Testimony before the U.S. House of Representatives
Committee on the Judiciary
Subcommittee on the Constitution and Civil Justice

"Oversight of the False Claims Act"

ERC
ETHICS RESOURCE CENTER

Testimony of
Patricia J. Harned, Ph.D.
President
Ethics Resource Center

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Good afternoon Chairman Franks, Ranking Member Cohen, and Members of the Subcommittee. Thank you very much for the opportunity to testify today regarding the Oversight of the False Claims Act.

I am president of the Ethics Resource Center (ERC), America's oldest nonprofit organization dedicated to independent research and the advancement of high ethical standards and practices in public and private institutions. ERC was established in 1922, and has become widely known for our rigorous research and our analysis of emerging issues in workplace ethics.

Most notably, our center generates the US benchmark on business ethics: a longitudinal cross-sectional survey of employees known as the *National Business Ethics Survey (NBES)*.[1] Findings from the NBES study reveal the most effective steps that business leaders can take to improve conduct and avoid overstepping the law. We've been fielding the survey since 1994; therefore, the longitudinal nature of the data tracks the progress of Corporate America in addressing their ethics and compliance issues.

Our center also consults with companies to assess and help improve their ethics and compliance programs and cultures. When it comes to fraud, we have worked with organizations at both ends of the spectrum; we've helped companies that are taking a preventative step to avoid problems before they happen, and we've also provided support to organizations after misconduct has occurred.

Finally, ERC educates officials within the federal government on new insights stemming from our research and practice. For example, we have shared findings from our research with the Office of the Inspector General (OIG) for the U.S. Department of Justice and the OIG for the U.S. Department of Housing and Urban Development; we have discussed what research has to say about the hallmarks of an effective ethics and compliance program with the Interagency Suspension & Debarment Committee; and we've presented data on whistleblowing to the Securities & Exchange Commission's Whistleblower Office as well as other agency officials tasked with oversight of federal whistleblower ombudsman programs.

It's important to note that while ERC's research was cited in the *Fixing the False Claims Act* report that has been the impetus for today's hearing, our center was not involved in the writing of the report itself. Neither am I an expert on the False Claims Act. The views I express today are based on the objective research findings and observations of the ERC, and not any other entity.

A central focus in today's discussion of the False Claims Act is the proposal for the establishment of a voluntary system for accreditation of rigorous compliance programs, as an incentive for businesses to prevent fraud. I'd like to address a few questions that are

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[1]Since 1994 the Ethics Resource Center has conducted the *National Business Ethics Survey;* a survey of employees in business workplaces across the US. We ask employees to tell us about the work their companies have done to address ethics and compliance; the violations that they have observed; and the extent to which these violations were addressed. See: www.ethics.org/nbes.

fundamental to that proposal; namely what research has to say about whether it is reasonable to expect that businesses can prevent and detect fraudulent activity in the first place. If a company has invested in an ethics and compliance program that actually works, can we expect that the number of instances of fraud will go down? When fraud does occur, should we anticipate that the reporting of violations will go up? Finally, if a set of standards are established to define "state of the art" programs, is there evidence to suggest that industry practices will improve?

My testimony today can be summarized as follows. First, the Ethics Resource Center's research has shown that when companies establish well-implemented ethics and compliance programs, not only do they successfully reduce the frequency of fraudulent activity; they establish cultures that decrease the likelihood that such misconduct will take place, and increase the likelihood that any incident that does occur will be handled responsibly. Second, we know from the input of employees across the country that fraud is a frequent occurrence in U.S. workplaces, and while some companies have elements of an effective program in place, many more have work to do before they can say that they have well-implemented programs. And finally, while there is some precedent that an effort to incentivize "gold standard" or "state of the art" programs will provide strong incentive for businesses to focus on the most effective activities that improve their ethics and compliance programs. Yet it is also important to note that unless certification standards reflect the complexities of organizational ethics and culture (in addition to compliance), and if care is not taken in the selection of the certifying entity (or entities), the process may have the unintended consequence of reducing rather than raising standards of business conduct.

