BUILDING INCENTIVES IN YOUR COMPLIANCE & ETHICS PROGRAM

Society of Corporate Compliance & Ethics White Paper

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SCCE WHITE PAPER

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I. The scope of this white paper

For those with compliance and ethics program responsibility, or for those called upon to assess these programs, one of the questions to be addressed is the role of incentives in the program. This issue was highlighted by the 2004 revisions to the Federal Sentencing Guidelines standards, which now require, in item 6 of the 7 standards:

> "(6) The organization's compliance and ethics program shall be promoted and enforced consistently throughout the organization through (A) appropriate incentives to perform in accordance with the compliance and ethics program; . . ."[1]

What does this mean, and what is the appropriate role of incentives in a program? Item 6 of the Guidelines goes on to address discipline separately, so it is clear that this means something other than negative incentives. In other words, the simple proposition, "you get to keep your job if you don't break the rules" will not be enough.

Although incentives are an essential element of compliance and ethics programs, surprisingly little attention has been paid to this topic, as compared to other elements such as codes of conduct, helplines, training, and recently, risk assessment. In this SCCE white paper it is our objective to help compliance and ethics professionals address this important topic.

The scope of this paper includes a variety of approaches to the topic. We start with likely objections to using incentives, and then discuss the reasons for including an incentive-based approach. We then analyze the different aspects of this question: personnel evaluations; considering compliance and ethics in promotions; compliance and ethics input in developing and assessing all incentive and reward systems; rewards and recognition for those employees and managers who show compliance and ethics leadership; rewards and recognition for the compliance and ethics staff; and the most controversial issue, rewards for whistleblowers. In this paper we may at times refer to "incentives" to include all of these elements. Throughout we refer to "compliance and ethics" as a term of art to incorporate the full range of activities in this field, whether they are described as compliance programs, ethics and integrity, business practices, specific risk areas such as privacy, or similar nomenclature. At the end we provide a list of

[1] USSG section 8B1.2 (b)(6).

credits for those who have assisted in this project, a bibliography and an appendix of examples and materials for use by the practitioner.

II. The objections to using incentives.

Those who do compliance and ethics work can usually expect to encounter objections to their activities, and this is certainly true in dealing with incentives and rewards. Here you are venturing into an area that draws attention and can actually affect the culture of an organization. You can expect to see serious resistance, including those who consider the setting of goals and determination of rewards and promotions to be their own domain. Here are some of the objections most frequently raised in this area.

a. People should not be rewarded for doing their jobs

This is a very common objection to the idea of considering compliance and ethics in evaluations and rewards. The view is that people are supposed to do the right thing; if anyone is not ethical they should just be fired. From this perspective it is not appropriate to reward people for what they are already supposed to do.

There are two good answers to this concern. The first is that, in fact, incentive systems in companies do typically reward people for doing their jobs. For example, sales people are supposed to sell, yet they are frequently given commissions and other rewards for selling. CEOs are supposed to lead, yet have been given rewards and incentive packages that have drawn newspaper headlines. In fact, all employees are compensated for doing their jobs and often given more for doing more; that is how the system works.

But the strongest answer is that the incentives we are discussing are not just rewards for avoiding trouble. Rather, the recognition is for outstanding performance and leadership in the area of compliance and ethics. One easy example is having subordinates complete compliance training. While they are all expected to take the training, a company could rationally offer an incentive to the first work group to complete the training. Recognition could also be offered for managers who show leadership in their commitment to the compliance and ethics program and to doing the right thing. We provide more examples in other parts of this discussion.

b. It is impossible to evaluate employees' virtue or ethics

People will often misunderstand the meaning of the Sentencing Guidelines' language and what the purpose is. They will object that it is not really possible to evaluate and thus reward employees' virtue. If this were, in fact the objective of the Sentencing Guidelines the point would be well taken[2]. But the focus is not testing employees' internal ethics, but in evaluating what they do on the job.

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[2] Although even in this area some have tried such assessments. See Beil, "How Memorial Health measures the ethics performance of its senior managers," 18 ethikos 8 (Jan./Feb. 2005).

For example, in evaluating a supervisor the process would not attempt to divine what the person's moral beliefs were. Rather, the question would be what type of leadership did this person demonstrate? Did the supervisor encourage subordinates to raise difficult questions openly, use the code of conduct as a guide, and complete compliance training on time? The recognition is not for what the supervisors thought or believed, but what they said and did as managers to promote the code of conduct and encourage an ethical environment.

Finally, to those who say this is "impossible," the simple and complete answer is that companies are already doing it, as the examples and references in this paper make clear. It is certainly impossible to argue that something is "impossible" when others are already doing it.

c. This is too subjective, unlike sales or production

Resistance to this effort can also come in the related objection that, unlike sales or production, evaluating this subject is too subjective. Because it is not just a matter of counting numbers it is not really feasible.

This objection has a surface plausibility, but it does not hold up to actual experience. One response is that even measures that appear strictly objective are often influenced by less objective factors requiring judgment. In the words of one expert, "all performance reviews are subjective. Just because it's hard doesn't mean you can't do it."[3] Assessments based on sales may be subject to re-evaluation based on factors outside of the sales force's control, such as natural disasters and demographic shifts. Disputes may arise over who really made the sale, how should the sale be measured, was the real value of the sale accurately calculated, etc. Production numbers may appear objective, but be subject to closer analysis based on issues of quality and cost. Thus, even superficially "objective measures" may not be easy when it comes to assessing employees' performance.

Moreover, a cursory review of a sample of employee evaluation forms will reveal more than a few judgmental elements. For example, these management characteristics, which had to be assessed, are from actual company forms:

Leadership
Innovation
Developing subordinates
Embracing change
Encouraging teamwork
Communicating effectively
Team commitment
Treating co-workers with respect and dignity
Taking accountability for professional growth

[3] Interview with Joan Dubinsky, Ethics Officer, International Monetary Fund, Dec. 14, 2006.

