

Again in §8B2.1 the Commission defined the purpose of a compliance program to be, in part, "taking reasonable steps to prevent illegal conduct in organizational activities." I would urge the Commission to consider changing the phrase "illegal conduct" to "violations of law," in all mentions (e.g., including §8B2.1 (a) (b), etc.). The Commission's words, when published, will be read closely and carefully. The term "violations of law" creates a subtle but potentially very significant change in the spirit of that statement in two ways. First, the "violations of law" has, in common usage, a much broader implication than the phrase "illegal conduct" and speaks to the Commission's increased focus on getting organizations to speak to the spirit, not simply the letter, of the guidelines. Second, many tend to think of violations of law as something to prevent (i.e., before they occur) and illegal conduct as something to address (i.e., after it occurs).

Part of proposed guideline §8B2.1 (i.e., subsection (b) (2)) speaks to the role of "high level personnel of the organization" who shall "be assigned direct, overall responsibility to ensure the implementation and effectiveness of the program to prevent and detect violations of law." The guideline, in part, speaks to the requirement that these individuals engage in periodic meetings with the "governing authority or an appropriate subgroup of the governing authority." I would urge the Commission to make two changes to the wording of this statement.

First, change "periodically" (i.e., as stated in the Commentary) to "quarterly" and consider stating that as part of the guideline itself. The danger of using the term "periodically" is that it may, de facto, encourage adherence to the letter but not the spirit of this proposed guideline. As I have observed so many times, organizations and their management rarely embrace change simply because they believe it is the right thing to do. Most often, they embrace change when the "cost" for not doing so becomes too great. Providing senior level managers with specific guidance in this and other areas takes into account the fact that many will, at least initially, not embrace the spirit of the guidelines and will, instead, comply with the most narrow definition (i.e., that definition that requires the least change) instead. I assume that the goal of this proposed guideline (and others) is to provide the structure and clarity necessary to ensure that the behavioral change the Commission seeks not only becomes habit on the part of those organizations that are affected by the Federal Sentencing Guidelines but that they also adopt the right kind of habit.

Second, I would urge the Commission to add the phrase (provides the high level person) with "overall responsibility for ensuring the implementation of the program with direct access to the governing authority in between designated meetings." The goal of this modification is to ensure that person has access on an as needed basis (i.e., when he or

she specifically believes such contact is necessary) in addition to regularly scheduled access. As before, my experience is that, at least initially, engaging in the culture change the Commission aims to engender will be facilitated by as much clarity as can be provided without becoming too rigid or unnecessarily constraining. Put even more bluntly, unless this is stated in the final wording, it is most unlikely to ever occur in the real world of organizations. Further, and equally important, that high-level person must have, and indeed be mandated to, meet with the governing authority or the appropriate subgroup in private, and I would urge the Commission to rewrite the proposed text to reflect that. All too often I have been witness to meetings such as these where the responsible person changes what he or she might otherwise say to the members of the governing authority (almost always in the direction of being less candid than might otherwise occur or than the situation actually requires) when his/her superiors or other more senior level people are present in the room.

Regarding proposed guideline §8B2.1 subsection (b) (4), I recommend that the Commission take this further and specifically extend the training requirement to upper levels of the organization. Even more important, I recommend that this phrase require that the training upper-level individuals participate in be of the same length and depth as the training in which others within the organization participate. Too often ethics and compliance training for the broad employee population is “condensed” for senior managers, either because they claim, or because others presume, that their time is “too valuable” to do otherwise. The nature of the training that senior managers take part in may be different from the nature of the program that employees take part in, and that is as it should be—but not the length (and, therefore, the commitment it symbolically speaks to). So, for example, when I designed and helped facilitate training for employees, managers, and senior managers at Pacific Bell, following a series of widely publicized unethical and illegal sales practices during the 1980s, we required training for senior managers be of the same length as that of first level supervisors. We did, however, change the orientation of the training for senior managers to focus on their unique ability to build and maintain an ethical work culture throughout the organization.

