

The Case for Compliance Programs: The Legal and Policy Mandates

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Introduction: The Case for Compliance

The ultimate mission of every college and university is to create and communicate human creativity and knowledge through research, teaching, and free expression of artistic endeavors. Honesty and integrity are necessary hallmarks of all that we do in higher education.

For knowledge to be advanced and the free exchange of ideas to be undertaken successfully, truthfulness, individual accountability, and ethical behavior are necessary companions; anything less compromises our commitment to academic excellence and merit as prevailing values.

Just as this is true in our academic enterprise, so must it be true in our other activities: our co-curricular activities, our operations, and our administration of our institutions of higher education—the entire range of activities that make up university life and external interactions. While different activities—be they academic, financial, administrative, operational, or other—may be governed by the application of different specifics, they must all be bound by a common high standard of ethical and honest behavior.

University¹ faculties have published the results of significant research on how organizations can create and maintain ethical environments and a commitment to compliance with the law. Higher education has “talked the talk.” Our institutional mission to create and communicate human creativity and knowledge and advance the free expression of ideas likewise calls upon our academic and administrative leaders to “walk the walk” by building effective ethics compliance programs.

In the paper below, we set forth “the Case for Compliance” based on three principles:

- A. *The Legal Case for Compliance:*** *Universities should have ethics and compliance programs to ensure they fulfill their U.S. and international legal and regulatory obligations.*
- B. *The Value Case for Compliance:*** *Ethics and compliance programs enhance the university’s community culture.*
- C. *The Business Case for Compliance:*** *Academic, business and administrative processes benefit from ethics and compliance programs.*

¹ For easy and consistency, in this article we will refer to an institution of higher education, whether it is a community college, four year college or a university, as a “university.”

A. The Legal Case for Compliance:

Universities should have ethics and compliance programs to ensure they fulfill their U.S. and international legal and regulatory obligations.

Attorneys practicing higher education law often discuss the question, “Is it necessary for a university to have a compliance program”? The simple answer is “yes.” Universities operate in an environment governed by a vast and constantly changing array of federal, state and local regulations. The sheer number of these laws, their complexity and the gravity of violating many of these regulations necessitates a comprehensive and effectively maintained compliance program.²

The risks for a university operating without an effective compliance program are great than ever. For example, recent amendments to the federal False Claims Act (FCA) significantly increase risk for universities. These amendments now:

- Trace federal funds through grants and subcontracts;³
- Expand reverse false claims;⁴
- Cover failure to return overpayments;⁵
- Expand whistleblower protections.⁶

Given the increased complexity of the regulatory landscape and increased economic risks resulting from non-compliance, Universities should consider the Federal Sentencing Guidelines for Organizations and other statutory provisions discussed below.

1. The U.S. Federal Sentencing Guidelines for Organizations

a. A Short History of Compliance

1986 - Defense Industry Initiative on Ethics and Conduct

The Defense Industry Initiative (DII) is general considered the beginning of formal organizational ethics and compliance programs. During the 1980s, allegations of fraud and government mismanagement resulted in a Presidential Blue Ribbon Commission on Defense Management (called referred to as the “Packard Commission”).

² See Holland & Knight, Corporate Compliance Answer Book, Chapter 32 Institutions of Higher Education, p 1113-1116 (Practicing Law Institute 2011)

³ 31 U.S.C. § 3729(b)(2) See generally Holland & Knight, Corporate Compliance Answer Book, supra Chapter 11.

⁴ See U.S. ex rel. Huangyan Imp. & Export Corp. v. Nature’s Farms Products, Inc., 370 F. Supp 2d 993 (N.D. Cal. 2005).

⁵ 31 U.S.C. § 3729(b)(3).

⁶ 31 U.S.C. § 3730(h).