These management assessment factors are certainly no more quantifiable than "promotes the code of conduct" or "encourages open communication," which are factors that could be used in assessing a manager's commitment to compliance and ethics. Even if the task may be difficult, merely requiring hard work should not stand in the way of implementing effective approaches.

d. The risk of use against the company in litigation

To a trial lawyer, the question may arise what happens if an employee's evaluation shows an ethical weakness and that employee later breaks the law? This circumstance could be used as evidence against the company. The argument would be that the company knew this person was a bad actor but continued to retain him or her.

This concern does not, however, take away from the value of the process. After all, if an employee is a bad actor there may already be other evidence of that fact available elsewhere. Moreover, this concern exists regarding any step taken to evaluate a company's compliance and ethics profile. The best way to address this concern is not to abandon the effort to improve conduct, but to ensure that appropriate action is taken any time a deficiency is found. If an employee's assessment shows a weakness in this area, the company should take steps to strengthen that employee's performance. Not only is this the safest legal course, but it is the one most in the company's interest.

e. OSHA's concerns

There are concerns about reward systems beyond the ones raised internally by those unfamiliar with the use of incentives in this area. Specifically, the Occupational Safety and Health Administration ("OSHA") has questioned the use of rewards tied to a decline in reports of injuries and violations.[4] The concern expressed by the agency is that rewarding the absence of reported injuries will lead to pressure not to <u>report</u> actual injuries or violations.

This concern is premised on the observation that people tend to look for the shortest route to obtain rewards. While making the workplace safer is the ideal, employees who want to game the system could just refuse to report incidents in order to obtain the reward.

OSHA's concern recognizes a factor that must be considered in all reward and incentive systems: the stronger the incentives are, the stronger the controls and checks need to be. It is likely that every incentive system can be gamed if it is not monitored and controlled. The lesson here is not that incentives are improper, but that they need to be developed, implemented and monitored carefully, with strict accountability.

f. The compliance and ethics people should stick to their own business

In response to proposals that compliance and ethics staff should have a role in promotions, evaluations and rewards you may get pushback along the lines that the

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[4] Richter, "Employee Incentive Programs: A VPP Perspective," <u>The Leader</u> 12 (Winter 1999; VPPPA)

compliance and ethics people should not try to run the whole business. They should keep to what relates to their subject, such as codes, training, and helplines. Compliance and ethics people may be accused of empire building and of intruding on the domain of the human resources department.

There may also be a specific objection to having compliance and ethics included in the personnel evaluation form, in these terms: "if everything someone thought was important was made part of the evaluation form there would be too many things covered and it would not be practical. We cannot cover everything."

In reality, these objections reflect the point that incentives, evaluations and rewards really do drive behavior and are an important element of power. People do not typically voluntarily yield power, and the control of rewards and assessments is a clear element of power.

The answer to these objections goes to the core of what compliance and ethics is about. Compliance and ethics is not just a corporate decoration, some frivolous public relations step to make the company look good. As the Sentencing Guidelines make clear, companies must focus on the corporate culture, affecting how employees think and act. If we intend a compliance and ethics program to be successful and actually to change culture and affect employees' behavior then the process must be genuinely intrusive. As for the objection about the need to avoid overloading the personnel evaluation form, this is a test of the company's actual commitment to compliance and ethics. While it is easy for senior management to talk the talk of ethics, having it affect pay and recognition is a true test of commitment. If it is not important enough to be part of the rewards and evaluations, then the company may lack a real commitment to its professed values.

From an internal political perspective, however, it is important for compliance and ethics staff to work cooperatively with their colleagues in HR and elsewhere. Rather than springing a full-blown plan on them by surprise, it may be more effective to work with them from the beginning to gain their support. The compliance and ethics people need to help other managers realize how substantial an undertaking it is to have an effective, best practices program, and that it will affect those things people value in a company, including pay and advancement.

III. The reasons for using incentives

Now that we have considered the objections to using incentives in the program, we should discuss the reasons for doing this. No matter what the objections may be, these reasons are really what will drive companies to incorporate incentives as part of their programs.

a. The US government's standards

As noted above, the Sentencing Guidelines' 2004 amendments now make it clear that incentives must be part of a compliance program if it is to receive credit in sentencing.

As the Report of the Ad Hoc Advisory Group on the Organizational Sentencing Guidelines concluded, "a culture of compliance can be promoted where organizational actors are judged by, and rewarded for, their positive compliance performance."[5] And, as history has also made clear, other agencies and enforcement personnel tend to follow these same standards in making enforcement decisions.

While the Sentencing Guidelines had previously referred only to discipline and not to incentives, an argument could have been made, even under the 1991 version, that incentives needed to be considered in programs.[6] First, the Guidelines have always required "due diligence," and required companies to be at least as good as "industry practice." Given that incentives are key drivers in organizational behavior, they could be read into the "diligence" standard. Also, because their use was widespread in at least some industries (specifically in the defense industry and in environmental compliance), they might also have been seen as a necessary element, and certainly part of best practices. But in any event it is clearly required today under the revised Sentencing Guidelines.

Incentives had been a part of governmental standards even before 2004. For example, the Department of Justice's criminal environmental enforcement unit issued a letter in July 1991 stating that it would consider companies' environmental compliance efforts. The government listed the questions it would ask: "Was environmental compliance a standard by which employee and corporate departmental performance was judged?"[7] The Environmental Protection Agency, in its definition of environmental management systems entitled to favorable consideration by the government, included the existence of "appropriate incentives to managers and employees to perform in accordance with the compliance policies, standards and procedures."[8]

The Department of Health and Human Services, Office of Inspector General ("OIG") has provided guidance to the healthcare and pharmaceutical industry on what it expects to see in compliance programs. In 2003, focusing on the pharmaceutical industry, the OIG included elements of incentive systems.[9] In describing the minimum expected elements

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[5] Ad Hoc Advisory Group on the Organizational Sentencing Guidelines, Report 91 (Oct. 10, 2003), at http://www.corporatecompliance.org/resources/documents/FullReport.pdf.