Proposed guideline §8B2.1 subsection (b) (5) would require organizations to take reasonable steps to periodically evaluate the effectiveness of their programs to prevent and detect violations of law. Measuring the effectiveness of a compliance and ethics programs has been the subject of enormous debate for years. Central to that debate is the question, “How do we define effectiveness?” The Commission’s guidelines could help provide direction in answering that question. Ultimately, the effectiveness of any training should be measured by its impact in changing employee’s behavior (or sustaining and maintaining desired behavior). So, for example, an evaluation that simply reports the number of calls to the Hotline as a measure of effectiveness often masks the real truth. The program may be completely effective or completely ineffective regardless of the

United States Sentencing Commission

January 25, 2004

Page 4

[2-82]

number of calls received. If training results in changed behavior, it works. If it doesn't, it does not.

Regarding the unreasonable delay in self-reporting by organizations (Section 8C2.5 (f)), which mandates a three point reduction in the culpability score for effective compliance programs if the organization delays unreasonably in reporting offenses, I urge the Commission to maintain this as it is currently described. As stated previously, organizations typically only change when the penalties associated with not changing become too great. The more personal and consequential those changes are, the more likely behavior will change. This is not meant to represent a Machiavellian view of management or of organizations in general, nor to suggest that senior managers are really Rasputins in disguise, waiting for opportunities to say, in effect, "If it's not prohibited, then I can do it." Rather, the argument is that providing specific, concrete guidance regarding requirements and consequences is much more likely to produce the desired behavior than anything that does not.

I hope that these comments are relevant and useful and speak to some of the issues the Commission hopes will be addressed during the public comment period. I would be most interested in testifying before the Commission in person if the benefit of my experience would be of help.

Yours very truly,

Craig Dreilinger, Ph.D.  
Clinical and Consulting Psychologist

cc: Paula Desio, Deputy General Counsel

[ 2 - 83 ]

**Ethics & Policy  
Integration  
Centre**

1717 K Street, NW • Suite 600  
Washington, DC 20036-5346  
(202) 547-1789 ~ FAX: (202) 517-9108  
info@Ethics-Policy.net  
<http://www.EPIC-Online.net>

28 January 2004

United States Sentencing Commission  
One Columbus Circle, N.E., Suite 2-500  
Washington DC 20002-8002  
Attention: Public Affairs

Re: Response to Request for Public Comment on Amendments to Chapter Eight

This letter and attachment are offered in response to the Commission's request for public comment. I have consulted internationally on ethics and compliance programs since 1993 with an emphasis on program evaluation and good governance in emerging market economies. My practice has involved evaluating ethics and compliance programs for the U.S. Air Force under its Voluntary Disclosure Program and work with the Maryland Mediation and Alternative Conflict Resolution Office on a national project to evaluate public policy programs.

We believe that, on balance, the proposed changes/additions reflect well-considered evaluation of the corporate experience in designing and implementing an effective program to prevent and detect violations of the law ("compliance programs"). We are confident that the provisions, such as those aimed at achieving a culture of commitment to compliance, will provide greater guidance to organizations and courts regarding the criteria for evaluating such programs.

There are areas, however, where we think they can be improved as set forth in the following pages and the attachment. We think three issues are important enough to warrant further discussion and request the opportunity to address the Commission: (1) prominent display of the requirements for program evaluation, (2) prominent recognition of the challenges of designing and implementing ethics/compliance programs for small to medium enterprises, and (3) promising confidentiality to encourage employees to come forward with their concerns.

Sincerely,

/S/

KENNETH W. JOHNSON  
Director,  
Ethics & Policy Integration Centre

Attachment: Proposed Amendments/EPIC Recommendations

cc: Paula Desio Deputy General Counsel

[2-84]

**A. Require a more active, policy role for the governing authority**

It is helpful to distinguish between governance and management and ensure that both aspects of organization life are covered by the Federal Sentencing Guidelines for Organizations (FSGO). We recommend that the FSGO make more explicit that the governing authority has an active role in—and responsibility for—requiring and setting broad guidance for the compliance program.

