How to Incentivize Whistleblowers to First Use Internal Reporting Tools

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CURRENT LEGISLATION

The Dodd-Frank Wall Street Reform and Consumer Protection Act incentivizes employees to report wrongdoing to the government. While the Act may have good intentions, it potentially leaves companies wanting to get a handle on internal affairs and better manage company culture out of the loop. How, then, can companies compete with the government?
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DODD-FRANK’S IMPACT ON COMPANIES

Whistleblower protections, in place in some form since the 1970s, have been strengthened significantly in recent decades. Most recently, the Dodd-Frank Act, signed into law in July 2010, expanded existing whistleblower protections in three key ways, by:

- Creating new programs within the Securities Exchange Commission (SEC) and the Commodities Futures Trading Commission (CFTC) to give financial rewards to whistleblowers who provide information to the government of violations of securities law and the Commodity Exchange Act;

- Broadening anti-retaliation protections to encompass employees of subsidiaries and affiliates of public firms, as well as employees of statistical rating organizations; and

- Lengthening the statute of limitations for a whistleblower to file a retaliation claim.

Although the concept of rewarding whistleblowers may have merit, observers worry that the law will undermine a company’s internal mechanisms for reporting fraud and other such misconduct. The financial incentives offered by the Act may encourage employees to supersede internal reporting mechanisms and go directly to the government. The Final Rules of the Act, which were adopted on May 25, 2011, solidified that employees have no obligation to first report company wrongdoings through internal methods provided by their company. While reporting internally first can potentially increase the reward a reporter may receive from the Securities and Exchange Commission (SEC), the reporter is slated to receive between 10% and 30% of the recovery, regardless.
While encouraging employees to report wrongdoings is noble, the method by which the Act is attempting to achieve this goal is flawed. The Act allows for the SEC “to not disclose records or information that have been obtained for uses such as surveillance, risk assessments, or other regulatory and oversight activities—except it may not withhold information from judicial or congressional inquiry.” v

Essentially, this places employers in an impossible situation. Should an employee report concerns directly to the SEC without also sharing those concerns with the employer? The employer may very well not learn of the wrongdoing until court proceedings have been initiated. Further, the SEC has no obligation to provide the employer with information regarding the complaint, so that the employer can’t remedy the situation prior to litigation or official sanction.

**WHY EMPLOYERS SHOULD CARE**

- In fiscal year 2013, the SEC’s Office of the Whistleblower paid out more than $14 million to whistleblowers and received 3,238 tips. As of the end of FY 2013, the SEC’s whistleblower fund had a balance of $439 million. vi

- With the U.S. Supreme Court ruling in Lawson v. FMR, private firms that contract with public companies may be subject to anti-retaliation laws, too. vii

- Firms able to successfully encourage internal reporting of wrongdoing are empowered to respond rapidly to internal misconduct, potentially reducing shareholder losses and reputational damage
CREATING A CULTURE THAT ENCOURAGES INTERNAL COMMUNICATION

Many companies already have internal reporting mechanisms in place, like ethics hotlines. But with the SEC offering generous financial rewards to whistleblowers, how can a firm encourage employees to report concerns internally first?

Creating a culture rooted in open communication and integrity is crucial in motivating employees to report legal or ethical violations internally. The Ethics Resource Center notes that “employees are much more likely to act against misconduct and report wrongdoing when they feel good about where they work and believe they have influence in the workplace.” viii To get there, a firm must alleviate employee fears of retaliation or alienation by coworkers, and bolster employee trust in management’s ability to address serious issues. ix This can be attained by establishing tone at the top, implementing targeted hiring and training practices, managing allegations the right way, and fostering company loyalty.

TONE AT THE TOP

It is no surprise that tone at the top drives the organizational culture. Senior executives must communicate not only that illegal activity will not be permitted within the company, but that internal reporting is welcome and necessary for maintaining the integrity of the firm. Further, the C-suite must ensure consistency between company policies and managerial behavior, set the expectation that everyone is responsible for reporting substantive violations they witness, and use transparency to build trust.