[6] Murphy, "Evaluations, Incentives and Rewards in Compliance Programs," 3 Corporate Conduct Quarterly (now ethikos) 40 (1994).

[7] US Department of Justice, Factors in Decisions on Criminal Prosecutions for Environmental Violations in the Context of Significant Voluntary Compliance or Disclosure Efforts by the Violator (July 1, 1991), in Kaplan & Murphy, Compliance Programs and the Corporate Sentencing Guidelines: Preventing Criminal and Civil Liability, Appendix 2 (Thomson/West; 1993 & Ann. Supp.).

[8] Environmental Protection Agency, Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations; Notice (Dec. 22, 1995), in Kaplan & Murphy, Compliance Programs and the Corporate Sentencing Guidelines: Preventing Criminal and Civil Liability, Appendix 3 (Thomson/West; 1993 & Ann. Supp); Environmental Protection Agency, Final Policy Statement on Incentives for Self-policing: Discovery, Disclosure, Correction and Prevention of Violations section IIB, definition of Compliance Management System (Mar. 30, 2000).

[9] Department of Health and Human Services, Office of Inspector General, Compliance Program Guidance for Pharmaceutical Manufacturers, 68 Fed. Reg. 23731 (May 5, 2003) at http://www.corporatecompliance.org/resources/documents/050503FRCPGPharmac.pdf.

the office referred to: "written policies, procedures and protocols that verbalize the company's commitment to compliance (e.g., by including adherence to the compliance program as an element in evaluating management and employees)." Elsewhere the Guidance explains that "adherence to the training requirements as well as other provisions of the compliance program should be a factor in the annual evaluation of each employee." It even went so far as to suggest that "pharmaceutical manufacturers may also consider rewarding employees for appropriate use of established reporting systems as a way to encourage the use of such systems."

References to incentive systems have also appeared in settlement agreements reached by government with companies.[10] For example, in the 2006 deferred prosecution agreement with Mellon Bank, the US Attorney's Office for the Western District of Pennsylvania included this provision:

> "Performance evaluation criteria and compensation should also be linked to specific steps taken by [substantial authority] personnel to support the compliance and ethics program (e.g., briefing "direct reports" on the code's application and the importance of raising compliance and ethics issues; ensuring that "direct reports" have completed required training)."[11]

b. Other standards

In addition to standards established by the US government, others have carried this approach forward. In the UK the Office of Fair Trading, which is the principal enforcer of competition law in that country, issued a guidance document on compliance programs indicating that such programs may be taken into account when assessing penalties. In describing the things that could be included in a creditworthy program the OFT listed "the inclusion of adherence to your compliance policy as an objective against which an individual's and a department's performance are to be appraised."[12]

The Competition Bureau Canada, in its 2008 Information Bulletin on compliance programs, notes how incentives tie in with corporate culture:

> "Providing appropriate incentives (for instance, compliance could be considered for the purposes of employee evaluations, promotions and bonuses) for performing in accordance with the compliance program can play an important role in fostering a culture of compliance. Incentives can work as effective tools for a business that wishes to promote compliance by employing concrete actions."

[10] See Jordan & Murphy, "Compliance Programs: What the Government Really Wants," 14 ACCA Docket 10, 22 (July/Aug. 1996).
[11] Settlement Agreement with Mellon Bank, N.A., Appendix A, Para 6.c) (Aug. 14, 2006), at http://www.corporatecompliance.org/resources/documents/LetterUSAttorney_MellonBank.htm.
[12] Office of Fair Trading (UK), How your business can achieve compliance: A guide to achieving compliance with competition law 14 (March 2005).

For this Canadian competition law enforcement agency, the existence of an effective compliance program, including the use of incentives, is a factor that is taken into account in its determination of how to proceed against companies in enforcement actions.[13]

In Australia the national standards organization, Standards Australia, has promulgated standards for compliance programs in AS 3806-2006. This detailed standard contains several references to incentives:

> 4.1.4(i) Line management's responsibility includes "Integrating compliance performance into employee performance appraisals"
> 4.3.2 Factors supporting development of a compliance culture: (i) "Performance appraisal systems that include assessment of compliance behaviour and which link performance pay to achievement of compliance obligations." (j) "Highly visible rewarding of compliance behaviour"
> 5.2.3(d) Practices demonstrating a commitment to compliance include: "Linking of compliance and behaviour to incentives and performance management."
> 6.1.2(c) Recommendations in reviews should include: "Recognition of exemplary compliance behaviour by teams, work units and individuals."[14]

Reitaku University in Japan, under the guidance of noted Professor Iwao Taka, has issued an Ethics Compliance Management System Standard for use by companies serious about compliance and ethics. In the Guidance Document issued to offer advice on the application of the standards, companies are told to cover "the evaluation of departments and individuals who are actively embracing the purpose and spirit of ethical-legal compliance." The Guidance observes that "if this evaluation is integrated with the personnel evaluation and reward system within the organization it would surely have a strong positive effect." In the sample materials included in the Guidance there is reference to HR as responsible for the "System of awards for achievement & contribution in ethical legal compliance."[15]

In the US defense industry the major companies in that industry have joined and subscribed to the standards of the Defense Industry Initiative on Business Ethics and Conduct (DII). The DII was the forerunner of industry compliance practices groups, and one of the initial sources for the Sentencing Guidelines standards. Members must agree to six broad principles, and then respond to a questionnaire enumerating specific points expected to be in a program.[16] Question 14 asks:

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[13] Competition Bureau Canada, Information Bulletin, Corporate Compliance Programs 15-16 (2008) at http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/Compliance-Bulletin-090808-Final-e.pdf/$FILE/Compliance-Bulletin-090808-Final-e.pdf.

[14] Australian Standards 3806-2006.

[15] Reitaku University, Business Ethics & Compliance Research Center, Guidance Document for the Implementation of the Ethics Compliance Standard 2000, 42, 93, 94 (2001) at http://www.consumer.go.jp/seisaku/shingikai/iinkai2/ecsguide(i).pdf.