The Commission found that public confidence in the defense industry had been eroded by reports of waste, fraud and abuse within both the industry and the Defense Department. The Commission concluded that the defense acquisition process, the defense business environment, and confidence in the defense industry could be improved by placing greater emphasis on corporate self-governance. Subsequently, several leading defense contractors voluntarily joined together to establish the DII, which had three main purposes:

- To nurture and promote a culture of ethical conduct within every company in the defense industry;
- To promote self-governance as a means of confirming management's commitment to abide by ethical standards – even when they exceed legal requirements – and of discovering and correcting instances when conduct falls below these standards; and
- To share best practices in dealing with ethics and business conduct issues, which included the development of formal Codes of Ethics and mandatory ethics training for employees, internal “hotlines” and other reporting mechanisms, with a promise of no retaliation

However, the 1980's were rife with corporate corruption scandals that extended well beyond the defense industry. (Anyone remember Ivan Bosky, Michael Milken and “Junk Bonds”?) These scandals lead to additional programs designed to encourage greater corporate self government.

b. The 1991 U.S. Federal Sentencing Guidelines for Organizations

The Federal Sentencing Guidelines were created by the U.S. Congress in 1984 to provide certainty and fairness in sentencing and to avoid unwarranted sentencing disparities. The Federal Sentencing Guidelines also sought to maintain sufficient flexibility to permit individualized sentencing when warranted through use of mitigating or aggravating factors. Congress also created the United States Sentencing Commission which was delegated the responsibility for periodically reviewing and amending the Guidelines.

In response to corporate corruption scandals, the U.S. Federal Sentencing Commission submitted to Congress in 1991 amendments to the Federal Sentencing Guidelines that established a set of standards to govern the sentences federal judges impose on organizations convicted of federal crimes. The intent of the new organizational sentencing guidelines was to “prevent and deter organizational wrongdoing” by providing credit to organizations with “an effective program to prevent and detect violations of law.”⁷ These amendments were also designed to encourage greater self governance efforts. Under these Guidelines, the hallmark of an effective ethics and compliance program was “due diligence in seeking to prevent and detect criminal conduct.”⁸

⁷ See U.S. Federal Sentencing Guidelines § 8B2.1.

⁸ *Id.*

c. The 2004 Amendments to the Federal Sentencing Guidelines for Organizations

The Enron and WorldCom scandals of 2001 and 2002 caused a period of reflection on the effectiveness of corporate self governance and compliance efforts. In 2004, the Federal Sentencing Guidelines were amended to require more than simple legal compliance to prevent and detect criminal conduct. The guidelines were amended to reflect the growing consensus among policy makers⁹ that in order to have an effective compliance program, an organization must establish and maintain an organizational culture that “*encourages ethical conduct and a commitment to compliance with the law.*”¹⁰

The 2004 Amendments also added an “eighth” element of an effective compliance program. The new Guidelines provided that, “In implementing [an effective compliance program], the organization shall *periodically assess the risk of criminal conduct* and shall take appropriate steps to design, implement, or modify each requirement [for an effective compliance program] *to reduce the risk of criminal conduct identified through this process.*”¹¹

d. The 2010 Amendments to the Federal Sentencing Guidelines for Organizations

In 2010, the Federal Sentencing Guidelines were again amended to include the following provisions:

- **Reporting Requirements:** High level personally must have regular and direct access to the Board or appropriate committee (e.g. Audit Committee) to report at least annually on the compliance and ethics program. If criminal conduct is detected high level compliance personnel must have prompt access to the Board.¹²
- **Response to Criminal Conduct.** If criminal conduct is detected an organization must consider: restitution or other reparations to victims; self-disclosure and cooperation with the government; and amendments to its compliance program to ensure further criminal conduct does not occur.¹³

⁹ Section 805(a)(2)(5) of the Sarbanes-Oxley Act directed the Federal Sentencing Commission to review and amend, as appropriate, the Federal Sentencing Guidelines and related policy statements to ensure that the guidelines that apply to organizations “are sufficient to deter and punish organizational criminal misconduct.”

¹⁰ U.S. Federal Sentencing Guidelines §8B2.1(a)(2)

¹¹ U.S. Federal Sentencing Guidelines §8B2.1(a)(2)

¹² U.S. Federal Sentencing Guidelines §8B2.1(b)(3) and 2011 U.S. Federal Sentencing Guidelines Manual Commentary.

¹³ U.S. Federal Sentencing Guidelines §8B2.1(a)(2) and 2011 U.S. Federal Sentencing Guidelines Manual Commentary.