The source of a corporate board's authority is the owners of the enterprise.<sup>1</sup> The board is the pivotal authority. Its authority is neither granted nor defined by management. Policies generated by the board control everything, both governance and management.

In practice, however, the board is often considered an advisor to management rather than its source of authority. Indeed, many recent corporate ethics failures in the U.S. can be traced to the failure of boards to exercise their authority as representatives of the owners.

The FSGO should require a more active board role. See e.g., *IN RE CAREMARK INTERNATIONAL INC. DERIVATIVE LITIGATION*, 698 A.2d 959 (Del.Ch. 1996) where Chancellor Allen noted the Federal Sentencing Guidelines for Organizations and expressed the view that “a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists.”

The Chancellor also said such a reporting system should be designed to provide “timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with laws and its business performance.”

This more active role of the governing authority should be reflected in three areas:

- Recommendation: §8B2.1 subsection (b)(1) Include term “governing policies,” to read:

“The organization shall establish governing policies and compliance standards and procedures to prevent and detect violations of law.”

---

<sup>1</sup> John Carver and Caroline Oliver, *Corporate Boards that Create Value: Governing Company Performance from the Boardroom* (San Francisco: Jossey-Bass, 2002), pp. xxi-xxii.

- Recommendation: §8B2.1 subsection (b)(2): Change order to place governing authority first in order, then organizational leadership and provide that governing authority shall:

- (1) Set policy for the compliance program
- (2) Ensure that the compliance program meets its own requirements for information

See proposed language in the attachment.

- FSGO 3 Recommendation: §8B2.1 subsection (b)(3): define members of the “governing authority” as “substantial authority.”

**B. Provide for a more active role for organizational leadership**

- Recommendation: §8B2.1 subsection (b)(2): require that they also demonstrate commitment to the compliance program as a matter of leadership. See proposed language in the attachment.
- Recommendation: §8B2.1 subsection (b)(4): Include statements of the organizational leadership demonstrating their commitment to the program as examples of appropriate communication. See proposed language in the attachment.

**C. Include requiring the senior personnel administering the compliance program to have access to the governing authority**

As presently drafted, subsection (b)(2) requires only that the “high-level responsible officer” report to the board. In practice, such an officer often does not administer the program. Indeed, the “ethics/compliance officer,” is frequently not the responsible officer, yet has significant insight into the operations of the compliance program. We recommend that this division of authority be recognized in the guidelines. See proposed language in the attachment.

**D. Integrate risk assessment and program evaluation in §8B2.1(c)**

The provision requiring risk assessment is a positive development, but it should be expanded to require that the risk assessment be translated into specific expected program outcomes and the program be regularly evaluated to determine whether the program is effective at meeting expected outcomes.

Where the corresponding commentary specifies that organizations must prioritize the actions taken to implement an effective compliance program and modify such actions in light of the risks identified in the risk assessment, this can best be done with reference to expected program outcomes.

In the same vein, the requirement for program evaluation should be removed from subsection (b)(5) and placed in §8B2.1(c). The provisions for auditing, monitoring, and reporting in subsection (b)(5) are internal to the program itself. Evaluation of the program itself is not aimed at compliance per se, but rather the program effectiveness. Program evaluation is more akin to risk assessment and establishing program outcomes. For example, subsection (b)(1) is informed by the risk assessment in §8B2.1(c). It could be a part of that subsection, but is properly some that must be done to inform the "steps" required in the program. See the attachment for proposed language.

#### **E. Do not require training in subsection §8B2.1(b)(4)**

The importance of subsection (b)(4) is that the [governing policy and] compliance standards and procedures be adequately communicated, not that any particular form be required. Especially for the small to medium enterprise (SME), training may not be the best or most cost-effective way to proceed. Without more definition, requiring training invites training merely for the sake of meeting a requirement. Furthermore, if any communication is advisable, it is that the organizational leadership communicate its commitment to the program.