[16] Kaplan & Murphy, Compliance Programs and the Corporate Sentencing Guidelines: Preventing Criminal and Civil Liability, Appendix 18A (Thomson/West; 1993 & Ann. Supp.).

> "Is implementation of the code's provisions one of the standards by which all levels of supervision are expected to be measured in their performance?"

As a result the DII members routinely include code performance in their management assessment systems – a commitment that dates back to the formation of DII in the late 1980's.

c. Practical reasons

Whatever the government or other bodies may advise, however, the ultimate question for any compliance and ethics initiative is whether it actually works. Does it help in preventing misconduct and leading employees to act ethically and legally? To this point the late management expert, Peter Drucker, offers a succinct answer:

> "[C]hanging habits and behavior requires changing recognitions and rewards. People in organizations, we have known for a century, tend to act in response to being recognized and rewarded – everything else is preaching. . . . The moment they realize that the organization rewards for the right behavior they will accept it."[17]

This conclusion was also well expressed by Stephen Cutler, Director, Division of Enforcement of the SEC in advising companies on how to set the right tone at the top:

> "[M]ake integrity, ethics and compliance part of the promotion, compensation and evaluation processes as well. For at the end of the day, the most effective way to communicate that "doing the right thing" is a priority, is to reward it. Conversely, if employees are led to believe that, when it comes to compensation and career advancement, all that counts is short-term profitability, and that cutting ethical corners is an acceptable way of getting there, they'll perform to that measure. To cite an example from a different walk of life: a college football coach can be told that the graduation rates of his players are what matters, but he'll know differently if the sole focus of his contract extension talks or the decision to fire him is his win-loss record."[18]

The point is a simple one that is intuitive. People tend to do what gets rewarded. This is how organizations communicate what management values most highly. Employees look to see who gets promoted and who gets passed over, who gets the bonus and who is ignored. The use of rewards is one of an organization's most effective communications tools. The stories of who are the heroes and what conduct leads to advancement become part of the culture of an organization.

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[17] Drucker, "Don't Change Corporate Culture – Use It!" Wall Street Journal (Mar. 28, 1991).

[18] Cutler, Director, Division of Enforcement, SEC, "Tone at the Top: Getting It Right," Second Annual General Counsel Roundtable (Dec. 3, 2004) at http://www.sec.gov/news/speech/spch120304smc.htm.

Indeed, given the prevalence of reward, evaluation and incentive systems in organizations, it would be difficult to conclude that this was anything other than an essential tool. If bad actors or those with questionable ethics are rewarded and promoted, the tone at the top of the organization and the culture throughout the organization will likely lead to similar behavior at all levels of the organization. By contrast, if those who champion compliance and ethics are selected as leaders and are seen by other employees as being rewarded and recognized, that then becomes the model for success in that organization.

IV. Personnel evaluations

What are the ways incentives become part of the compliance and ethics program? The first one we examine here is the inclusion of compliance and ethics performance in employees' assessments and evaluations. In this process the employee's performance evaluation includes some element related to compliance and ethics. Because most major companies use written evaluation forms this would mean inclusion of this point in these forms. For those companies that use other forms of assessment and feedback to employees throughout the year this same analysis would apply.

What is it that would be assessed? As noted above in addressing objections to the use of incentives, this assessment does not usually attempt to measure one's intrinsic virtue or personal sense of values. Instead it measures the employee's leadership in promoting the company code of conduct and ethical business practices. The process involves measuring the application of management skills to achieve an objective, i.e., promoting the code and the compliance and ethics program. In appendix 1 we include a list of these factors. Examples include:

> __ Uses the code of conduct and encourages subordinates to do the same
> __ Actively takes steps to implement the compliance program and the code of conduct
> __ Attends appropriate compliance training, and makes sure subordinates get appropriate training and know the rules that apply for their jobs
> __ Is willing to challenge questionable conduct or proposals

Once a company has decided to include this point in assessments there are a variety of ways to proceed. The simplest is a check-off item on the form. An example would be:

> Has this employee supported the code of conduct and acted ethically in business decisions? Yes___ No___

This has the advantage of covering the point and making the process fairly easy for the supervisor. It may serve to remind employees that compliance and ethics is an important point in the company. But this simplicity may also tend to make the process rather perfunctory, a "tick and flick" exercise in which the supervisor ticks the "yes" answer and quickly flicks the page to the next item. If this occurs it may breed skepticism among employees. One way to limit this risk is to require that the evaluator identify something specific that is the basis for the score. This helps ensure that the evaluator is more engaged, and makes the assessment more reviewable.[19]

A more nuanced approach would include specific factors and require a rating drawn from a range of scores, perhaps 1-5, with 1 being poor and 5 outstanding. Taking this a considerable step further, the form could include specific management objectives as part of the rating. For example, a manager might have goals that include having all subordinates complete the compliance training, and achieving a high score regarding ethics and compliance in 360 reviews. The use of 360 reviews, in which an employee's colleagues above, below and at peer level are surveyed about that employee, is one way to cover the less quantifiable aspects of these evaluations.

Setting specific compliance and ethics goals for business managers has substantial advantages. It can lead managers to think more realistically about the importance of management leadership in promoting the code of conduct and the compliance and ethics program. It can provide specific objectives for management to focus on, rather than using just vague or undefined terms. It also acknowledges the direction of the Sentencing Guidelines that "high-level personnel of the organization shall ensure that the organization has an effective compliance and ethics program . . ."[20] Promotion of the program is not a function that can simply be delegated to one compliance and ethics officer. Of course, even with such specific goals the managers should still also be evaluated on how they achieve their other goals, i.e., ethically or by improperly cutting corners.

