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## Revisions to the Federal Sentencing Guidelines for Organizations

### Opportunities Arising for Compliance and Ethics Programs

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The next several months provide an ideal window of time for companies to revisit their compliance and ethics program in light of recent changes to U.S. Sentencing Guidelines (Guidelines), specifically Chapter 8, Part B, entitled *Remediating Harm from Criminal Conduct, and Effective Compliance and Ethics Program* from the [United States Sentencing Commission](#) (Commission). Since 1991, these Guidelines have served as corporate America's blueprint in structuring effective programs to prevent and detect violations of law. The 2010 revisions take effect November 1, 2010, unless Congress passes legislation to reject or modify the Guidelines. So now is the time to act to maximize potential benefits for your company.

#### Effective Compliance and Ethics Program Defined

Under the Guidelines, a corporation (or any other organization as defined later in this article) that is convicted of a crime may be eligible for a reduced sentence if it had an "effective" compliance and ethics program (Program) in place at the time the crime was committed. The Guidelines spell out the minimum requirements for an effective Program.

To have an effective Program, the Guidelines specify that an organization must exercise due diligence to prevent and detect criminal conduct. They must also promote an organizational culture that encourages ethical conduct and demonstrate a commitment to compliance with the law. The Guidelines forward the following seven minimum requirements for encouraging ethical conduct and demonstrating a commitment to compliance with the law:

1. The organization needs to establish standards and procedures (such as a code of conduct and appropriate policies and procedures) to prevent and detect criminal conduct.
2. The governing authority (i.e., board) must be knowledgeable about the content and operation of the Program, and exercise reasonable oversight with respect to its implementation and effectiveness. In addition, high-level individual(s) must be assigned overall responsibility for the Program, and specific individual(s) delegated day-to-day operational responsibilities. Those with day-to-day responsibilities shall report periodically to the high-level individual(s), and, as appropriate to the governing authority or a subgroup on the effectiveness of the Program. To carry out these responsibilities, organizations must allocate adequate resources, appropriate authority and allow responsible individuals direct access to the governing authority or subgroup of the governing authority.



3. The organization must use reasonable efforts to avoid placing in a substantial authority position those whom the organization knew, or should have known through the exercise of due diligence, had engaged in illegal activities or other conduct inconsistent with an effective Program.
4. The organization shall take reasonable steps to communicate periodically and in a practical manner the Program's standards and procedures throughout the organization, including training that is tailored to members of the governing authority, high-level personnel, substantial authority personnel, the organization's employees, and applicable agents of the organization.
5. The organization shall take reasonable steps to:
  - a. Ensure that the Program is followed, including monitoring and auditing to detect criminal conduct
  - b. Periodically evaluate the Program's effectiveness
  - c. Have and publicize a system, which may include mechanisms that allow for anonymity or confidentiality, whereby the organization's employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation
6. The organization shall promote and enforce the Program consistently throughout the organization through appropriate:
  - a. Incentives to perform in accordance with the Program
  - b. Disciplinary measures for those engaging in criminal conduct or failing to take reasonable steps to prevent or detect criminal conduct
7. After criminal conduct has been detected, the organization shall take reasonable steps to respond appropriately to the criminal conduct and to prevent further similar criminal conduct, including making any necessary modifications to the organization's Program.

The Guidelines also call for the organization to periodically assess the risk of criminal conduct and take appropriate steps to design, implement, or modify requirements of the Program to reduce the risk of criminal conduct identified through the risk process. This periodic assessment is the result of the Commission being directed through Section 805(a)(2)(5) of the Sarbanes-Oxley Act of 2002 (SOX) to review and amend the Guidelines and related policy statements to ensure that they "*are sufficient to deter and punish organizational criminal misconduct.*"

### **Changes to the Guidelines and What They Mean to Your Organization**

The current proposed changes are meant to address the following two concerns:

1. What efforts are required to show that reasonable steps were taken to respond to criminal conduct and to prevent further similar conduct?
2. What efforts would be needed to allow companies to get "credit" for having an effective Program if "high-level or substantial authority personnel" are involved in the criminal conduct?

The first concern has two aspects: (i) "reasonable steps" to respond to criminal conduct and (ii) acting "appropriately" to prevent further similar criminal conduct. The first aspect is that the steps to remedy the harm caused by the criminal conduct may include providing restitution to identifiable victims. Other reasonable steps may include self-reporting and cooperation with authorities. The second aspect is that



the steps taken to prevent further similar conduct should be consistent with the other components of an effective Program that require assessment and modification of the Program. These steps *may* include the use of an outside professional advisor to make sure there is an adequate assessment and implementation of the identified modifications to the Program.