We recommend retaining the "e.g.," but add the language extending the scope of training and including "statements of organizational leadership demonstrating commitment," or words to that effect. See the attachment for proposed language.

#### **F. Add language requiring that a program offer a promise of confidentiality where appropriate and enforceable at law**

The proposed amendment replaces the existing reference to "reporting systems without fear of retribution" with the more specific requirement for the implementation of "mechanisms to allow for anonymous reporting." The FSGO should follow the relevant provision in Sarbanes-Oxley, which requires a "confidential, anonymous" reporting mechanism.<sup>2</sup> As has been pointed out in the

---

<sup>2</sup> Under Section 301 of the Sarbanes-Oxley Act of 2002, audit committees are required to establish procedures for receipt of complaints by employees:

(4) COMPLAINTS- Each audit committee shall establish procedures for--

literature, this precise wording is grammatically problematic, but the intent reflects experience that the appropriate officials will gain more information where they are able to promise confidentiality than when they only offer anonymity. See proposed language in the attachment.

**G. In all steps other than §8B2.1(b)(1) refer to “compliance standards and procedures,” not “violations of law”**

Since an organization must establish adequate compliance standards and procedures to “prevent and detect violations of law”, the test thereafter should be whether they have adequate structures, systems, procedures, and practices to follow those standards and procedures. For example, the mechanism to seek guidance and report concerns will be more valuable if employees and other agents can raise issues of compliance standards and procedures precisely because they are designed to prevent and detect actual violations.

Therefore, after successfully complying with §8B2.1(b)(1), references in steps 5, 6, and 7, in particular, should refer to these compliance standards and procedures, not just to violations of law.

**H. In all steps after §8B2.1(a) refer to “compliance program”**

We further recommend that in §8B2.1(b)(1) the cumbersome term “program to prevent and detect violations of law” be described as a “compliance program” thereafter.

**I. Response to Issue Number 1: Self-reporting should be treated as a rebuttable presumption**

The Commission requests comment regarding whether the prohibition should be eliminated so that an organization could be considered for the reduction under §8C2.5(f) regardless of whether the organization unreasonably delayed reporting the offense after its detection.

In our view, elimination of this prohibition may be appropriate to encourage organizations to implement compliance programs without having to deal *ab initio*

---

(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.



Chapter Eight Amendments 2004

28 January 2004

Page 6

with the issue of self-reporting. Self-reporting as a matter of policy is problematic for many counsel in view of the "litigation dilemma" so well discussed in the Advisory Group's report. While we feel strongly that organizations should both self-report and remedy any harm they cause, it is also our view that the two factors (an "effective program" and "self-reporting") should not be bound together except where the failure to self-report tends to indicate that the program was not effective.

If this is followed, however, the reduction in the culpability score under §8C2.5(f) for an effective program to prevent and detect violations of law currently should remain at three.

**J. Response to Issue Number 4: Provide a separate provision re: the challenges to the small to medium enterprise (SME)**

The Commission asked whether there were factors or considerations that could be incorporated into Chapter Eight (Sentencing of Organizations), particularly §8C1.2, to encourage small and midsize organizations to develop and maintain compliance programs?

Domestically and around the globe, approaching ethics and compliance programs for the small to medium enterprise (SME) has been challenging. While there are references to these challenges throughout the guidelines, we recommend that an additional section, §8B2.1(d), be added to give specific guidance to the judiciary. The Commission's doing so will be particularly helpful to those making the case for the SME ethics/compliance program as they will be able to point to a separate provision addressing the SME.

We recommend language and commentary covering the following points:

Each small to medium enterprise ("SME")<sup>3</sup> is unique, often taking on the character of its owners and managers. There is surprisingly little research ethics and compliance programs for the SME. Moreover, it is difficult, at best, to generalize the SME experience.

