Seven Elements:
Staying Aligned with the
Federal Sentencing Guidelines

**A strong compliance program
and a committed ethical culture demonstrate
organizational intolerance for bad behavior.**

Seven Elements: Staying Aligned with the Federal Sentencing Guidelines

A WHITE PAPER | JULY 2012

A best-practices approach provides a solid foundation by which to identify, communicate, resolve and remediate any fraudulent or unethical behavior, protecting your organization by remaining in-step with the US FSGO's "seven elements" of a successful ethics and compliance program.

In 2010, the US Sentencing Commission updated the standards for what they consider a sound corporate compliance program and how such a program can protect an organization against prosecution and penalty. According to these standards, a better compliance program can lessen the severity of enforcement – along with reducing the risks of malfeasance in the first place – so organizations should align their governance, risk and compliance (GRC) initiatives with the "seven elements of an effective ethics and compliance program" set out in the Federal Sentencing Guidelines for Organizations (FSGO).

Originally established in 1991 by the US Sentencing Commission (USSC), the FSGO established prosecutorial guidelines intended to deter organizations from grand-scale misconduct in what some have referred to as a "carrot and stick" approach to proper organizational behavior. According to the Ethics Resource Center, the FSGO were designed to "encourage businesses to establish compliance/ethics programs to help 'prevent and detect organizational wrongdoing.'" [1]

The Guidelines did this by mandating that an organization's compliance and ethics program contain certain "elements" which could make the organization eligible for lesser penalties in the face of malfeasance. Like the enforcement version of a code of ethical business conduct, the FSGO provides standards that organizations could then pass along to their employees, taking into account regulations mandated by industry and legislated by government.

Of course, a lot has transpired across the organizational landscape in the 20 years since the establishment of the FSGO. Since then, the FSGO have undergone a number of updates and revisions – especially relevant in light of events such as 1999's Holder Memo, the WorldCom and Enron scandals, the 2002 SOX Act, the 2008 financial crisis, 2010's Dodd-Frank Act, etc. The "seven elements," while debated and tweaked, are still regarded as cardinal points for effective compliance.

These "seven elements" stand to illustrate the importance of ethics & compliance programs from the perspective of regulatory and enforcement agencies. From the *enforcement* side, the FSGO allow for lighter penalties for those companies with better ethics and compliance programs and an established commitment toward detecting and discouraging misconduct. From the *reinforcement* side, the seven elements provide a self-mapping tool for organizations that both protects them from penalty and enables their overall success.

The Guidelines were indeed path-breaking, not only because they provided the first broad-based incentive for organizations to implement formal C&E programs, but also because they set forth governmental expectations (albeit in a broad way) of what such programs should entail – the now well-known "seven steps."

These included written standards, program oversight, training, means to receive reports of suspected wrongdoing, discipline for violations, and auditing. All of these had long been, of course, a matter of sound risk management, but with the Guidelines they assumed something akin to the force of law. [2]

– Jeffrey M. Kaplan, Kaplan & Walker LLP,

To mitigate risk, organizations are encouraged to apply these seven elements, which describe the assets of superior compliance initiatives:

Implement compliance standards, codes of conduct, and policies and procedures.

Specify certain executive-level individual(s) with the responsibility to oversee compliance.

Apply due diligence toward not delegating substantial discretionary authority to individuals who have had a propensity to engage in illegal activities.

Establish communication, awareness and employee training programs specific to compliance standards.

Implement compliance monitoring and auditing systems, including a reporting system so that employees can report misconduct without fear of retribution.

Apply consistent and adequate processes and procedures for enforcement and discipline.

Respond appropriately to incidents and take steps to prevent further similar offenses, including any necessary modifications to compliance programs intended to prevent and detect violations of law.

The FSGO's seven elements provide a way to gain a better understanding of an organization's compliance structure. While the FSGO perspective is one of mitigation of penalty, the seven elements add significant substance to organizational culture on a much larger scale.