SCREENING AND HIRING

At the core of a culture of open communication is a workforce of integrity-minded people. By evaluating candidates’ ethical dispositions during the interview process, a firm can more consciously build a staff that values honesty and integrity. While some firms have incorporated full-blown behavioral assessments into their screening process, others use tailored behavioral interview questions focused on moral dilemmas and how the candidate would respond in given scenarios. x
Creating a climate supportive of internal reporting also requires ongoing education and training at all levels of the organization. As the Association of Certified Fraud Examiners notes, “Not only are employee tips the most common way occupational fraud is detected, but our research shows organizations that have anti-fraud training programs for employees, managers and executives experience lower losses and shorter frauds than organizations without such programs in place.”

Before an employee can report potential legal or ethical violations occurring within the company, he/she must first understand what constitutes wrong-doing. As the Ethics Resource Center explains, “Before an employee even starts thinking about whether (and where) to report, he or she has to recognize that there is a wrong that needs to be righted, that what was witnessed was misconduct and that there is an obligation to do something about it.” By educating employees about relevant laws, regulations, and company policies, a firm can equip employees with the knowledge necessary to spot illegal or inappropriate behavior. Additionally, informing employees about all internal reporting avenues—as well as explaining company anti-retaliation policies and what retaliation looks like in practice—should be an integral part of a firm’s training program.

Managers, too, should be trained on how to properly handle allegations. Such training should encompass standard procedures for collecting pertinent information concerning the allegation, forwarding the report to the appropriate company official, and communicating to the whistleblower that the allegation will be investigated. Further, managerial training on anti-retaliation policies is critical.

To be most effective, training should be ongoing, and employees should be reminded of internal reporting procedures and anti-retaliation policies more than once during the year. For example, Wal-Mart has created an annual “Ethics Awareness Month” to keep ethical conduct at the forefront of employees’ minds. Additionally, companies should convey this information through a range of communication avenues, such as via webinars, employee handbooks, email, and in person. To be most effective, training should be ongoing, and employees should be reminded of internal reporting procedures and anti-retaliation policies more than once during the year. For example, Wal-Mart has created an annual “Ethics Awareness Month” to keep ethical conduct at the forefront of employees’ minds. Additionally, companies should convey this information through a range of communication avenues, such as via webinars, employee handbooks, email, and in person.
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MANAGING ALLEGATIONS THE RIGHT WAY

At the front line of communicating and representing a firm’s values, managers and supervisors play a critical role in establishing and maintaining a culture of open communication and integrity. Further, many reports are made to supervisors: 82% of National Business Ethics Survey (NBES) respondents in 2013 said they had reported a concern to their direct supervisor at some point. Supervisors’ responses to such complaints can make or break a firm’s internal reporting program.

By establishing a genuine open-door policy, taking reports seriously, and responding quickly and effectively, supervisors can encourage employees to report concerns internally. To ensure that complaints are being addressed promptly, a company may wish to adopt a policy requiring investigation of the tip within a specified time frame. If an employer fails to act on reports of wrongdoing, the employee is much more likely to look outside the organization for remediation than if the employer responds promptly and appropriately. That is why it is important for an organization to not only communicate to the reporter what action is being taken to investigate the issue, but also maintain consistency in enforcing company policy and disciplining employees.

Employers should also create a company policy that requires employees to report misconduct and wrongdoing to management. This allows employers to discipline employees for failure to comply with internal policies. The danger, of course, is in retaliation claims. In order for an employer to discipline an employee, the employer must show there was an appropriate internal reporting method available and the employee failed to use it. Additionally, the employer would need proof the employee was aware of the policy.

FOSTERING COMPANY LOYALTY

Finally, firms can strengthen their culture of communication by taking steps to build employee loyalty to the company, its values, and its ethical policies. To foster stronger employee commitment to the organization, a firm may invest in employees’ professional development, allow work schedule flexibility or remote work, offer competitive compensation, and maintain equitable, consistent enforcement of policies.
INCENTIVIZING INTERNAL REPORTING