As amended, the U.S. Federal Sentencing Guidelines for Organizations provide the following elements for an effective compliance program:

**e. Federal Sentencing Guidelines for Organizations:
Elements of an Effective Ethics and Compliance Program**

In order to be effective, an organizations ethics and compliance program must include:

1. High level company personnel who exercise effective oversight. Individual(s) with day-to-day responsibility must have the authority to report directly to the Board or an appropriate subcommittee: (a) at least annually regarding the effectiveness of the program, and (b) promptly if criminal conduct is discovered
2. Written policies and procedures/Code of Ethical Conduct.
3. Compliance and ethics training and education.
4. Lines of communication, including anonymous reporting lines and a policy of non-retaliation.
5. Standards enforced through well-publicized disciplinary guidelines.
6. Internal compliance monitoring.
7. Response to detected offenses and corrective action plans. If criminal conduct is detected, the organization restitution or other reparations must be made, if appropriate; the criminal conduct should be reported and the organization should cooperate with government officials; the compliance program accessed and amended to ensure further criminal conduct does not occur; and
8. Periodic risk assessments

f. Application of the Federal Sentencing Guidelines to Higher Education

i. General applicability

The Federal Sentencing Guidelines for Organizations apply when the convicted defendant is an organization. According the Federal Sentencing Guidelines Manual, Commentary 8A.1.1

"Organization" means "a person other than an individual." 18 U.S.C. § 18. The term includes corporations, partnerships, associations, joint-stock companies, unions, trusts, pension funds, unincorporated organizations, governments and political subdivisions thereof, and non-profit organizations. (Emphasis added)

ii. Fiduciary Responsibility

1996 - *In re Caremark International Inc. Derivative Litigation*,

In *Caremark*,¹⁴ the Delaware Chancery Court was asked to review a proposed settlement of litigation against the company's directors. The company engaged in illegal payments in violation of the federal anti-referral payments law. The suit alleged that the company's directors' breached their fiduciary responsibility to the shareholders through a lack of proper oversight.

The *Caremark* court stated, in effect, that a board of directors has a fiduciary responsibility to assure that the company has an effective compliance program following the Federal Sentencing Guidelines. According to the court,

Any rational person attempting in good faith to meet an organizational governance responsibility would be bound to take into account [the Federal Sentencing Guidelines] ... and the opportunity for reduced sanctions....

The *Caremark* decision was upheld by the Delaware Supreme Court in *Stone v Ritter*, 911 A.2d 362 (Del.Sup. 2006).

iii. Other Federal and State Regulations

In recent years, other federal laws and guidelines have been amended or promulgated that require recipients of federal funds to have effective ethics and compliance programs, including the Federal Acquisition Contracting Regulations (FAR);¹⁵ the Deficit Reduction Act (Medicaid);¹⁶ and the Health and Human Services Office of Inspector General (HHS OIG) Guidelines.¹⁷

States have also mandated compliance programs. For example, organizations in New York that receive Medicaid funding must have compliance programs that comply with specific regulatory requirements.¹⁸

¹⁴ 698 A.2d 959 (Del Ch. 1996).

¹⁵ 72 Fed. Reg. 65,873 (Nov. 23, 2007)

¹⁶ 42 U.S.C. § 1396a.

¹⁷ <http://oig.hhs.gov/compliance/compliance-guidance/index.asp>

¹⁸ 18 NYCRR Part 521.

iv. International Laws and Standards

More than ever, Universities are actively developing international operations, including overseas campuses. Thus, they must also be cognizant of international compliance requirements. For example:

- **OECD Compliance Guidelines:** In February 2010 the Organization for Economic Cooperation and Development (OECD) adopted a “Good Practice Guidance” framework that was addressed to companies for establishing and ensuring the effectiveness of internal controls, ethics, and compliance programs for preventing and detecting the bribery of foreign public officials in their international business transactions. The Guidance recognizes that to be effective, such compliance programs should be interconnected with a company’s overall compliance framework.¹⁹
- **U.K. Bribery Act 2010:** The Bribery Act creates the following offences: Active bribery: promising or giving a financial or other advantage; Passive bribery: agreeing to receive or accepting a financial or other advantage; Bribery of foreign public officials; The failure of commercial organisations to prevent bribery by an associated person (corporate offense).²⁰ The Act’s provisions are more aggressive than the U.S. Foreign Corrupt Practices Act in that they cover commercial bribery and do not provide an exception for small “facilitating payments” to foreign officials.²¹