Collectively, an integrated system of compliance brings these seven elements closer together. An integrated approach, taking full advantage of compliance

data, addresses factors such as due diligence and accountability as well as proper documentation and reporting.

The best practices outlined below offer specific ways to maximize these seven elements. In doing so, organizations can better protect themselves and their brand from undue risk. While there is some one-to-one correlation between the seven elements and the seven best practices provided here, the comparison ends there. More ostensibly, the best practices overlay all of the elements. Instead of direct connections, look instead for multiple points of contact between elements.

Seven Best Practices to Keep Your Program Aligned with the FSGO's Seven Elements

A best-practices approach, using a common template for your compliance data, provides a solid foundation by which to identify, communicate, resolve and remediate any fraudulent or unethical behavior. The relationship between your ethical culture and your compliance practices is very dynamic, like spokes of a wheel made up of the various facets of your compliance initiatives – policies, training and awareness, issue management and resolution, reporting, risk assessments, etc. – and each of these spokes must also connect with other spokes. The hub is your compliance data, which you can use to manage risk and not just advert it. These best practices reflect the ways that these spokes dynamically link to one another:

Best Practices #1: Lead with your Code.
Your Code of Conduct is vastly important to the overall health of your ethics and compliance initiatives. Your Code is your starting point for all compliance activities and must comprehensively address the question of how you want your organization to act. Like the constitution is to the government, your Code should be the sounding board for policies and procedures going forward and should resonate with your workforce and stakeholders, at all levels. Your policies, then, are like laws, and should reflect the intent of the Code of Conduct. Tracking and attestations for your policies puts your Code into action at the level of business operations – and it makes your policies measurable. But codes and policies cannot be a once-and-done deal – best practices call for a policy lifecycle methodology that links policies to real-time regulations, maintains a consistent look and feel to those policies, and keeps policies fresh and active for your employees.

Best Practices #2: Encourage and promote ethical behavior.
This sounds like a no-brainer, but unfortunately, this practice is often taken for granted. Awareness and communication are priorities when it comes to developing and maintaining an ethical culture. Just saying you are an ethical organization doesn't make your employees ethical in their business practices. Employees must be engaged in the ethics process. Be careful to not just "check the box" when it comes to employee ethics training. Look for ways to add training as your business environment and processes change. Training should be dynamic while reflecting the

By every measure, strong ethics programs and strong ethics cultures produce substantially better outcomes – less pressure, less misconduct, higher reporting, and less retaliation – than in weaker ethical environments. [3]

– 2011 National Business Ethics Survey

organization's culture and be refreshed consistently, because people start to "not see" something when it's there all the time. An integrated system also allows for certification tracking, which adds to program accountability.

Best Practices #3: Address risk and incident assessment using both proactive and reactive methods.

No matter how much you drive awareness, no matter how thoroughly you train you workforce, no matter the strength and presence of your Code and your policies, incidents are going to happen. Alignment with the FSGO's seven elements is all about due diligence and preparation. Proactively, your entire compliance program should operate as a reflection of your organization's ethical culture. If a storm is brewing, you should be able to detect it long before the first raindrops fall. One way to do this is to leverage employee surveys and risk assessments (both formal and informal) to strengthen your overall detection capabilities. These tools can be used to augment auditing processes already in place, sharing compliance data in a collaborative fashion.

For reactive detection methods, nothing is as effective as an anonymous, multi-language phone/web-based reporting program, to identify issues before they happen and give your employees the confidence to come forward when incidents do occur. Statistics support the effectiveness of hotlines as fraud control measures: according to the Association of Certified Fraud Examiners' *2012 Report to the Nations* report, tips are the leading means of detection of workplace fraud (43%), and phone- and web-based hotlines are the leading means of capturing those tips.[5] Taken collectively, these compliance management and incident reporting systems provide a wealth of compliance data that can be injected back into the overall compliance system for more insightful analysis.

Best Practices #4: Manage incidents with consistency.