Once the detail on this step is set the next question is the rating or value to be assigned; how important is this element in the employee's overall evaluation? The simplest is the "check the box" approach, with no special value assigned. It is on the form but left up to the supervisor's discretion how to count it. In companies that want to emphasize the priority of this area, however, they may set the compliance and ethics rating as a threshold for achieving one's bonus, or as a percentage gateway. For example, the employees who receive "5" get 120% of bonus, those with "4" get 100%, and so on. It could also be assigned a percentage value, perhaps representing 20% of the employee's total evaluation.[21]

At Catholic Healthcare West senior managers are rated on a number of elements tied to the Sentencing Guidelines standards for compliance and ethics programs. Their rating in these categories acts as a threshold for determining bonus eligibility. However, rather than setting a minimum it has evolved into a competitive element, with those who are subject to the rating trying to surpass one another.[22]

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[19] Emailed comment from Professor Paul McGreal, Southern Illinois University, Dec. 31, 2006.
[20] USSG section 8B1.2 (b)(2); see Competition Bureau Canada, Information Bulletin, Corporate Compliance Programs 9 (2008) (similar emphasis).
[21] See Biegelman & Biegelman, Building a World-Class Compliance Program 100 (John Wiley & Sons, Inc.; 2008) (At CA, up to 10% of executive compensation was based on how they handled compliance requirements.).
[22] Presentation by D. Roach, SCCE Corporate Compliance Workshop, Dec. 2, 2005, Houston, TX.

Whatever approach is adopted there are some important cautions to consider in this effort. One should never assume that attempts to alter the evaluation process will go smoothly or that supervisors will approach this the way intended. For many supervisors assessment of subordinates is considered one of the more difficult parts of their jobs. If there is a way to ease the process and get it done more quickly there will be a strong temptation to find a shortcut. It is necessary, therefore, to check how these assessments are being done, including auditing, testing and monitoring the process.

Part of executives' and managers' responsibilities should include monitoring how well subordinate supervisors are doing such assessments. For example, if the CEO wants to take an active role in the compliance and ethics program, he or she could start this process at the executive level, and then discuss with the other officers how they will rate their direct subordinates. Each supervisor down the ladder could then be charged with the same monitoring responsibility. In fact, the evaluation of any supervisor should take into account how well that supervisor, in turn, used the evaluation of subordinates to promote the compliance and ethics program.

As part of the monitoring process it should be made clear to all supervisors that it is unacceptable to simply give every subordinate the same perfect rating. Since all employees typically do not perform all tasks at the same level it is highly unlikely that all would show the same level of commitment and leadership in the compliance and ethics program (i.e., everybody cannot be "above average"). But expect resistance on this; there will be some supervisors who insist all their subordinates are ethical and therefore deserve perfect ratings. This misses the point. The employees are not measured on their personal values, but on how they exercise leadership in creating an ethical work environment.

Once supervisors have been won over there should then be occasions where employees' ratings reflect weakness in compliance and ethics leadership. At this point we should recall the lawyers' objections raised above; there needs to be follow up on all negative compliance assessments. The assessment system should require remediation plans for those with weaknesses in this area. For example, such plans would be mandatory for those with ratings below a certain level. Of course, the fact that such plans are required and will thus require more work by the supervisor will create a perverse incentive never to give a poor rating; management will have to take a strong position and supervise the process in detail to prevent this.

V. Monitoring of, and input on, promotions

One of the purposes of employee evaluation systems is to identify candidates for promotion to positions of increasing authority. This touches on another aspect of the Sentencing Guidelines 2004 revisions that may prove difficult for companies to apply. Item 3 of the 7 standards states:

> "(3) The organization shall use reasonable efforts not to include
> within the substantial authority personnel of the organization

> any individual whom the organization knew, or should have known through the exercise of due diligence, has engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program."[23]

The Sentencing Guidelines commentary for item 3, goes on to state that companies need to avoid promoting people who have "engaged . . . in conduct inconsistent with an effective compliance and ethics program."[24]

Combining this with item 6's focus on incentives sends the message that companies need to consider employees' compliance and ethics performance in determining their eligibility for promotion. This step not only helps to meet the legal standards and convince government skeptics that a company is committed to ethics and compliance, but it also sends a strong message to employees at all levels that advancement in the company requires serious attention to doing the right thing and setting a positive example.

One way for companies to follow this path is to set a minimum standard for the compliance and ethics part of an employee's assessment in order to be considered for promotion. For example, if compliance and ethics has a 1 to 5 scale on employees' evaluation forms, perhaps only those scoring a 3 or above would be eligible for any promotion. Companies can also go the next step beyond this and make compliance and ethics an explicit factor in determining promotions. While satisfactory ratings could still be a threshold, the overall evaluation of those eligible for advancement would include a thoroughgoing review of the candidate's record as a leader in compliance and ethics.

Companies wanting to ensure that this approach moves beyond form into substance, and also seeking to fully empower the compliance and ethics function, can set a requirement that the compliance and ethics office have input into the company's promotions. This would certainly be an indication of due diligence in determining promotions.

In one company's case this requirement came about as a result of an unfortunate incident involving a promotion. A relatively senior manager was promoted in the company, but shortly thereafter was terminated for violations of the code of conduct. It turned out that at the time of the promotion the manager had been under investigation by the compliance and ethics office, but no one had consulted them regarding the promotion. The company's board of directors made it clear that this was not to happen again, and that the compliance and ethics office was to be consulted. While this consultation could be just a simple check for investigation and disciplinary matters, the review could be much broader, seeking input on whether a manager was fully committed to the company's code of conduct and its compliance and ethics program.

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[23] USSG section 8B1.2 (b)(3).
[24] USSG section 8B1.2 (b) Commentary, note 4(B).

Requiring that the compliance and ethics office have a say in promotions ties in with the general advice from some experts that compliance and ethics needs a seat at the table for major decisions. It would clearly be a sign of empowerment, and send a strong signal to the government and to the employees

This is another area to anticipate strong resistance, especially if the "compliance officer" is really a junior level person, and officers are not comfortable with this person being involved in or having advance knowledge of promotions. Any objections along these lines are a red flag that compliance and ethics people are positioned too low in the organization.

