

Could the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 be Helpful in Reforming Corporate America? An Investigation on Financial Bounties and Whistle-Blowing Behaviors in the Private Sector

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Abstract The purpose of this study is to investigate whether the availability of financial bounties and anonymous reporting channels impact individuals' general reporting intentions of questionable acts and whether the availability of financial bounties will prompt people to reveal their identities. The recent passage of the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 creates a financial bounty for whistle-blowers. In addition, SOX requires companies to provide employees with an anonymous reporting channel option. It is unclear of the effect of these provisions as they relate to whistle-blowing. Our results indicate that a financial bounty has the potential to increase participants' propensity to report questionable acts and their willingness to reveal their identities when reporting, but the availability of an anonymous reporting channel does not affect participants' propensity to report questionable acts. These findings could potentially help corporate management, government policy makers and accounting researchers to assess the effectiveness of their internal compliance programs and help determine if financial bounties in the private sector could encourage whistle-blowing.

Keywords Whistle-blowing · Dodd-Frank Act · Financial bounties · Anonymous reporting channel

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Introduction

According to the 2007 National Business Ethics Survey conducted by the Ethics Resource Center, more than half of employees witnessed an act of misconduct in their company within the past year. In addition, more than two in five employees who observed misconduct did not report what they saw. Most surveys indicate that "...employees have much to lose from blowing the whistle. In 82 % of the fraud cases where the whistle-blower's identity was revealed, the person was allegedly fired, quit, or had his or her responsibilities changed significantly". The Sarbanes–Oxley Act (hereafter SOX) whistle-blowing provisions were incorporated in efforts to protect individuals who choose to come forward with relevant information of misconduct. Specifically, Section 302, 15 U.S.C. § 7241 mandates that corporations establish procedures for confidential reporting of accounting or auditing irregularities. Section 806, 8 U.S.C. 1514A, prohibits a company from taking any retaliatory action against a whistle-blower who has brought wrongdoing to the attention of either a supervisor or a regulator or law enforcement official, and entitles an employee who has been subjected to retaliation to reinstatement, back pay and legal fees.

One of the intentions of SOX was to protect whistle-blowers, however, out of the 491 employees who filed SOX claims during the first three years of the Act, only 3.6 % of the cases were determined in favor of the employee (Moberly 2007). In addition, SOX has attempted to make great improvements to encourage whistle-blowing in public companies, although it does not incorporate a financial bounty. Therefore, the effectiveness of the SOX provision of whistle-blowing protection is questionable.

On July 21, 2010 President Obama signed into law the Dodd–Frank Wall Street Reform and Consumer Protection

Act of 2010 (hereafter Dodd–Frank Act) in an effort to improve corporate governance. Similarly, the Securities and Exchange Commission (hereafter SEC) voted unanimously on November 3, 2010 to propose a whistle-blower program to reward individuals who provide the agency with high-quality tips that lead to successful enforcement actions. The goal of the Dodd–Frank Act is to offer a simplistic model for potential whistle-blowers to disclose pertinent information related to alleged frauds. In a recent speech, SEC Chairman Mary L. Schapiro indicated that, “...We get thousands of tips every year, yet very few of these tips come from those closest to an ongoing fraud. Whistle-blowers can be a source of valuable first-hand information that may otherwise not come to light. These high-quality leads can be crucial to protecting investors and recovering ill-gotten gains from wrongdoers.”¹ The Dodd–Frank Act expands the SEC’s authority to compensate individuals who provide the SEC with information about violations of the federal securities laws and accounting fraud early in the investigation process. Providing financial bounties to encourage whistle-blowers is not a new idea. A financial bounty is incorporated into the False Claims Act and has been utilized by Crime Stoppers for many years and has successfully resulted in increasing whistle-blowing in fraud cases against the government and with police investigations. Comparatively speaking, financial bounties in fraud cases, specifically securities and accounting cases, within the private sector are a relatively new concept to encourage whistle-blowing.

Alvarado (2007) states individuals and groups who historically have detected most corporate fraud have little incentive to blow the whistle. Financial bounties are said to be the government’s number one deterrent against fraudulent behavior. Prior literature (Salciđl 2010) has shown that the potential financial bounty in the government sector significantly increases the frequency of whistle-blowing. Based on our literature review, we are unaware of any empirical studies that investigate the impact of financial bounties to promote whistle-blowing in the private sector. The purpose of our study is to examine the effect of financial bounties and anonymous reporting channels on people’s propensity to report questionable acts. In the next section of the article we discuss the background on whistle-blowing, reporting channels, and financial bounty programs, develop the hypotheses tested, followed by a discussion of our research method and results. The final section of the article discusses the study’s implications as well as its limitations.