Before I go any further, I'd like to offer one technical note. As I speak today, I will use the term "effective," "well-implemented" and "strong" ethics and compliance program. I recognize that there is a legal element to the term "effective" when it comes to the matter of program design. ERC is the business of understanding the difference that these programs make when it comes to employees and their conduct. So when I refer to an "effective" program, I am saying that a program encourages employees to do right, and to follow the rules. Similarly, a "well-implemented" or "strong" program is one that employees know about, and make use of when violations occur.

The Efficacy of Effective Ethics and Compliance Programs

First and foremost, ERC has found that when an ethics and compliance program is well-implemented within a corporation,[2] there is a demonstrable impact on the conduct of its employees.

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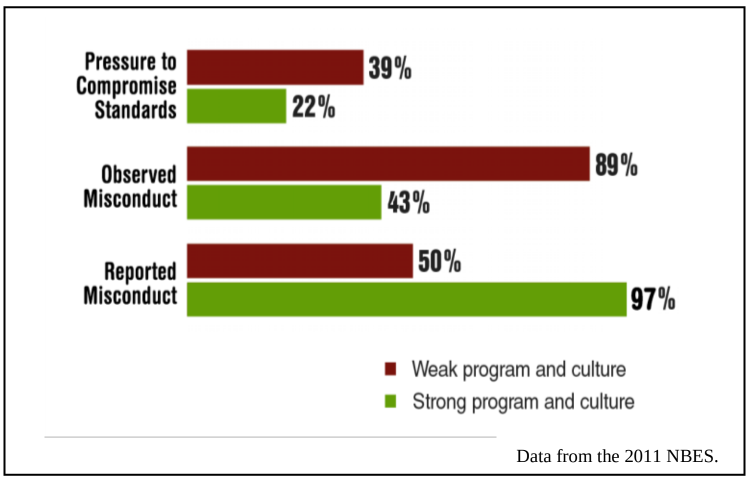
[2] In ERC's research, a well-implemented (effective) program provides the elements of a program as defined by the Federal Sentencing Guidelines for Organizations, and the program is used by employees in their daily activities. They seek advice in uncertain situations, receive positive feedback from their supervisor for ethical conduct, they feel prepared to handle ethics issues that arise, they can raise issues to management without fear of retaliation, they are rewarded for their ethical conduct, and questionable means are not rewarded even if they produce results.

Our research has consistently shown the important dynamic that takes place within businesses that have effective ethics and compliance programs in place. Employees in organizations with well-implemented ethics and compliance programs are more likely to say that they work in companies that have strong ethical cultures – in other words, their business leaders care about ethics, their supervisors support the tone coming from the top, and the values and standards of the organization are observed in everyday business decisions.

Together, these well-implemented programs and strong cultures make a substantial difference. For example, when a strong program and culture are in place, misconduct decreases by more than half (52 percent) compared to companies where the program and culture are weak.

Similarly, the data suggest that in organizations with strong programs and cultures, the *potential* for wrongdoing is lessened as well. For example, 44 percent fewer employees in companies with well-implemented programs say that they feel pressured to compromise standards or break the law in order to do their jobs. In the same vein, 90 percent of employees in organizations with strong programs and cultures say that they know how to appropriately handle a violation of wrongdoing if it were to arise. This compares to only 63 percent who do not work in such an organization.[3]

Figure 1. Impact of Well-Implemented Ethics and Compliance Programs on Employee Conduct



Also importantly, when wrongdoing does occur, the rate at which employees step forward to report a violation increases by 94 percent. They are less likely to doubt that action will be taken. Business leaders in these companies are therefore more aware of wrongdoing that has taken place.