To reinforce the message that upper management is genuine in its attempts to create an environment of open communication, a firm may choose to incentivize internal reporting. Employees may likely fear retaliation or discrimination if they blow the whistle internally, so recognizing or rewarding an employee’s bravery and dedication to company ethics may provide the extra nudge necessary to encourage these individuals to come forward. The 2011 NBES survey found that “72 percent of employees who agreed their companies reward ethical conduct did report; but far fewer employees (57 percent) who do not see ethics rewarded choose to report.” XVI Such incentives may be either monetary or non-monetary.
With the SEC providing cash incentives for whistleblowing, firms may be wondering whether they should do the same to encourage employees to report internally. Providing monetary rewards for internal whistleblowing may be a way for a firm to “put its money where its mouth is,” so to speak. Firms adopting this approach may opt to give out spot bonuses or paid vacation days. xvii

If an employee’s motivation for reporting wrongdoings is solely financial, however, there is little an employer can do to prevent him from reporting directly to the government, as few employers can offer similar financial rewards—nor should they. As a result, financial rewards may not be the best solution for some employers. Financial rewards may delay reporting; if the reward is set as a percentage of the fraud amount uncovered, individuals may be encouraged to wait to report until the fraud amount increases. Further, monetary rewards may be unnecessary; individuals driven by personal ethical standards to report wrongdoing will likely do so without the enticement of monetary gain.

If your firm does choose to offer financial rewards for whistleblowing, the terms and conditions attached to such rewards should be clearly communicated. Misunderstanding of company policies can create feelings of ill will among those who do take the leap to report their concerns while dissuading future whistleblowers from coming forward.

Non-monetary incentives are also an option. Public recognition of the whistleblower’s role in stopping company fraud may be a beneficial means of lauding the whistleblower, reinforcing the company’s commitment to integrity, and encouraging others to report concerns. One multinational firm that has adopted this approach gives out annual awards to employees for exemplary ethical conduct. xviii

Rolling ethics plaudits into personnel evaluations may be another means of thanking employees for their honesty and trust in the company. In 2013, 67% of companies surveyed in the National Business Ethics Survey said they counted ethical conduct as a measure of employee performance in evaluations. xixv
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PARTING THOUGHTS

Encouraging employees to report misconduct internally can be a challenge, given employee fears of retaliation, distrust of management’s ability to correct problems, and financial rewards for external reporting. However, if a firm is successful in doing so, it is empowered to respond rapidly to internal misconduct. Receiving information timely enables the company to investigate allegations and take appropriate action to minimize financial, legal, and reputational damage.

As a result, firms should make the effort to build a culture that embraces internal reporting and rewards positive ethical conduct. Although some whistleblowers’ primary motivation may be financial gain—and little can be done to prevent these individuals from going to the government first—many employees may be motivated to report wrongdoing if they feel the organization is supportive of internal reporting and if they believe they can make a positive change in the organization by doing so.
WHAT EMPLOYERS SHOULD KNOW ABOUT WHISTLEBLOWER PROTECTIONS

- Dodd-Frank whistleblower rewards apply to reports of violations of securities law and the Commodity Exchange Act. Under the program, whistleblowers who provide high-quality, original information may be eligible for between 10% and 30% of successful actions resulting in sanctions of $1 million or more.

- Whistleblowers are not required to first report their concerns internally before providing information to the government.

- The SEC is not required to disclose the information obtained or the identity of the whistleblower, except as required by judicial orders or congressional investigations.

- Dodd-Frank’s whistleblower program allows anonymous submissions to the SEC, provided that the complainant has legal representation.

- Dodd-Frank extends anti-retaliation protections to employees of “any subsidiary or affiliate whose financial information is included in the consolidated financial statements” of a public company and to employees of “nationally recognized statistical rating organizations.” “Employers may not discharge, demote, suspend, harass, or in any way discriminate against you because of any lawful act done by you in providing information to us under the whistleblower program or assisting us in any investigation or proceeding based on the information submitted.”

- The March 2014 U.S. Supreme Court ruling in Lawson v. FMR expanded Sarbanes-Oxley whistleblower protections to employees of private contractors providing services to public companies, meaning that private employers may need to put in place additional internal reporting and anti-retaliation policies.
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5 Dodd-Frank.


9 Ravishankar.


14 “National Business Ethics Survey 2013.”


16 “Inside the Mind of a Whistleblower.”

17 Jones and Lublin.


19 “National Business Ethics Survey 2013.”

20 Dodd-Frank.


22 Jaeger.