While preventing the promotion of bad actors is an important objective, there is an additional step a company can take to promote ethics and compliance as part of its culture. Some companies engage in succession planning or the identification of high potential employees. They use various processes to identify and encourage employees considered to be likely candidates for future leadership positions. If in fact compliance and ethics is an important value to the company then that element should be included in this process. Those interested in being selected for this special treatment should know that a strong compliance and ethics record and commitment are positive factors that will be considered.[25]

VI. Compliance and ethics input in all incentive/reward systems

In considering compliance and ethics programs it can sometimes be easy to get caught up in the details and the exact language of the Sentencing Guidelines and to lose sight of the ultimate purpose. These programs exist to prevent and detect violations. To prevent misconduct it is essential to understand the power of reward and incentive systems. People do what gets rewarded, and tend to take the most direct path to the reward. It is also fair to assume that the stronger the incentive the more likely it is to affect behavior. If enormous rewards and recognition are offered to those who achieve X, it is highly likely that many will try to reach this goal. And experience also teaches that they will look for the fastest, most direct route to the goal.

This understanding leads to the recognition that misaligned incentive systems can encourage unethical or illegal conduct. For example, it is rational for a company to reward sales; sales are essential to a company's success. But if the goals are too high, the rewards enormously rich, and meeting the goals becomes the singular focus of the organization to the exclusion of other considerations, will this not lure employees in a potentially dangerous direction?

The Sears brake repair story illustrates this phenomenon.[26] Sears had reportedly decided to increase revenue in its auto service centers by providing incentives to its service employees. A significant portion of the employees' pay was tied to the ability to achieve

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[25] Interview with Joan Dubinsky, Ethics Officer, International Monetary Fund, Dec. 14, 2006.

[26] See Trevino & Nelson, Managing Business Ethics 186-89 (Wiley; 2004 3rd Ed).

results such as the sales of new brake systems. Apparently those designing this system did not think about how this would work in practice in an environment where the store employee has all the knowledge and the customer must rely on that employee's honesty. As alleged by enforcement officials, this incentive system resulted in what appeared to be a pattern of fraud by Sears auto repair operations, and a serious detriment to the company's reputation.

Consider the more recent impact of the shift of senior executive compensation to stock options. Senior executives whose options were "in the money" stood to reap millions in personal gains. Yet these same executives were often in control of the pricing mechanisms for these options. The result was a plethora of allegations involving the top management of major companies and the improper pricing and reporting of options for these executives.[27]

One lesson from these cases is the importance of setting realistic goals and reasonable rewards. If there is too much at stake this in itself can drive employees in questionable directions. On the other hand, it is not necessary to conclude that strong incentives are corrupt or even undesirable. The key is that companies need to exercise care in setting these incentives. This leads to a basic proposition: the stronger the incentives the stronger the checks and controls need to be. There is nothing wrong with offering handsome rewards for results, but there also need to be appropriate controls.

How can this balance be achieved? How can controls be imposed when the very people setting the rewards may stand to benefit from them? One step to help add a control perspective is to ensure that the compliance and ethics officer is there when the incentive plans are considered. Compliance and ethics would be there to act as the devil's advocate, and to ask the questions "what could go wrong" and "how would this look in the newspapers?" The compliance and ethics person can make other managers step back and examine their proposals from a more realistic perspective, and can escalate to the board any plan that is likely to drive employees to unethical conduct.

This step is very similar to the idea of requiring compliance and ethics review for promotions, and ties in with the need for a compliance and ethics person to be involved in major decisions. It is also clearly a sign of compliance and ethics empowerment that sends a strong signal to the government and to the employees. As was true for review of promotions, winning support from human resources may be a challenge, since this is terrain that has traditionally belonged to that department.

VII. Rewards and recognition

In addition to paying employees for doing their assigned tasks and the usual annual reviews and bonuses, companies frequently provide special types of rewards and recognition. These may be such things as travel, cash prizes, small tokens or letters of appreciation. These rewards and recognition help make up the culture of a company;

[27] See, e.g., Forelle & Bandler, "As Companies Probe Backdating, More Top Officials Take a Fall," Wall Street Journal A1, Col. 5 (Oct. 12, 2006).

employees frequently mold their behavior based on who gets rewarded and who does not. As Deal and Kennedy observed in their groundbreaking work on Corporate Cultures, "Culture-shaping managers . . . seek ways to provide frequent and visible praise or other recognition for even modest contributions to the service of important values."[28] Those who are recognized can become the heroes and part of the stories of the company's history.

How should rewards be integrated into the compliance and ethics program? In many companies there is an existing system of rewards. A company may have a high-profile chairman's award for special contributions to the company. The sales organization may fly the top performers to Hawaii for the annual sales conference. Compliance and ethics can be integrated into existing rewards by adding compliance-related factors into the criteria for these rewards. This helps remind employees that compliance and ethics is valued, and that it is a part of everything that matters in the company.

Rewards may also be provided specifically for contributions to the compliance program, and for those who show leadership in promoting the code of conduct. It is best if these rewards are at least on a par with other rewards. Thus, if the top sales people go to Hawaii and the top production person gets a thousand dollar check, the top compliance and ethics performer should get something more than a solo lunch at the local bistro. In the corporate world appearances always matter.

Rewards and recognition are powerful tools. Even in companies that have not otherwise offered these it is worth considering to promote the compliance and ethics program. Employees are likely to remember the fact that meaningful recognition was given for leadership in this area. If an employee is ever asked by the government about the company's compliance and ethics program and its code the person is very likely to respond with the story about the awards dinner. Such outstanding recognition will be part of the stories employees recount to new employees at the company. When done right it can be one of the surest ways to affect the culture in an organization.

Often the field of compliance and ethics involves activities like investigations, audits and discipline that are not always well received. Even requiring employees to attend training may not be a happy experience. But the area of rewards and recognition is one that can be positive and benefit from imaginative approaches. There are numerous ways to provide recognition in this field. Perhaps the easiest and least expensive is the recognition letter from a senior executive, such as the CEO or the compliance officer.