The Need for – and Prevalence of – Effective Ethics and Compliance Programs

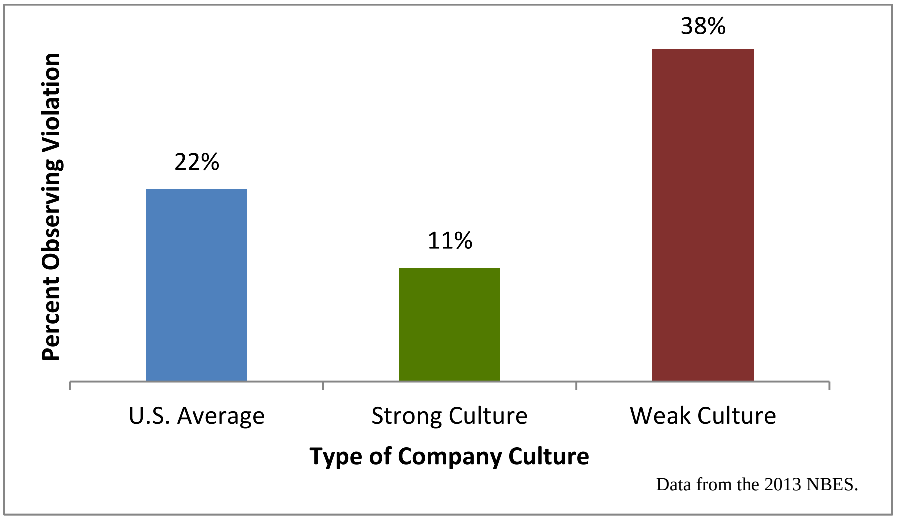
There is a need for effective corporate ethics and compliance programs, particularly when it comes to the False Claims Act. In 2013, more than one in five US business employees (22

[3] Ethics Resource Center. (2011). *National Business Ethics Survey.* Arlington, VA: ERC.

percent) said that within the past twelve months they observed at least one incident that might be considered a False Claims Act violation.[4]

The prevalence of potential FCA violations is also linked to ethics culture. The percentage of employees who observed an incident that might be considered an FCA violation drops by seventy-one percent where employees say they work in a strong ethical culture.

Figure 2. Prevalence of Potential FCA Violations (2013)[5]



Yet if effective ethics and compliance programs have such a significant impact on business conduct, it is reasonable to ask why it is that fraudulent business activity continues to occur. Certainly part of the reason is that misconduct is a reality for *every* organization.[6]

Even in organizations with the strongest of programs and cultures, misconduct does occur. Interestingly, though, the nature of the problem tends to be more isolated to an individual actor, and a single incident. Fraudulent activity in these organizations is more likely to be a matter of a bad apple, as opposed to a bad tree. But misconduct does still take place.

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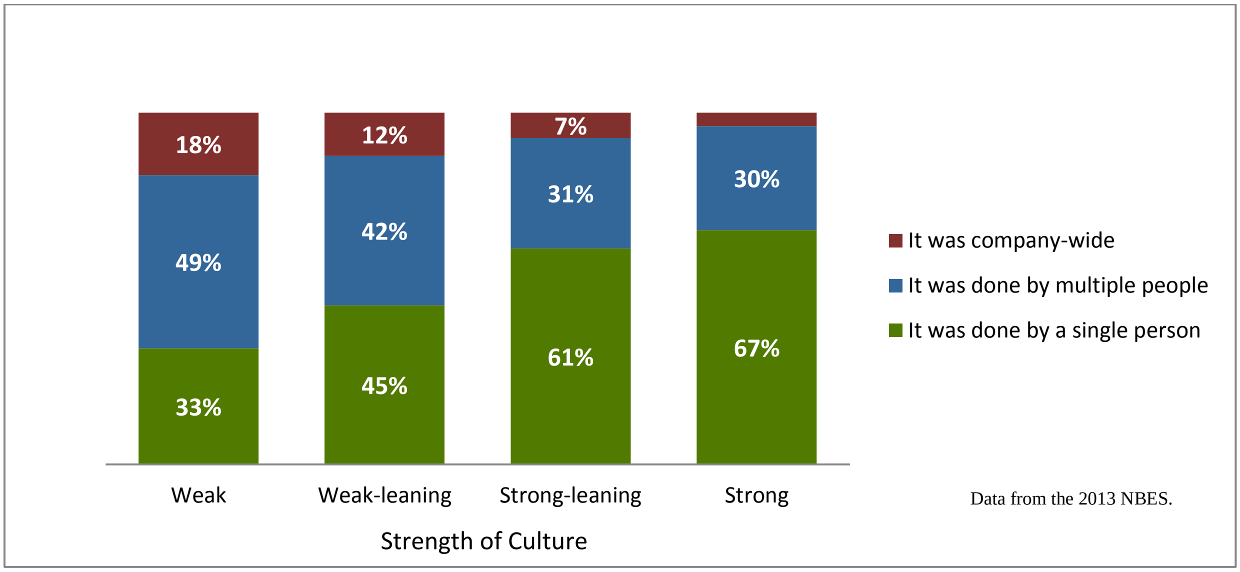
[4] As a part of the *National Business Ethics Survey*, ERC asks employees if they have observed specific types of behavior within the past twelve months. No attempt is made to determine the extent to which violations were knowingly or willfully committed. For purposes of this testimony, the types of violations that could be considered FCA violations were combined to generate an overall statistic. However, it is unknown whether the incidents were actual violations of the FCA. Metrics included: Delivery of substandard goods or services; Lying to customers, vendors, or the public Falsifying and/or manipulating financial reporting information; Falsifying invoices, books, and/or records; Falsifying time reports or hours worked; Violating contract terms with customers or suppliers; Falsifying time reports or hours worked.