In most economies, SMEs provide the bulk of jobs, especially new jobs, and contribute significantly to the welfare of their communities because they are so closely connected. On the other hand, SMEs often lack the capital, staff, or time of large, complex enterprises ("LCEs") to address many business

---

<sup>3</sup> There are many definitions of the SME, especially the small enterprise. The World Bank definition of the small enterprise is under 300 employees, while the U.S. Small Business Agency definition is 500 employees.

issues. For example, tracking and meeting changing laws and regulations are relatively more costly for the SME.

Though many of the best practices developed over the last two decades reflect the experiences of LCEs, the process of developing standards, procedures, and expectations is the same for all enterprises. The answers for each enterprise will depend upon the size and complexity of the enterprise itself. The goal for the SME, then, is not to duplicate the standards, procedures, infrastructure, practices, and expectations of LCEs, but to learn from them—and to improve them.

SMEs have an additional incentive to adopt the discipline of responsible business conduct: to create a wider commercial network. Where owners and managers embrace the global language of responsible business through a Business Ethics Program, a network of business enterprises and supportive NGOs based on shared values is possible. Such a network allows the individual SME to develop some of the synergies and economies of scale that only larger enterprises can afford.

Due to resource limitations, most small to medium enterprise (“SME”) program strategy and planning will be informal. Owners and managers will be less apt to use formal teams and processes to set goals, objectives, strategies, and action plans than large enterprises. Nonetheless, they can adapt the processes and best practices of LCEs to meet their circumstances.<sup>4</sup>

The following table is included in the forthcoming work identified above intended to address the concerns of SMEs. We do not recommend that it be included in the Guidelines, but it is illustrative of what may be possible.

---

<sup>4</sup> This language summarizes various provisions in a forthcoming work, Kenneth W. Johnson and Igor Y. Abramov, *Business Ethics: Manual on Managing the Responsible Business Enterprise in Emerging Market Economies* (Washington, D.C.: Government Printing Office, 2004).

<b>Business Ethics Infrastructure SME Conversion Chart</b>	
<b>Function</b>	<b>Typical SME Staffing</b>
<b>High-level responsibility for program oversight (the "Responsible Officer")</b>	Often an owner, but another highly respected employee, who has substantial authority in the enterprise, is preferable.
<b>Performing or coordinating the specific functions of the Business Ethics Program (the "Business Ethics Officer")</b>	<p>Typically, a respected staff member performs or coordinates the functions of the Business Ethics Officer.</p> <p>An SME can form or join a business association to develop training materials and provide a forum for managers to discuss ethics, compliance, and social responsibility issues, problems, and solutions.</p> <p>The SME can employ an independent answering service to provide a mechanism for employees and agents to seek advice or report concerns anonymously.</p> <p>The SME can use an outside service to conduct a periodic evaluation of its Business Ethics Program.</p>
<b>Advising the Responsible Officer and Business Ethics Officer that represents the enterprise as whole ("Business Ethics Council")</b>	<p>An SME can conduct regular meetings of all or representative employees, perhaps 30-60 minutes per meeting, once a month, to discuss enterprise core beliefs; standards, procedures, and expectations; and current ethics, compliance, and social responsibility issues.</p> <p>A medium enterprise, especially one with multiple locations, can appoint</p>

<b>Business Ethics Infrastructure SME Conversion Chart</b>	
Function	Typical SME Staffing
	<p>members to such a council, but meet regularly by telephone.</p> <p>An SME can form or join a business association to provide a forum to discuss current ethics, compliance, and social responsibility issues, problems, and solutions.</p> <p>A college, university, or business development council might host a forum for SMEs.</p> <p>A large enterprise can, and often should, host a forum for its suppliers and service providers to address the requirements of its program.</p>
<p><b>Advising the Responsible Officer, Business Ethics Officer, and employees and agents about professional ethics, compliance and social responsibility issues, most often seen in hospitals, ("Professional Ethics Council")</b></p>	<p>An SME can conduct regular meetings of all or representative professionals, perhaps 30-60 minutes, once a month, to discuss enterprise core beliefs, standards, procedures, and expectations on current professional ethics, compliance, and social responsibility issues.</p> <p>A medium enterprise, especially one with multiple locations, can appoint members to such a council, but meet regularly by telephone</p> <p>An SME can form or join a business association to develop training materials and provide a forum to discuss current professional ethics, compliance, and social responsibility issues, problems, and solutions.</p> <p>A college, university, or business</p>