Whether you get a report from a hotline call, or you identify a control weakness as part of a risk assessment, best practices call for a process that allows an organization to triage and manage the issue, in a collaborative, comprehensive fashion, from investigation through resolution. The FSGO specifically call for "consistent investigative processes" to make clear what will be investigated, how it will be investigated, and what should be used to determine case outcome and case disposition. Leverage integrated systems to aggregate your incident data and then process cases using investigation best practice workflows. These methods give your organization a substantial head start to resolve issues quickly and comprehensively.

Three key factors are inherent to a successful incident management system. First, accountability comes from collaboration, which promotes information sharing between users, case managers, investigators and external resources, and leads to quicker case resolution. Checks and balances within the case management system, especially when

The initial detection of a fraud scheme is often the most crucial moment in the fraud examination process – decisions must be made quickly to secure evidence, mitigate losses and execute the best investigation strategy available. The method by which a fraud is uncovered can open or close several options for an organization. For instance, the outcome of a case might vary substantially if the first time management learns of an alleged fraud is through an anonymous tip, as opposed to a law enforcement action. [4]

–2012 Report to the Nations, ACFE

automated, promote a higher level of responsibility among all parties involved in the investigation and reduce collective liabilities. Second, secure controls ensure that sensitive data is not compromised or "leaked" during an investigation. Third, a reporting and analytics component gives investigators and leadership alike greater visibility across the entire organization. This last factor is the first step in tying together all of your GRC data, from policies to training to investigations to risk assessments, so that investigations aren't just deemed as a way to punish the guilty, but also as a way of improving the overall system.

Best Practices #5: Practice compliance – never complacency.

Too often, organizations fall into the trap of wanting to appear as if they are doing the right thing, when in fact, non-compliance practices are the rule of the day. That makes for a reactive compliance program, rather than a proactive one. This "check-box" approach to compliance contains no coordination of compliance activities or oversight and lands organizations in deeper trouble almost every time. These organizations often have a false sense of security because they have a "program" in place, but when issues arise that require regulatory intervention, they often find themselves facing heavy penalties.

Best practices demand an overall strategy for compliance that is executed as part of your culture, not just a check-box on some worksheet. An innovative, integrated GRC methodology allows you to proactively identify issues while improving your remediation efforts, and takes into account on-demand training, interactive policy awareness, spot assessments and audits, collaborative incident management, corrective and preventative action planning, resolution and remediation management and root cause analysis.

Best Practices #6: Put your compliance data to work.

Too many times, when there is a failure in compliance, we look back and say, "if we only knew." In order to get that critical insight, you need access to your compliance data. However, many companies struggle with compliance systems and processes that are isolated or siloed. The lifeblood of an integrated GRC system is compliance data. Readily available, relevant compliance data enables enterprise-level reporting and trend analysis at a comprehensive level, including incidents, cases, courses and policies. This knowledge facilitates everything from risk assessments to corrective and preventative action planning – and overall better business decisions.

The value of integrated data is far-reaching, driving process transparency and accountability, two key factors in making sure your compliance program has adequate oversight at a people level and effective control measures at a process level. Enterprise-level trending provides insight into the root causes of issues – for example, when you can see that there is a lag in investigations at one particular foreign location, which correlates with less-than-average anti-bribery training certifications. Cross-platform integration also facilitates executive dashboards and

> Investigations that are managed poorly can certainly affect an organization and its individuals in a variety of damaging ways. If an issue and incident is not processed in an efficient and effective manner, the results could have an adverse impact on your organization, akin to sending an innocent man to prison.
>
> *– Jimmy Lin, VP, Product Management & Corporate Strategy, The Network*

board-level reporting, narrowing the distance between audit and regulatory committees and executive management. Ask any compliance officer, and they will say that they spend too much of their time chasing compliance data, and when they have it, they find it difficult to use.

Best Practices #7: Lead with integrity.