In one company, for example, a marketing manager received in the mail an unmarked envelope with her name on it. When she opened the envelope she realized it contained a competitor's proprietary planning information. She quickly closed the envelope and contacted the legal department. For this ethical act the manager received a glowing letter from the chief compliance officer, with a copy to her supervisor. A speaker from Boeing has recounted a similar story, with the hero also being written up in a company newsletter. In yet another example, a company CEO is reported to have charged his

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[28] Deal &Kennedy, Corporate Cultures 169 (Addison-Wesley Pub; 1982).

officers to bring him specific examples of employees who demonstrated model behavior; he, in turn, sent these employees personal commendation notes.[29] We have attached in Appendix 2 an example of a recognition letter. Perhaps an even more powerful variant on this method is to personally deliver the letter and read it to the employee. This approach, which has been described as a "gratitude visit," can have an impact on both the recipient and the person delivering the message.[30]

Lockheed-Martin provides two excellent examples that were reported in ethikos[31]. The company staged a contest inviting employees to develop their own videos to promote ethics in the workplace. Employees submitted two-minute videos produced on their own time and using their own resources. There were twenty videos submitted from all areas of the business, with three finalists selected and invited to the annual meeting for the company's ethics officers, in Orlando. This event, called the Ethics Film Festival, celebrated all those who participated, and awarded statuettes to the top three. Portions of the top three videos were included in the company's ethics training video.

Lockheed Martin also instituted an annual Chairman's Award for actions or behavior that exemplified the company's ethics commitment. Any employee could submit nominations; each business unit could submit one finalist. The winner is selected by the CEO and the president and presented with a crystal bowl at the company's annual senior management meeting. Award recipients are written up in the company's newspaper.

What other awards and recognition can be given? One starting point is to consider anything that is used in the company for recognition for any purpose - cash, certificates, time off, lunches, etc. But beyond this the possibilities are endless. For example, Appendix 3 includes a list of ideas taken from training sessions for compliance professionals; within 15 minutes, working in teams, they have been able to come up with numerous clever ideas. For those who would like a source of ideas to get the thinking process started, there is an entire book, 1001 Ways to Reward Employees, that can help with this process[32]. It is important to remember, too, that when it comes to recognition, even very small rewards can have a big impact.

One other variant to consider for giving rewards is the recognition of entire work groups. This has the benefit of demonstrating that the company values compliance and ethics, but with an added kick – it can harness the enormous power of peer pressure. For example, if the company offers a free lunch to the work group that completes the code training first, this can make it almost impossible for one employee to hold out, lest he or she cause the entire group to miss out. This result can be achieved with even very small rewards for the group's members. In one business that used this approach, small rewards for entire work groups caused a dramatic decline in injuries in the workplace.[33] The value of rewarding

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[29] Trevino & Nelson, Managing Business Ethics 251 (Wiley; 2004 3rd Ed).
[30] Pink, "Gratitude Visits," New York Times (Dec. 14, 2003) at http://query.nytimes.com/gst/fullpage.html?sec=health&res=9D07E4DF163CF937A25751C1A9659C8B63
[31] Sears, "Lights! Camera! Action! Lockheed Martin's Ethics Film Festival," 17 ethikos 8 (Jan/Feb 2004).
[32] Nelson, 1001 Ways to Reward Employees (Workman Pub; 1994).
[33] Webb, "Ottenberg's: A Recipe for Rewarding Safety: Bakery's Incentive Program Cuts Costs, Improves Productivity," Washington Post F11 (Feb. 19, 1990).

groups was recognized, for example, in the Australian Standards for compliance programs, section 6.1.2(c), which calls for "Recognition of exemplary compliance behaviour by teams, work units and individuals."[34] On this point, though, it is worth reiterating the concern expressed by OSHA; because of the power of peer pressure the company needs to be very sensitive to the risk of groups taking short cuts to achieve the reward. The same group that pressures colleagues to work safely could also pressure a co-worker not to report an injury, lest the entire group lose out on a reward. As is true with other elements of incentive systems, strong forces need comparably strong controls.

In designing these reward programs it is also wise to remember the words of the Australian Standards which refer to "Highly visible rewarding of compliance behaviour." Except in special cases such as recognition of a whistleblower who wishes to remain confidential, there is great value in praising outstanding compliance and ethics behavior in front of the entire company. This is part of the process of molding the company's culture.

VIII. Rewards and recognition for the compliance and ethics staff

As noted above, employees trying to determine what a company's priorities and values really are will look to see who gets rewarded and who gets passed by. Who are the heroes and who are the goats? In this landscape they will observe what happens to those who are part of the company's compliance and ethics program. How are the champions of compliance and ethics treated? What is their record when it comes to salary, bonus treatment, promotion and other recognition? Is the compliance and ethics office where almost-retired loyal workers are put quietly out to pasture, or is this a function that really matters? How the compliance and ethics staff members are treated will be read by employees as an essential sign of their importance.[35]

The message here is that the company should treat its compliance and ethics staff well. If the company is serious when it talks about how integrity is its first value, if it intends to follow the "gold standard" for its program, if all of this is more than mere lip service then its money should be behind its words. The financial treatment of the compliance and ethics officer and staff should communicate clearly that this is an important function that the company values highly. Words alone will not do this; actions will. On the other hand, there should be some caution exercised in determining how to reward the compliance and ethics staff; it is best if incentives are de-coupled from objectives and benchmarks that would call into question the compliance and ethics staff's objectivity.[36]

Companies should also consider whether compliance and ethics is a path for promotion in the company. If compliance and ethics really does matter then service in that area should

[34] Australian Standards 3806-2006.
[35] Braithwaite & Murphy, "Clout and Internal Compliance Systems," 2 Corporate Conduct Quarterly (now ethikos) 52, 62 (Spring 1993).
[36] See United States v. C.R. Bard Inc., CV93-10276-T, plea agreement (D. Mass; Oct. 14, 1993); Sigler & Murphy, Interactive Corporate Compliance: An Alternative to Regulatory Compulsion 83 (Quorum Books; 1988).

be considered a positive factor in selecting people for promotion. A stint in the compliance and ethics program would become a ticket that needs to be punched for those who want to get ahead in the company.