<b>Business Ethics Infrastructure SME Conversion Chart</b>	
<b>Function</b>	<b>Typical SME Staffing</b>
	<p>development council can host a forum for SMEs.</p> <p>A large enterprise might host or sponsor a forum for its suppliers and service providers.</p>
<p><b>Individuals at various levels of the enterprise who link a central ethics office with the field ("Business Conduct Representatives")</b></p>	<p>For the SME, these may be respected, knowledgeable staff members at its various levels or locations, who have the right to communicate directly with the Owner/Owner-representatives, Responsible Officer, or Business Ethics Officer on responsible business conduct issues: ethics, compliance, and social responsibility.</p> <p>These Business Conduct Representatives can also conduct responsible Business Conduct training and education and assist in program evaluation at local levels.</p>
<p><b>Related executive and department functions, such as the Chief Financial Officer; Legal Counsel; Human Resources; Internal Audit; Environmental, Health and Safety; government procurement; and Investor Relations</b></p>	<p>The SME often uses trusted, independent professionals to perform many of these functions. If so, they should participate in enterprise responsible business conduct training programs and, where practicable, its discussions of current ethics, compliance, and social responsibility issues.</p> <p>These independent professionals can form their own independent forums to discuss current ethics, compliance, and social responsibility issues.</p> <p>They may also be engaged to advise SME owners and managers on how to</p>

<b>Business Ethics Infrastructure SME Conversion Chart</b>	
<b>Function</b>	<b>Typical SME Staffing</b>
	design and implement a Business Ethics Program using this Manual and other resources. Provided they respect the confidences and proprietary information of each SME, they can amortize the cost of providing these services over multiple clients.
<b>The individual responsibility of every employee and agent of the enterprise to abide by the standards and procedures and strive to meet reasonable stakeholder expectations</b>	<p>Individual responsibility of employees and agents applies to all enterprises regardless of size.</p> <p>In the SME, it may be difficult for employees to seek advice or report concerns confidentially and anonymously. Owners and managers of SMEs must work to develop an organizational culture where employees and agents are able to speak up confidently and safely.</p>



**SPECIFIC PROPOSALS FOR AMENDMENTS TO THE DEFINITION OF AN "EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW"**

[2-95]

DEFINITION OF AN "EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW"			
Basic Questions	Existing Provisions	Proposed Amendment	Epic Recommendations
Background		<p>Consequently, the new guideline at §8B2.1 proposed by the Advisory Group contains separate subdivisions describing several important characteristics of an effective compliance program:</p> <ul style="list-style-type: none"> <li>the purpose of a compliance program and the importance of preventive due diligence and organizational culture in carrying out such a program (§8B2.1(a));</li> <li>the seven minimum attributes that should be present in all compliance programs (§8B2.1(b)); and</li> <li>the need for risk assessments and related compliance program adaptation as a basis for constructing and operating a generally effective program to prevent and detect violations of law (§8B2.1(c)).</li> </ul>	<p>Needs assessment is properly recognized as necessary for an effective compliance program. It provides the factual basis for each step. No less important—in the same vein—is for the organization to establish expected program outcomes and regularly evaluate the compliance program to determine whether it was effective. A program is unlikely to hit targets it does not explicitly aim for.</p> <p><i>Epic Recommendation</i></p> <p>In implementing subsection (b), the organization shall conduct ongoing risk assessment; take appropriate steps to design, implement, or modify each step set forth in subsection (b) to reduce the risk of violations of law identified by the risk assessment; and regularly evaluate its program with reference to specific expected program outcomes. (§8B2.1(c)).</p>