The Complete Compliance and Ethics Manual 2023
Using Incentives in Your Compliance and Ethics Program

By Joseph E. Murphy, JD, CCEP[1]

Introduction

Incentives help drive behavior.

While incentives are common in businesses, homes, schools and other contexts, the use of incentives in the context of compliance and ethics programs has been slow to catch on. This has been true because many compliance and ethics officers don't understand that "appropriate incentives" are a required element of an effective compliance and ethics program as articulated under the Federal Sentencing Guidelines and because too many in management and on boards believe that most employees will naturally "do the right thing." Unfortunately, the evidence suggests just the opposite. Without adequate controls and incentives, most of us will (at least occasionally) do the wrong thing.

With the growing distrust of business and the increasing levels of misconduct, it will become critically important for businesses and other organizations to do a better job of using incentives as a tool to drive the kind of behavior they expect of employees. By developing appropriate compliance and ethics incentives, management and boards can demonstrate their commitment to compliant and ethical conduct in the organization; they can significantly reduce the risk of illegal or unethical conduct; and they can fulfill their fiduciary obligations to ensure that the organization has an effective compliance and ethics program.

Mr. Murphy's article on aligning incentives provides a road map for organizations that understand the incentive imperative but have been struggling with execution. It is a must read for every compliance and ethics officer, as well as for board members and management who are concerned about the impact of non-compliance. I have heard many board members and managers tell me that they are serious about compliance and ethics. The adoption of some of the incentives described in this article will give those board members and leaders a chance to prove that commitment!

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Scope

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 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.[2]

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 risk assessment.[3] In this article, it is our objective to help compliance and ethics professionals address this important topic.

The scope of this article 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 using incentives: 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 (an increasingly sensitive issue, as a result of the whistleblower provisions in Dodd Frank). In this article, 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 credits for those who have assisted in this project, a bibliography, and appendices with examples and materials for use by the practitioner.

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 that of 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.

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 of when this can work is for subordinates who 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.

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.[4] But the focus is not on testing employees' internal ethics, but on evaluating what they do on the job.

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 article make clear. It is certainly impossible to argue that something is *impossible* when others are already doing it.

This Area Is too Subjective, Unlike Sales or Production

Resistance to this effort can also come in the related objection that, unlike sales or production, evaluating compliance and ethics is too subjective. Because the subject matter is not just a matter of counting numbers, evaluating 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."[5] 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 to translate when it comes to assessing employees' performance.

Moreover, a cursory review of a small 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 evaluation 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.

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. Specific behaviors that promote compliance and ethics can be used as employee performance objectives and form part of the basis for the evaluation;[6] supervisors can be trained on what these mean and how to address them in evaluations.

Risk of Use Against Company in Litigation

To a trial lawyer, the question may arise about what might happen if an employee's evaluation shows an ethical weakness, and then 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.

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.[7] The concern expressed by the agency is that rewarding the absence of reported injuries will lead to pressure not to *report* 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. For example, when a work unit claims perfect results, there should be some type of on-sight checking. When an instance occurs of someone gaming the system, there should be strong discipline and the example (with identities omitted) publicized to others as a warning.

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 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.”

From an internal political perspective, it is important for compliance and ethics staff to work cooperatively with their colleagues in human resources 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.

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.