[5] Ibid.

[6] In 2013, 41 percent of employees across the US indicated that they observed some sort of violation that they considered to be a violation of the law or their organization's standards for business conduct. Ethics Resource Center. (2013). *National Business Ethics Survey*. Arlington, VA: ERC.

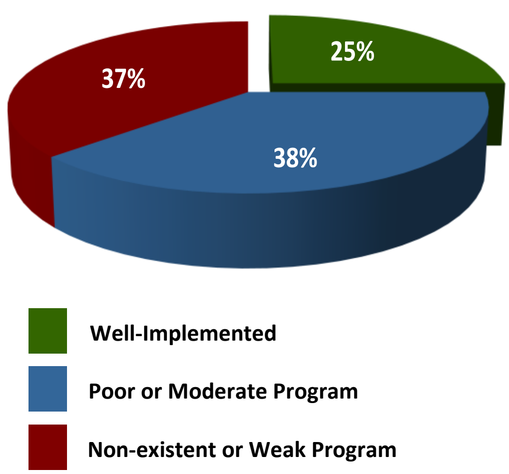
Figure 3. Strength of Culture and Scope of Misconduct



Another reason fraudulent activity continues – sometimes in egregious ways – has to do with the extent to which businesses have actually implemented programs that are fully effective.

A predominance of companies in the US have established codes of conduct, and nearly as many have put into place hotlines to receive whistleblower reports. Training on ethics and compliance is a growing trend, too.[7] Nevertheless, as of 2011 only one quarter (25 percent) of US employees indicated that their employer had a comprehensive program that was operating effectively; that is, a program that could significantly improve the conduct of their workforce. This is where a certification process has the potential to play an important role.

Figure 4. Percentage of Well-Implemented Ethics and Compliance Programs in U.S. Corporations (2011)



Data from the 2011 NBES.

[7] Ethics Resource Center. (2011). *National Business Ethics Survey*. Arlington, VA: ERC.

Standards for Certification of Effective Ethics and Compliance Programs

Standards for certification (or the like) do shift corporate behavior. Even further, if the standards are based on criteria that are known to encourage good conduct, they will in turn prompt ethical corporate behavior.

Take, for example, the Federal Sentencing Guidelines for Organizations (FSGO).[8] Promulgated by Congress in 1991, the guidelines were put into effect by the U.S. Sentencing Commission to help federal judges impose fair and consistent sentences when corporations violated U.S. law. The guidelines identified seven elements for effective ethics and compliance programs, and created a "carrot and stick" regime for assessing corporate culpability and giving credit, including sharp reductions in penalties, when an effective compliance and ethics program was in place to "prevent and detect violations of law." The FSGO also imposed severe penalties for companies that "tolerated, encouraged or condoned" improper behavior.

