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## ***Compliance Update\****

### ***Sentencing Commission Toughens Definition of an Effective Compliance Program***

On April 30, the U.S. Sentencing Commission sent to Congress recommended amendments to the U.S. Sentencing Guidelines for Organizations, which the Commission had voted to recommend to Congress on April 8, 2004 (“Amended Guidelines”). These amendments will become effective on November 1, 2004, unless rejected by Congress. The amendments substantially modify the Guidelines’ definition of an effective compliance program and are likely to have a significant impact on the law and practice of corporate compliance.

The U.S. Sentencing Guidelines for Organizations, which were promulgated in 1991, both created the first broad-based incentive for companies to develop compliance programs (by providing for the mitigation of fines for federal criminal offenses if a company had an effective compliance program in place at the time the offense was committed) and set forth the factors that the government considers essential to an effective compliance program. Various other pronouncements in the years since 1991, including the Sarbanes-Oxley Act of 2002 and regulations promulgated by the SEC and securities exchanges, as well as company practices, have added to the working definition of an effective compliance program.

As noted by the Sentencing Commission in a press release dated May 3, 2004, the amendments “enhanced the rigor and detail of” the Guidelines’ requirements for an effective compliance program.<sup>1</sup> Some of the more noteworthy aspects of the revisions to the Guidelines include:

- *Enhanced Focus on Ethics and Culture.* The Sentencing Guidelines currently provide mitigation credit to companies that, at the time of occurrence of the misconduct, had “an effective program to prevent and detection violations of law.” The amendments require compliance programs to go beyond prevention and detection of legal violations, also to “promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.” This focus on promoting ethical conduct is something that we see in recent legislative and regulatory requirements relating to compliance and is also reflected in the

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\* The materials contained in this Compliance Update are for informational and educational purposes only and are not intended and should not be construed as legal advice or as an invitation to an attorney-client relationship.

<sup>1</sup> U.S. Sentencing Commission News Release, May 3, 2004, which can be found at <http://www.ussc.gov/PRESS/rel0504.htm>.

new name given to compliance programs by the Amended Guidelines – “compliance and ethics programs.”

- *Board Oversight.* The Amended Guidelines require companies’ boards of directors to be “knowledgeable about the content and operation” of the program and to exercise “reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program.”
- *Management Responsibilities.* The Amended Guidelines require high-level management to “ensure that the organization has an effective compliance and ethics program.”
- *Compliance Officer Responsibilities.* The Amended Guidelines require the individual with day-to-day responsibility for the program to report periodically to high-level personnel and, as appropriate, to the board or board committee overseeing the program on the effectiveness of the program. That individual should also have adequate resources and authority, including access to the board.
- *New Training Requirements.* The Amended Guidelines make effective training mandatory, unlike the current version of the Guidelines, which lists training as only one method by which organizations can communicate their compliance standards. The Amended Guidelines provide that high-level personnel and members of the Board must receive compliance training and specify that agents should be trained as appropriate. The revised Guidelines also specify that the communication and training requirement is ongoing, requiring periodic updates.
- *Program Evaluations.* The Amended Guidelines require that the organization take reasonable steps “to evaluate periodically the effectiveness of the organization’s compliance and ethics program.”
- *Reporting Systems.* The Amended Guidelines require organizations to have and publicize a system whereby the organization’s employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation. The Amended Guidelines specify that such a system may provide mechanisms that allow for anonymity and confidentiality. Interestingly, the Amended Guidelines require reporting mechanisms for agents as well as employees and specifically require mechanisms for seeking guidance as well as for reporting suspected violations.
- *Performance Incentives.* The Amended Guidelines require that the compliance and ethics program be promoted through appropriate incentives to perform in accordance with the compliance and ethics program.
- *Risk Analysis.* The Amended Guidelines mandate that, in implementing the other program requirements, a company “shall periodically assess the risk of criminal conduct and shall take appropriate steps to design, implement or modify each requirement...to reduce the risk of criminal conduct identified through this

process.” Application Note 6 to the Amended Guidelines specifies various factors that should be evaluated in assessing risks, including the nature and seriousness of potential criminal conduct; the likelihood of the occurrence of potential criminal conduct; and the organization’s prior history.

Many of the new requirements for an effective compliance program created by the Amended Guidelines represent the learning of the compliance community in the years since the Guidelines were originally promulgated in 1991. These Amended Guidelines present a challenge to corporations to upgrade their compliance efforts and will undoubtedly steepen the learning curve for best practices in the compliance field. They can be found at <http://www.ussc.gov/2004guid/2004cong.pdf>, beginning on page 76.