2. The 1992 COSO Report, *Internal Controls – Integrated Framework*

a. COSO Background and Summary:

While the Federal Sentencing Guidelines for Organizations were being developed, a group of leading public accounting organizations called the Committee of Sponsoring Organizations (COSO) joined together to address perceived deficiencies in financial accounting practices. COSO’s report *Internal Control – Integrated Framework* sets forth a methodology for helping assure ethical and legally compliant accounting and financial reporting practices.²² The COSO report sets forth a comprehensive risk

¹⁹ <http://www.oecd.org/dataoecd/5/51/44884389.pdf>

²⁰ <http://www.fco.gov.uk/en/global-issues/conflict-minerals/legally-binding-process/uk-bribery-act>

²¹ Other countries have similar corporate ethics and compliance guidelines. See e.g. King II Corporate Governance Principles of South Africa.

<https://www.saica.co.za/TechnicalInformation/LegalandGovernance/King/tabid/626/language/en-ZA/Default.aspx>

²² <http://www.coso.org/guidance.htm>

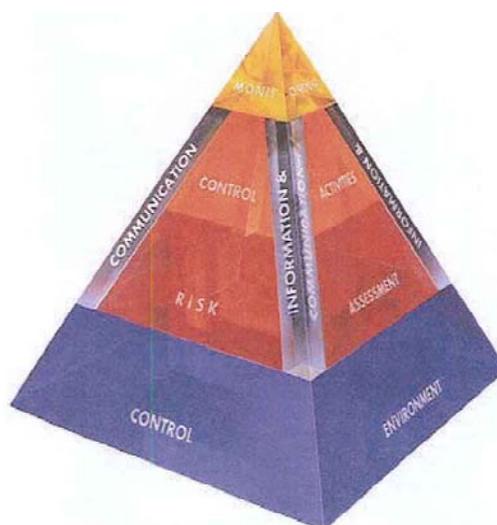
assessment methodology and a process for establishing a system of internal controls designed to achieve: effectiveness and efficiency of operations; reliability of financial reporting, and compliance with applicable laws and regulations.²³ The COSO standards further advise:

- Integrity and ethical values of the people who create, administer and monitor internal controls ... are essential elements of the control environment.”
- The ethical “tone at the top” is critical to effective internal controls.
- Audit committees should help assure that “ethical values be communicated” and “explicit guidance ... be given” to an entity’s staff.

b. COSO Internal Control Framework

The following illustrates and explains the COSO framework:

- **Each section of the pyramid is critical to a successful integrated compliance program**
- **Monitoring** = assessing compliance controls through on-going activities and evaluations, with modifications made as appropriate.
- **Control Activities** = compliance policies and procedures.
- **Information and Communication** = Clear message from top management to all personnel that control responsibilities must be taken seriously and embrace their own role in the internal control system. Ready means for personnel to communicate information upstream.
- **Risk Assessment** = The identification and analysis of risks relevant to achieving NYU’s objectives, including financial, operational, reputational, legal and regulatory.
- **Control Environment** = The environment in which personnel operate, including the people, their individual attributes, and expectations for integrity, ethical values and competence — and create the environment in which they operate.



c. COSO Applicability to Universities

The COSO Internal Control Framework is applied to Universities by:

- OMB Circulars A-133²⁴ and Compliance Supplement²⁵
- AU 110 and SAS 78 Auditing Standards²⁶
- PCAOB 5 Auditing Standards²⁷

²³ *Id.*

²⁴ <http://www.whitehouse.gov/sites/default/files/omb/circulars/a133/a133.pdf>

²⁵ http://www.whitehouse.gov/omb/circulars/a133_compliance_supplement_2011

²⁶ <http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-00110.pdf>

²⁷ http://pcaobus.org/Standards/Auditing/Pages/Auditing_Standard_5.aspx

3. Sarbanes Oxley Act of 2002

Despite the efforts in the 1990's to encourage compliance and good self governance, corporate corruption scandals continued to unfold, including the Enron and WorldCom corporate scandals. As a result of these scandals, Public Law 107–204 (the Sarbanes-Oxley Act or “SOX”) was passed.