Background

Effective whistle-blowing should significantly reduce one’s incentive to engage in wrongdoing (Howse and Daniels 1995). Two conditions are necessary for the whistle-blowing to be an effective internal control mechanism: (1) the observer of wrongdoings or questionable acts decides to report the act and (2) the whistle-blowing is properly and effectively handled (Near and Miceli 1995). The whistle-blowing literature mainly addresses the following two issues: how to increase one’s intention to report wrongdoings or questionable acts and how to increase the effectiveness of the reporting. This study seeks to investigate how to increase one’s intention to report wrongdoing by incorporating financial bounties and anonymous reporting channels into the whistle-blowing process.

There are several current statutes that attempt to encourage whistle-blowing but slightly differ in their approach. As previously stated SOX provides protection for whistle-blowers at public companies but lacks the financial bounty component. The Securities Act, 15 U.S.C.78u-1(e), provides for a financial reward to an individual who provides information to the SEC regarding insider trading. Under this statute, the SEC has complete discretion as to whether to provide a reward to the whistle-blower. Also, this statute sets a 10 % cap of the whistle-blower’s share of any reward. Accordingly, this is a highly underutilized provision given that only five individuals have received awards under the program totaling \$159,537 over the 20 year life of the provision. The False Claims Act (FCA), 31 U.S.C. § 3729 provides a financial bounty to individuals who report fraud against the government, entitling individuals to receive between 15 and 30 % of any award that the government may receive.

The Dodd–Frank Act has some similarities and differences to the prior established whistle-blower provisions. Similar to the False Claims Act, the Dodd–Frank Act requires the SEC and the Commodities Futures Trading Commission (CFTC) to pay between 10 and 30 % of the reward to whistle-blowers who voluntarily provide information regarding a violation of securities or commodities laws leading to a government recovery. The whistle-blower is not able to receive a reward if he or she is convicted of a criminal violation in connection with the fraudulent activity. Interestingly, the Dodd–Frank Act expands some of the FCA provisions by allowing the whistle-blower to provide information that may already be publicly available, but if the information enhances the claims and allows the government to gain a better understanding of the claim, the whistle-blower is still entitled to share in the recovery. This new requirement of providing “original information” is a key distinction in comparison to SOX.

The Dodd–Frank Act also expands the population of individuals who could potentially receive a claim. In order

¹ <http://www.sec.gov/news/press/2010/2010-213.htm>.

to classify as a whistle-blower under the Dodd–Frank Act, (1) the whistle-blower’s information cannot be gathered through an SEC-mandated audit and (2) employees of regulatory agencies, the Department of Justice, a self-regulatory organization, the Public Company Accounting Oversight Board or any law enforcement organization are ineligible to obtain a portion of the reward (Stauffer and Kennedy 2010). A whistle-blower may recover a reward obtained by the government as part of any action brought by the SEC under the securities laws or brought by the CFTC under the Commodity Exchange Act. Although the Dodd–Frank Act expands the individuals who could potentially claim a reward, it also incorporates a provision that could potentially limit its usefulness. First, a whistle-blower may only receive an award under the Dodd–Frank Act if the award exceeds \$1 million. In comparison, the FCA does not impose any limitations on the potential fraud amount. Second, the Dodd–Frank Act does not provide a whistle-blower with a private cause of action, which allows a whistle-blower to initiate and to continue litigation even if the government declines to participate. Therefore, the whistle-blower must be confident that the evidence is convincing enough to entice the government to pursue a case and the award must exceed \$1 million. Lastly, a whistle-blower can remain anonymous and report the alleged fraud violation via an attorney with the understanding that the whistle-blowers’ identity will remain anonymous unless the SEC is required by law to disclose the identity or disclose to another governmental agency who is bound by the confidentiality restrictions. For a review of reward receipt process under the Dodd–Frank Act, please refer to Table 1: Overview of Reward Receipt under The Dodd–Frank Act.

