strengthen supervision and restriction of third-party mechanisms**

On this basis, further improve its regulatory and restraint mechanisms. On the one hand, third-party management committees at all levels should strengthen their membership composition and improve their selection criteria based on existing explorations. And make full use of big data to select regulatory targets that meet the case, and carry out supervision and evaluation work. Secondly, on the basis of continuously improving the internal supervision system, external forces such as National People's Congress deputies, CPPCC members, courts, and social organizations are introduced to supervise their work. At the same time, regulatory agencies at all levels should actively explore ways of cross regional regulatory cooperation, break through barriers between regulation and supervision, and achieve mutual recognition of cross regional compliance.

### **5. Conclusions**

The compliance reform of the enterprises involved is a national innovation in the governance of enterprise-related crimes, which has important practical significance and far-reaching significance. In order to optimize the application of the third-party mechanism and maintain the substantive fairness in enterprise crime cases and natural person crime cases, this paper proposes to limit the application conditions of the third-party mechanism. In order to guarantee the quality and effectiveness of the third-party mechanism, it is necessary to optimize the selection mode of the members of the third-party organization and establish a diversified funding guarantee system during the start-up process. In the process of operation, we should also explore the establishment of dynamic supervision and evaluation period, improve the external supervision of the third-party mechanism, clarify the effectiveness evaluation criteria of the compliance rectification of the



enterprises involved, and build the optimal model of China's third-party mechanism according to local conditions.

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