SOX Section 406 requires that as part of “internal controls” public companies must adopt and publish a Code of Ethics which promotes:

- Honest and ethical conduct;
- Avoiding conflicts of interest;
- Full, fair, accurate, timely and understandable disclosures;
- Compliance with government laws, rules and regulations;
- Internal reporting of violations of the code, and
- Accountability for adherence to the code.

While most of the provisions of SOX are limited to public companies, the National Association of College and Business Officers (NACUBO) have analyzed SOX and recommended that Universities follow certain provisions, including SOX Section 406, as best practices.²⁸

Additionally, recent amendments to SOX have made its whistleblower protections applicable to all organizations.²⁹ Any employee who files a complaint, gives testimony, provides information or otherwise assists in an SEC, Congressional or law enforcement investigation is protected. Under SOX, an employee whistleblower may not be harmed or discriminated against in the terms and conditions of employment because of any lawful act done as a whistleblower.³⁰

B. The Values Case for Compliance:

1. Effective Ethics and Compliance Programs Can Enhance A Values-Based Community Culture in Higher Education

In higher education, the process of building an effective compliance program starts with a handicap – the name. Look in Black's Law Dictionary, for example, and you will see “compliance” defined as, “*Submission, obedience, conformance.*” Clearly, an

²⁸ See e.g. NACUBO and PriceWaterhouseCoopers *Sarbanes Summit: Taking the Right Path*, and *NACUBO Checklist for Higher Education* (NACUBO recommendations regarding Sarbanes-Oxley Act of 2002).

²⁹ SOX §§806, 1107.

³⁰ *Id.*

ethics and compliance program based primarily on mandated submission and obedience will not be well received on most American campuses.

Nowadays, instead of submission and obedience we need to think of compliance programs as a reflection of an organizational culture that is defined by norms or beliefs shared by the university community. This culture is shaped by the organization's leadership and is often expressed in terms of shared values and guiding principles. In turn, these values and principles are reinforced by systems and procedures implemented throughout the organization. Together, these values, guiding principles, systems and procedures form a University's compliance program.

The concept of compliance as "shared values" driven by organizational leadership was described by Lynn Sharpe Paine, in *Managing for Organizational Integrity*, Harvard Business Review (March-April 1994). According to Paine, it is the responsibility of an organization's leadership to:

Define and give life to an organization's guiding values, to create an environment that supports ethically sound behavior, and to instill a sense of shared accountability among employees . . . The need to obey the law is viewed as a positive aspect of organizational life, rather than an unwelcomed constraint imposed by external authorities.

Thus, a university ethics and compliance program should reflect the shared values of the university community and its leadership. These values should embrace a desire to fulfill the university's academic mission with integrity and include a commitment to establishing systems and procedures designed to ensure that the university's legal, regulatory and ethical responsibilities are fulfilled.

A "shared values" compliance program may be summarized by the following philosophy, processes and expected results:

- **Philosophy**

The organization clearly communicates, not just by word, but by deed, high ethical values that are shared by employees.

- **Process**

As social beings we are guided by values and ideals that are often shared with our peers. With shared values compliance, the community engages in self governance according to chosen standards that:

- Reflect *organizational* values & standards;
- Are *management* driven (i.e. they are *not driven* by lawyers, but *guided* by lawyers who advise managers on their legal obligations) and integrated by management (not lawyers) into organizational systems, and
- Provide *guidance* that *enables* responsible conduct.

- **Expected Results**

If members of the community are socially motivated to follow the rules, they will do so because they share organizational beliefs. Thus, their behavior is more strongly voluntary – they defer rather than simply comply. Surveillance and sanctioning are less necessary and people are more likely to follow rules “when no one is watching.”

2. All Members of the University Community Can Enhance A Values-Based Ethics and Compliance Program

While ethics and compliance programs must have the visible support of university leadership to succeed, there are statistically validated processes that encourage values-based ethics and compliance programs; cost little to implement, and at the same time, promote a more satisfied and effective workforce.