As a best practice, "ethical leadership" is vague. While the FSGO's seven elements contain specific, functional areas of focus, at the core is the need for strong, living-and-breathing ethical leadership. Accountability is so important to the good standing of your ethics and compliance initiatives, as well as to your revenues, reputation and your alignment with the seven elements. While your workforce continues to be your best line of defense against non-compliance, it is only effective if it exists in an environment of trust and confidence. Tone at the top is the primary catalyst for enterprise ethics, and leaders should take ultimate responsibility for the state of compliance within their organization. It is also up to those executives to embed the compliance process into their management culture, on a daily basis.

Integrated GRC systems – operating as an ethics and compliance lifecycle – provide a means for organizations to match "people ethics" with "process ethics." That way, when leaders do indeed walk the talk, there is evidence to back it up. This closed-loop cycle drives transparency and promotes proper escalation of incident reporting. And, robust compliance analytics inherent to these systems provide leaders with role-based views, board-level reporting and oversight capabilities that work to bolster their compliance efforts. The end result is a business leader, in charge of a knowledgeable, ethical workforce, who can leverage risk to a competitive advantage while staying in the middle of the compliance channel.

Ethical Gains

An effective ethics and compliance program, especially when taken in perspective of the FSGO's seven elements, is like an insurance policy: you buy it not because something has happened, but because something could happen. Along with the obvious benefits of helping your organization to better manage risks, incidents and issues and misconduct, a strong compliance initiative acts as due diligence if and when regulatory action is taken against your organization. Your compliance program – along with the presence of a strong and committed ethical culture – stands to illustrate your lack of tolerance for bad behavior. In the eyes of the enforcement agencies such as the U.S. Securities and Exchange Commission and the U.S. Department of Justice, it becomes an asset toward leniency and deferred prosecution.

Of course, there are substantial gains across the board when both a solid compliance program and an engaging ethical culture are in place at an organization. According to the *2011 National Business Ethics Survey* by the Ethics Resource Center, these factors, which align with the FSGO's seven elements, can reduce the incidence of misconduct by as much as 75%.[6] There is also a

direct correlation to the valuation of an organization: the Ethisphere Institute found that companies that made its list of the World's Most Ethical Companies "outperformed the Standard & Poor's 500 by delivering a 53% return to shareholders since 2005, significantly higher than the S&P, which has been down 4% in the same period." [7]

Alignment with these seven elements, using a best-practices, integrated GRC approach, goes a long way toward protecting your organization from harsh enforcement – and perhaps the occurrence of misconduct in the first place.

_____

REFERENCES:

[1] *The Federal Sentencing Guidelines for Organizations at Twenty Years*. Ethics Resource Center. May 2012. http://ethics.org/resource/federal-sentencing-guidelines-organizations-twenty-years

[2] *Semi-Tough: A Short History of Compliance and Ethics Program Law*. Jeffrey M. Kaplan, Kaplan & Walker LLP. May 2012

[3] *2011 National Business Ethics Survey*, Ethics Resource Center

[4] *2012 Report to the Nations*, Association of Certified Fraud Examiners (ACFE)

[5] *Ibid*

[6] Testimony Before the United States Sentencing Commission. Patricia Harned, Ethics Resource Center. March 25, 2010. http://www.ussc.gov/Legislative_and_Public_Affairs/Public_Hearings_and_Meetings/20100317/PHarned_Testimony.pdf

[7] *The World's Most Ethical Companies*. Helen Coster, Forbes. March 22, 2010. http://www.forbes.com/2010/03/22/ethisphere-ethical-companies-leadership-citizenship-100.html

ABOUT THE NETWORK

The Network, Inc. is a leading provider of integrated GRC solutions that enable organizations to mitigate risk, achieve compliance and ultimately, create better, more ethical workplaces. Combining dynamic SaaS-based technology with expert-level services, The Network's Integrated GRC Solutions help companies around the world protect themselves from the risks posed by fraud and unethical conduct, detect issues early, and correct unethical or illegal behavior. Established in 1982, The Network serves thousands of organizations in every industry, including nearly half of the Fortune 500.

THE Netw●●rk
Integrated   GRC   Solutions

For more information about The Network,
call 1-800-357-5137 or visit www.tnwinc.com