

# HRD Liability Update

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## **Corporate Due Diligence For Criminal Activity: Implications For HRD**

**By John Sample, Ph.D. SPHR**

White collar crimes, such as tax evasion, deception, embezzlement and other forms of business fraud have forced the federal government to take an active role in preventing and curtailing such business practices (Albrecht, Wernz, and Williams, 1995). Powerful criminal sanctions now exist for a business convicted of a felony or serious misdemeanor under the Federal Sentencing Guidelines (Title 28, ss 994). These sanctions would be levied against an individual businesses, corporate officers, board members, and other employees for violations of the law, depending on the culpability of the business as measured on a culpability index (Gruner, 1993). In 1991, Chapter eight was added to the Federal Sentencing Guidelines to provide for sentencing of businesses whose employees commit crimes because the companies are vicariously liable for offenses committed by the agents, i.e., employees. The guidelines are used by judges for assessing criminal penalties when individuals are convicted of violating federal law. Chapter eight of the Sentencing Guidelines is designed to provide punishment, adequate deterrence, and incentives for businesses to maintain internal mechanisms for preventing, detecting, and reporting criminal conduct.

Directors HRD services may be called upon to assist in the development of a unique and highly specialized type of program for their employer. Such program development will require collaboration with human resource management, security personnel, corporate attorneys, and senior management.

### **Example of Criminal Activity**

An example would be an employee, while acting on behalf of the business as a loan officer in a bank, violates the law by intentionally discriminating against qualified applicants. The action automatically links the business as a co-defendant to criminal penalties if charges are brought and a conviction obtained. Simply taking the position that the employee was acting on his own will not by itself absolve the bank from being sanctioned under Chapter eight of the Federal Sentencing Guidelines.

Depending on the culpability, nature, number, and history of history of prior convictions, criminal fines range from court ordered community service and simple restitution up to fines in the range of \$70 million, including the possibility of prison terms. A sliding scale assists the federal court judge in assessing monetary penalties. The Sentencing Guidelines also allow for higher fines than the published amounts. If the conviction is a threat to the environment or the economic market, an upward departure from the published penalties is warranted and possible under the Guidelines.

### **Elements of A Program Under The Sentencing Guidelines**

The Federal Sentencing Guidelines describes in detail that culpability will in part be determined by the measures taken by the organization prior to the offense to prevent and detect criminal conduct, the level and extent of involvement in or tolerance of the offense by certain personnel, and the organizations actions after an offense has been committed (Federal Sentencing Guidelines).

Table 1 states the requirements for such a program. In addition to the requirement of training and publication, the sentencing guidelines require the development of compliance standards and procedures, the assignment of responsibility to high level corporate employees, provide monitoring and auditing to achieve compliance through consistent internal enforcement, including appropriate discipline for those responsible for infractions and of those who failed to detect the offense. Finally, is an offense is discovered, the business must take reasonable steps to respond appropriately and to prevent future similar offenses.

The advantages of developing a corporate compliance program for due diligence includes the prevention of criminal activity by agents and employees of the business, lowered penalties and reduced legal costs, and positive public relations and improved morale. Disadvantages to such a program may include an auditable paper trail that may force a mandatory response if criminal activity is surfaces, and the adverse publicity that follows such a revelation (Davis & McFarland, 1995).

### **Table 1**

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An effective program to prevent and detect violations of law" means a program that has been reasonably designed, implemented, and enforced so that it generally will be effective in preventing and detecting criminal conduct. Failure to prevent or detect the instant offense, by itself, does not mean that the program was not effective. The hallmark of an effective program to prevent detect violations of the law is that the organization exercised due diligence in seeking to prevent and detect criminal conduct by its employees and other agents. Due diligence requires at a minimum that the organization must have taken the following types of steps. . . (4) The organization must have taken steps to communicate effectively its standards and procedures to all employees and other agents, e.g., by requiring participation in training programs or by disseminating publications that explain in a practical manner what is required. (Source: *Federal Sentencing Guidelines Manual*, Chapter Eight Sentencing of Organizations, Sec. 8A1.2, p. 341).

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## **Developing a Compliance Program**

The following suggestions are designed to guide a business in developing a compliance program:

1. Risk Assessment. The business must determine its level of risk and potential legal problems. Interviews and focus groups of senior management and key personnel are a good starting point. Consider industry standards and regulatory requirements of state and federal agencies. Require that corporate legal counsel provide a legal assessment based on statutory requirements and case law.
2. Based on an assessment, prioritize issues based on highest risk potential. For some types of businesses, safety issues could be a pressing issue, especially if compliance with the Occupational Safety and Health Act is mandated. For other businesses, compliance with environmental regulations, sex harassment, or mergers and acquisitions could be the highest priority.
3. Having prioritized issues, select the most expedient medium for communicating clearly the position and expectation of the business relative to criminal activity. For some businesses, publication of policies and procedures in employee handbooks and other distributed documentation will be sufficient. The development of classroom instruction may be necessary in some settings. If training is required, utilize a standard instructional systems approach as advocated by Dick and Carey (1996). Especially important will be documentation of who attended each training program, and the extent to which the instruction was evaluated for effectiveness (Sample, 1995).
4. Just as the business practices must be monitored for compliance, so should the business monitor its compliance program. The potential for liability will change with the passage of time, and the program will have to be adapted with new laws, regulations and evolving case law.
5. Document all phases of the program - the development of policy statement and training programs, investigations, and follow-up disciplinary reports for violation of compliance requirements. If compliance with documentation becomes a financial and practical burden, and assuming no laws or regulations to the contrary, then consider a documentation retention program that would allow for the destruction of records after a period of time (Eshelman and Woodacre, 1996).

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