One process such process is to adopt *procedural justice* in management and organizational decision making. The concept of applied procedural justice is described in Tyler, Dienhart, Thomas, *The Ethical Commitment to Compliance: Building Value-based Cultures That Encourage Ethical Conduct and a Commitment to Compliance*, *California Management Review* (February 2008):

Procedural justice is important because it shapes the extent to which it is possible to build a values-based ethical culture....Not only do procedurally just cultures promote compliance, they also increase the probability that employees will become committed to their organizations' values and go beyond their job description to help their organization succeed. In particular, employees will voluntarily follow the rules.

There are four key procedural justice ideas: Voice, Neutrality, Respect, and Trust. The concept of Voice is simple – people want to have an opportunity to tell their side of the story in their own words. Thus, managers should listen to people. Give them a chance to explain their side of the story. Once people have done so, they are very willing to defer to decisions even if the decisions are adverse.

Managers must be neutral decision makers. People bring their problems to authorities when they view them as neutral, principled, decision makers who make decisions based on rules and values, not personal opinions and apply rules consistent with values across people and over situations.

Authorities are representatives of the organization. People draw a message about their status in an organization from the way they are treated by these authorities. Respect communicates high status and value. Disrespect suggests that you are marginal and unimportant.

Managers must earn the trust of their employees. Studies constantly show that the central attribute influencing evaluations about organizational judgments are about the character of the decision makers – are they sincere and caring; are they listening to and considering people’s views; are they trying to do what is right for everyone involved; and are they acting in the interests of the parties, not out of personal prejudice?

3. Suggested Readings on Values-Based Ethics and Compliance Programs

- Paine: *Managing for Organizational Integrity*, Harvard Business Review (March-April 1994)
- Weaver, Trevino, *Compliance and Values Oriented Ethics Programs: Influences on Employees’ Attitudes and Behavior*, Business Ethics Quarterly (April 1999)
- Joseph, *Integrating Ethics and Compliance Programs: Next Steps for Successful Implementation and Change*, Ethics Resource Center (2001)
- Leading Corporate Integrity: *Defining the Role of the Chief Ethics & Compliance Officer (CECO)*, Ethics Resource Center (2008)
- Tyler, Dienhart, Thomas, *The Ethical Commitment to Compliance: Building Value-based Cultures That Encourage Ethical Conduct and a Commitment to Compliance*, California Management Review (February 2008)
- Roach, Davis, *Establishing a Culture of Ethics and Integrity in Government*, Ethikos (September-October 2007).

C. The Business Case for Compliance:

Academic, business and administrative processes benefit from ethics and compliance programs

Effective compliance programs can serve as both a sword and a shield for Universities. As a shield, a compliance program can help protect universities from fines and penalties, false claims act/qui tam claims, reputational loss, operational loss and disruption, and agency and court imposed compliance programs.³¹

As a sword, effective compliance programs can increase the effective of business processes. Independent research studies, published university research findings and corporate surveys have established that organizations with effective compliance

³¹ See generally Holland & Knight, Corporate Compliance Answer Book, Chapter 32 Institutions of Higher Education (Practicing Law Institute 2011) for a historical discussion of Universities who suffered from fines, damages and other losses resulting in part for insufficient compliance controls.

programs have lowered cost of capital and credit;³² higher levels of growth and profitability;³³ better access to talent and information sharing among employees,³⁴ and enhanced reputation.³⁵

³² See Governance Metric International, Howard Sherman, Corporate Governance Risks and Rewards (Presentation: Conference Board Ethics and Compliance Conference, May 11, 2006); Ashbaugh, Collins, LaFond, Working Paper, Corporate Governance and Cost of Working Capital (Dec. 2004); Gompers, Ishii, Metrick, Corporate Governance and Equity Prices, Q.J.Econ. (Feb. 2003)

³³ Paine, Value Shift: Why Companies Must Merge Social and Imperatives to Achieve Superior Performance (McGraw Hill 2003)

³⁴ Where Morals and Profits Meet: The Corporate Value Shift (HBS Working Knowledge, Nov. 18, 2002).

³⁵ Id.