Companies may also consider establishing a career path for those who do compliance and control-related work. A route for advancement, combining paths in HR, internal audit, environment, health and safety, legal, compliance headquarters and compliance field work, and related functions could be mapped out for those who are interested.[37] Boeing Corp has reportedly started this process for its compliance and ethics staff.

Companies can also focus on the achievements of the compliance and ethics staff, singling out the top performers for special recognition. For example, in one major financial services company the person who developed their privacy program was recognized throughout the company, including mention in the company's annual report.

IX. What about whistleblowers?

The last question we consider in this paper is whether companies should provide rewards for whistleblowers. We are treating this separately from all the other aspects of this field because the topic is highly controversial. While the ideas covered above are all things that can add to the effectiveness of a compliance and ethics program, there is a concern that rewarding whistleblowers may not necessarily have a positive effect.

The idea behind rewarding whistleblowers is that companies need to have employees be alert to compliance and ethics issues and to raise questions and concerns when they see something that is not right. Employees who witness harassment or consumer fraud or price fixing activity should report this to management or the company's helpline. However it is well known that many people witness misconduct but do not report it, whether from fear of retaliation, indifference, or the belief that nothing will be done. Yet those who do raise issues may benefit their employers enormously by interdicting potentially disastrous misconduct. Therefore in order to reach employees and incent them to report issues, why not offer them a reward? A reward system would follow the model of the highly successful (for the government) US False Claims Act, which offers whistleblowers a large percentage of any damages the government recovers as a result of a whistleblower's reporting fraud in government contracting.

One example of this type of approach came from Bear Stearns which pursued such a policy, going so far as to inform employees: "We want people at Bear Stearns to cry wolf. If the doubt is justified, the reporter will be handsomely rewarded."[38] The company went on to inform employees how two administrative assistants reported another employee's submission of false taxi vouchers and as a result received an immediate cash award. Cash was the incentive for people to report violations by their

[37] Murphy & Leet, Working for Integrity: Finding the Perfect Job in the Rapidly-Growing Compliance and Ethics Field, Ch. XVIII. Advice for Companies: Finding the Right Person for Your Compliance Positions (SCCE; 2006).
[38] Trevino & Nelson, Managing Business Ethics 246 (Wiley; 2004 3rd Ed).

colleagues. In another company that reported success with this reward system, rewards were only given on condition that reporting employees provide their identities, to reduce the risk of false allegations.[39]

Perhaps not quite so direct is the language from the Office of Inspector General of HHS in its guidance on pharmaceutical compliance programs. OIG suggested: "Pharmaceutical manufacturers may also consider rewarding employees for appropriate use of established reporting systems as a way to encourage the use of such systems."[40]

What is the concern about such systems? Note first that we are not talking about rewarding people for good ideas, or for suggesting improvements in the compliance program; rather, the concern is about rewards for turning in fellow workers for money. The fear is that this will have a distinctly negative impact on employee morale, conjuring up the image of bounty-hunters. Will employees be looking over their shoulders to see who is watching them? Will they work secretively and avoid sharing anything with others who may be waiting to pounce at the first opportunity? If the rewards are high enough, will employees even be driven to "frame" fellow employees or unpopular supervisors to earn the cash? Of the issues involved in incentive programs, this is certainly one that has the potential for triggering strong negative reactions. Unionized work groups may be outspoken in their resistance, possibly tainting their approach to the entire program. For multinational companies there may be an even greater obstacle in places that have shown resistance to any type of hotline operation, such as France.

This is not to say that the desire to have employees raise issues is wrong. Companies should certainly be active in their steps to prevent retaliation. When employees call to report concerns the company should make it very clear that it appreciates the employee's courage in raising the issues. These steps need to be part of a company's approach to whistle blowing. But when it comes to handing out cash rewards or other rewards of value there appears to be a significant difference. On this point we would at minimum caution any company considering such rewards to take steps to learn employees' reactions in advance. Know whether your company's culture will support such steps, or whether there is a serious risk that this will be viewed as bounty hunting and possibly undermine the program.

Perhaps one way to employ rewards and incentives to promote use of the reporting system is to reward those who report issues that relate to systems and processes, rather than reporting violations by individual co-workers. For example, an employee who uses the reporting system to ask for advice on a difficult compliance question, identify a vulnerability in a compliance control system, or suggest a way to improve compliance training, could receive significant and highly-visible rewards. This could send the

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[39] Biegelman & Biegelman, Building a World-Class Compliance Program 207-08 (John Wiley & Sons, Inc.; 2008).

[40] Department of Health and Human Services, Office of Inspector General, Compliance Program Guidance for Pharmaceutical Manufacturers, 68 Fed. Reg. 23731 (May 5, 2003) at http://www.corporatecompliance.org/resources/documents/050503FRCPGPharmac.pdf.

message that the company favors those who utilize the reporting system, but without the possible negative aspect of paying those who report on colleagues.

X. Conclusion

For a compliance and ethics program to be effective it needs to affect the behavior of those acting for the company. Rewards and incentives clearly do this, and need to be included in any program. This paper has outlined ways to take this step.

In a practical world, compliance and ethics programs also must exist to help the company in times of crises when outside skeptics believe the company has done something wrong. A strong compliance and ethics program should demonstrate the company's good faith. But to do this it must meet the legal standards that would apply; these also require the use of incentives. Again, looking at things in a practical sense this also means that the company should be careful to document all aspects of its program, including the use of incentives. The simple recognition letters and the forms used for employee evaluations, the fact that the compliance officer attends the management sessions where incentive programs are developed, the recognition dinner for the field compliance staff – all of this needs to be documented at part of the compliance program's files.

Not only are incentives necessary in a program, but they also help put a more positive face on the program. Compliance and ethics should not only be about enforcing laws and rules. It should also include positive appeals to the best in human nature, and recognition that people in companies do good and even heroic things, and that they should be recognized for showing ethical leadership.

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e. Examples and forms
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   b. Recognition letter, Appendix 2
   c. Ideas for Using Incentives in Compliance and Ethics Programs (from SCCE and HCCA Academies, Appendix 3
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