The second concern provides an opportunity for companies to strengthen their governance, while providing more protection against criminal conduct by senior executives (called “high-level or substantial authority personnel by the Guidelines). These proposed changes can have the effect of bolstering “independence” by requiring individual or individuals with operational responsibility for Program to have a direct reporting relationship to the governing board or subgroup of the board. This goes beyond the individual(s) assigned overall responsibility for the Program, as defined in the second requirement of the Guidelines as previously identified, to include individual(s) delegated day-to-day operational responsibilities.

Prior to these proposed changes, even if a company had met all of the requirements in the Guidelines to have an “effective” Program, if a senior executive was involved in the criminal conduct the company did not get “credit” for the Program. As a result, very few organizations have received the three-level mitigation that was technically available if an organization had a Program that met the requirements to be effective. Under these changes, “credit” would now be available if a senior executive was involved, but only if all four of the following conditions are met:

1. The individual(s) with operational responsibility for the Program have direct reporting obligations to the governing authority or an appropriate subgroup thereof (e.g., an audit committee of the board or the full board of directors).
2. The Program detected the offense before discovery outside the organization or before such discovery was reasonably likely.
3. The organization promptly reported the offense to appropriate governmental authorities.
4. No individual with operational responsibility for the Program participated in, condoned, or was willfully ignorant of the offense.

These changes have significant ramifications for companies lacking a formal reporting relationship of those with Program operational responsibility directly to the governing authority. This could be especially true for organizations at both ends of the size spectrum. Large, multi-national, companies may have their Chief Compliance Officer reporting directly to the board or audit committee (although this is not yet common). However, is this individual the sole person with actual operational responsibility for the Program? On the other end of the size spectrum, smaller organizations may not have a formal corporate structure, including an accessible governing body, thus challenging them on their organizational structure. In any event, this is an opportune time for organizations of all sizes to reassess their reporting relationships with the context of compliance functions and responsibilities.

### **Wide Applicability**

Unlike SOX, the Guidelines apply to all organizations - public or privately held, large or small. It applies to virtually every type of organization. The *2009 Federal Sentencing Guidelines Manual* defines an “organization” to include: corporations, partnerships, associations, joint-stock companies, unions, trusts, pension funds, unincorporated organizations, governments and political subdivisions thereof, and non-profit organizations. The definition does not distinguish between organizational size meaning all sizes and types of organizations are susceptible to the same Guidelines. However, the scalability to



organizational size is an important theme as the Guidelines specify in several places that “reasonable” efforts are expected. The larger and more complex an organization is, the more that is reasonably expected of them.

While the Guidelines have been rarely used at sentencing of companies (since most criminal allegations are settled before formal sentencing), the real benefits are in setting out what constitutes an effective Program that a prosecutor or regulator might consider when determining whether a company is culpable (i.e., blameworthy) for the acts of an employee or agent. The Guidelines also serve as a national benchmark for effective compliance initiatives.

### **Diligence Now as Opposed to Later**

Clearly the diligence of an organization in seeking to prevent and detect criminal conduct should have a direct bearing on the appropriate penalties and probation terms for the organization if it is convicted and sentenced for a criminal offense. The key is not waiting for fraud to occur as the Guidelines are very clear that the diligence must be in place “prior” to the fraudulent activities occurring to receive any breaks in sentencing. It is akin to buying insurance in that it is too late to buy it when a disaster hits. Insurance must be in place beforehand in a continuous manner to reasonably protect covered parties. Likewise with fraud, organizations must be proactive in reasonably preventing and detecting criminal misconduct at all times. An effective Program is a large part of the solution.

These collective additions and suggestions of the Guidelines also draw focus on the increasing expectation to frequently revisit the Program to help ensure it addresses the current risk environment. An effective Program is very much a function of risk assessment and management. Tailoring Program elements to respond to specific environments through risk assessment and management activities is powerful in preventing and detecting criminal activities. While companies can greatly benefit from an on-going risk assessment process, at a minimum an annual review of the Program in conjunction with risk assessment efforts is prudent. The specific controls built into the Program should reflect the current environment including company personnel, organization structure, operating complexities, size and risks.

### **Stay Tuned for More Changes**

At the end of the hearings on these Guideline amendments, the Commission announced their plans to place significant priority on Chapter 8 in the 2011 amendment cycle. In fact, the Justice Department has already stated that it will ask the Commission to revisit the Commission’s decision to not require “regular and unannounced examinations” of facilities that are the subject of probation supervision by a court. Surely there will be more to come as the themes of risk, ethics corporate compliance and enforcement continue to be hot-buttons in this heightened legal and regulatory environment of the 21<sup>st</sup> century.

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