



**TESTIMONY BEFORE THE
UNITED STATES SENTENCING COMMISSION**

MARCH 17, 2010

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First, our chairman Michael Oxley asked me to express his regrets that he is unable to be here today. As you know, he is listed on your agenda as representing ERC, and I appreciate your flexibility in allowing me to be here in his place. The Ethics Resource Center is grateful to be able to offer our perspective on the proposed amendments to Chapter 8. Thank you for this opportunity.

I'd like to take a moment to tell you about our center. ERC is the country's oldest nonprofit devoted to high ethical standards and practices in public and private institutions. We are a research organization, and with that focus, ERC has created objective benchmarks to measure the effectiveness of compliance and ethics programs.

We are probably best known for our *National Business Ethics Survey*, a national study which we field every two years. The results provide the U.S. benchmark on workplace ethics, based on employee perspectives. We have drawn on the results of the 2009 *National Business Ethics Survey* in commenting on the Commission's proposed amendments.

ERC also published a seminal paper in 2007 called *Leading Corporate Integrity: Defining the Role of the Chief Ethics and Compliance Officer*. It's also relevant to today's discussion. I should point out that the two organizations represented by my fellow panelists – the Ethics and Compliance Officer Association and the Society of

Corporate Compliance and Ethics – contributed a great deal to that paper. In fact, Joe Murphy was one of the principal authors of the document.

ERC has commented on three specific points in the proposed amendments to Chapter 8 of the Sentencing Guidelines.

Subsection (b)(7): Reasonable steps after criminal conduct is detected

The first pertained to the reasonable steps an organization should take after criminal conduct is detected. Overall, ERC supports the Commission’s effort to clarify these steps through the application note.

We have seen repeatedly in our research that misconduct is widespread. In 2009, our *National Business Ethics Survey* showed that nearly one in two (49 percent) business employees observed at least one act that constituted a violation of the law or their employer’s ethics standards.

Our measures go beyond criminal misconduct. Nevertheless, the consistency of employee observation of wrongdoing suggests that every organization – even ones with effective compliance and ethics programs – will eventually detect criminal activity. For that reason, efforts by the Commission to clarify reasonable steps for response is helpful.

ERC’s specific comment with regard to this section focused on the suggestion that after remediation, organizations should assess their compliance and ethics programs as an effort to prevent further criminal conduct.

We would argue that this is an essential suggestion, but also that the proposed language does not go far enough. Following the detection of criminal misconduct, organizations should not only assess their programs, they should also be encouraged to assess their *organizational cultures*.

This is for two reasons.

First, in situations where criminal conduct has taken place, it is often a finding after the fact that a culture existed where employees felt they were unable to report what they knew was going on. In other cases, we find out later that employees felt pressured to engage in criminal activity in order to do their jobs. Culture is always a factor in misconduct. Understanding it is an important part of understanding how criminal activity took place.

The second reason for assessing culture is that it is the single largest determinant of the extent to which further criminal activity will occur.

ERC has found in its research that when an organization implements the seven elements of an effective ethics and compliance program (per the guidelines) and establishes a strong ethical culture, misconduct is reduced by as much as 75 percent, reporting doubles and retaliation against whistleblowers is essentially eliminated.

However, this is because both a program *and* a strong culture are in place. Our research has shown that compliance and ethics programs help to grow a strong culture in an organization, and it is the culture in turn that brings about these dramatic changes. When an ethical culture is not strong, the likelihood for misconduct increases.

That is why it is essential that an organization detecting criminal activity should not just assess its program to avoid future recurrence; it should also assess the culture itself.

§8.D1.4: Recommended conditions of probation for organizations

The second area for ERC's comments pertained to the recommended conditions for probation for organizations. In particular, ERC focused on the submission of information by these organizations to the court.

ERC suggests that an organization placed under probation should not only provide the court a *schedule* for the implementation of a compliance and ethics program, it should also explain *how it will measure the effectiveness* of its program. In progress reports, organizations should indicate progress in program implementation based on these measures.

Thanks to the 2004 amendments to the guidelines encouraging periodic measurement of program effectiveness, it is now common practice in the compliance and ethics industry to identify outcome measures for a program (e.g., observed misconduct, willingness of employees to report wrongdoing, retaliation against whistleblowers). Program effectiveness is determined – in part – against positive change in these metrics.

It is likely that organizations under probation will identify such measures of program success, as a part of its program implementation. But unless explicitly stated, these organizations may not be compelled to share their metrics with the court. Yet federal officials would be well served by the disclosure of these metrics and the ability to hold an organization accountable to them.

Issue for Comment: Three-point mitigation for an effective program even when high-level personnel are involved in the offense

Finally, the third area for ERC's comment focused on the suggestion of three-point mitigation for an effective program even when high-level personnel are involved in the offense.

We suggest two important changes for the Commission to consider.

First, if employees responsible for the compliance and ethics program are among the high-level personnel involved in the criminal offense, three-level mitigation should not be

applied. This will help ensure that companies appoint individuals to oversee the compliance and ethics function who have a high level of personal integrity, and who also have skills to do the job in situations that can sometimes be highly pressurized.

ERC's second suggestion is that the Commission should not identify the board or a board committee as the specific reporting relationship for "the individual(s) with operational responsibility for compliance." Organizations vary widely. Some have boards; some do not. Some boards have fiduciary responsibilities; others do not.

In 2007, ERC invited four other leading nonprofit organizations in the compliance and ethics industry to help us essentially define the adequate role, responsibility and reporting relationship of a chief ethics and compliance officer. Reporting relationship was the single biggest focus of our attention. Because of the diversity of organizations and cultures, in the end we identified a set of principles that grant ethics and compliance personnel appropriate access to senior management or the board but retain flexibility for each organization's circumstances.

In our paper summarizing the discussion, *Leading Corporate Integrity: Defining the Role of the Chief Ethics & Compliance Officer*, ERC, ECOA, SCCE and others recommended four principles. We encourage the Commission to lean on the good work of our nonprofits in trying to speak to the same issue.

We recommend that individuals with operational responsibility for compliance in the organization should be:

- **Held accountable to the governing authority** while carrying out the fiduciary responsibilities it has delegated;
- **Independent** to raise matters of concern (especially with regard to high level personnel) without fear of reprisal or a conflict of interest;

- **Sufficiently connected to company operations** in order to build an ethical culture that advances the overall objectives of the business; and
- **Provided with authority** to have decisions and recommendations taken seriously at all levels of the organization.

The paper is available on ERC's website (www.ethics.org), and we would be happy to provide a copy to the Commission.

With that I will conclude my remarks. Thank you again for this important opportunity. I'm happy to answer any questions.

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