In 2011 (the 20th anniversary of FSGO), the ERC empanelled an independent Advisory Group of distinguished former law enforcement officials, federal judges, prosecutors, academics, and compliance/ethics experts to examine the FSGO, its successes and failures, and to identify possible areas of improvement. The group found that from a judiciary and enforcement perspective, the FSGO were at best seldom utilized and inconsistently applied. But remarkably, the FSGO had achieved significant success from the standpoint of the ethics and compliance industry. In essence, the introduction of the FSGO encouraged vigorous efforts by many U.S. companies and other organizations to adopt comprehensive ethics and compliance programs.

The Advisory Group concluded that the seven elements of an effective program, as outlined in the FSGO, had become the de facto framework for U.S. corporations and have also come to serve as a reference point for many U.S. regulatory and enforcement agencies.[9] Even further, all of the research by the ERC that I have been discussing today is based on metrics that test the presence of an ethics and compliance program as defined in the FSGO. So not only do the FSGO provide a standard for companies to implement effective programs, we actually know that they *work*.

The proposal raised in *Fixing the False Claims Act* varies in some significant ways from the intent and application of the FSGO. It's beyond my scope to address the legal and regulatory specifics of defining and certifying a "gold standard" for an ethics and compliance program. Nevertheless, from ERC's perspective, an effort to review and certify ethics and compliance programs could have a tremendous influence on corporate priorities, provided:

- The entity establishing the standards is trustworthy, transparent, and free from conflicts of interest;

[8] See www.ussc.gov.

[9] Ethics Resource Center. (2012). *The Federal Sentencing Guidelines for Organizations at Twenty Years: A Call to Action for More Effective Promotion and Recognition of Effective Ethics and Compliance Programs.* Arlington, VA: ERC.

- Standards are established with significant and ongoing input from ethics and compliance practitioners, industry leaders, and enforcement officials;

- Criteria for a "gold standard" take into account differences in ethics and compliance program design because of organizational size, industry, and the context in which an organization operates; and

- Standards are living and breathing; meaning that they evolve with new insights from research and innovation in program practices.

Finally, and perhaps most importantly, it is imperative that any definition of an effective program include not only a focus on compliance, but also on ethics. Throughout my remarks today I have used the terms "culture" and "ethics"; this is for a specific reason. Companies that merely comply with the law aim for the minimum standard; they check the box when they've met expectations and they move on to other priorities. And that is the danger of a certification standard without the dimension of ethics.

ERC's research has shown that when employees perceive that their company leadership is genuinely committed to ethical conduct, misconduct is reduced by as much as 56 percent. In cultures where supervisors support employees for doing what is right, employee reporting of wrongdoing rises by more than a third (33 percent). While compliance standards and controls are essential, it is the commitment to ethics and culture that perpetuates right conduct in a company, and diminishes the need for enforcement through the False Claims Act.

Conclusion

By comparison to many other professions, the field of ethics and compliance is relatively young. Yet so long as corporate scandals occur, it is good and right to periodically ask whether the efforts by Corporate America to monitor their own conduct make any difference.

After more than two decades of research, I am pleased to report that there is good news. Companies that implement effective ethics and compliance programs, and also focus on establishing ethical cultures where standards are taken seriously, do prevent and detect fraudulent activity. Even further, they actually improve the conduct of their employees. And there is reason to expect that an effort to assess and certify effective corporate programs – if carefully and thoughtfully done – will improve corporate conduct even further.

Thank you again for the opportunity to address you today. I welcome your questions.

Research Reports by the Ethics Resource Center

The following research reports in the *National Business Ethics Survey* series were recently released by the ERC. Our research is available to the public for free at www.ethics.org.

- 2011 and 2013 *National Business Ethics Surveys*
- *Inside the Mind of the Whistleblower*
- *Retaliation: When Whistleblowers Become Victims*
- *Generational Differences in Workplace Ethics*
- *National Business Ethics Survey of Social Networkers: New Risks and Opportunities at Work*
- *National Business Ethics Survey of Fortune 500® Employees*
- *National Business Ethics Survey of the Construction Industry*