The Dodd–Frank Act also provides significant protection to whistle-blowers to prevent employer retaliation. Specifically, the Act provides an independent cause of action for a whistle-blower who has experienced employer retaliation which allows the whistle-blower to recover double back pay with interest and attorney fees. The whistle-blower is also entitled to reinstatement to the position prior to the retaliation. These two provisions significantly expand the protection offered under SOX by offering double back pay. In addition, whistle-blowers alleging retaliation from employers that fall under the Dodd–Frank Act may bring an action in federal district court without first filing a complaint with Occupational Safety and Health Administration (OSHA). As previously stated, the Dodd–Frank Act extends the SOX’s whistle-blower protection provisions. For a comparison of these expanded provisions, please see Table 2: Protection for whistle-blowers under the Sarbanes–Oxley Act and the Dodd–Frank Act.

Hooks et al. (1994) present a model of the whistle-blowing process involved in reporting fraud. The process

Table 1 Overview of reward receipt under the Dodd–Frank Act

Under the proposed rules, a whistle-blower is a person who provides information to the SEC relating to a potential violation of the securities laws.

To be considered for an award, a whistle-blower must ...

Voluntarily provide the SEC ...

In general, a whistle-blower is deemed to have provided information voluntarily if the whistle-blower has provided information before the government, a self-regulatory organization or the Public Company Accounting Oversight Board asks for it.

... with original information ...

Original information must be based upon the whistle-blower’s independent knowledge or independent analysis, not already known to the Commission and not derived exclusively from certain public sources.

...that leads to the successful enforcement by the SEC of a federal court or administrative action ...

A whistle-blower’s information can be deemed to have led to successful enforcement in two circumstances: (1) if the information results in a new examination or investigation being opened and significantly contributes to the success of a resulting enforcement action, or (2) if the conduct was already under investigation when the information was submitted, but the information is essential to the success of the action and would not have otherwise been obtained.

... in which the SEC obtains monetary sanctions totaling more than \$1 million.

Taken from <http://www.sec.gov/news/press/2010/2010-213.htm> on 12/3/10

starts with the occurrence of a significant wrongdoing (a trigger event or fraudulent act). Then, someone within the organization must observe the act and recognize a need to report. Next, the observer evaluates the available options and the benefits and costs associated with each option. The whistle-blowing report only occurs when the observer believes that the benefits of reporting outweigh the costs of reporting. Many moderating variables that may affect the whistle-blowing process, thereby the decision to report, have been studied. Hooks et al. (1994) classified them into four categories: (1) Organizational culture/tone at the top, (2) characteristics of the wrongdoing, (3) responsibilities and social influences, and (4) observer’s individual characteristics.

Near and Miceli (1995) also present a model of the effectiveness of whistle-blowing. In their model, they identify five primary factors that influence the effectiveness of whistle-blowing. They are characteristics of the (1) whistle-blower, (2) characteristics of the complaint recipient, (3) characteristics of the wrongdoer, (4) characteristics of the wrongdoing, and (5) characteristics of the organization. The first three factors are individual variables (i.e., variables relating to the whistle-blower, complaint recipient, and wrongdoer), and the last two factors are

Table 2 Protection for whistle-blowers under the Sarbanes–Oxley Act and the Dodd–Frank Act (Retrieved from <http://www.cov.com/files/Publication/7ed821ae-f749-485a-9554-a06fde78bdc8/Presentation/PublicationAttachment/e7ed9251-9fa6-46ac-b963-a1ed93390779/Dodd-Frank%20Act%20-%20Enhanced%20Protection%20for%20Whistleblowers%20Against%20Employer%20Retaliation.pdf> on 11/1/10)

The following table contains a comparison of the main provisions of the Sarbanes–Oxley Act and the Dodd–Frank Act.^a In some cases, the Sarbanes–Oxley Act’s protections have been amended by the passage of the Dodd–Frank Act

| | Sarbanes–Oxley Act (as amended to date) | Dodd–Frank Act |
|--|---|--|
| Scope of protected reporting | <p>Whistle-blowers are protected from retaliation for reporting violations of:</p> <ul style="list-style-type: none"> • any rule or regulation of the SEC; • federal criminal provisions relating to securities, bank, mail, or wire fraud; or • any federal law relating to fraud against shareholders. <p>Whistle-blowers are protected from retaliation if they have provided such information to:</p> <ul style="list-style-type: none"> • a federal regulatory or law enforcement agency; • a member or committee of Congress; or • a person with supervisory authority over the whistle-blower. | <p>Whistle-blowers are protected from retaliation for making disclosures that are required or protected under:</p> <ul style="list-style-type: none"> • the Sarbanes–Oxley Act; • the Securities Exchange Act Of 1934 (Exchange Act), including Section 10A(m), which requires each public company audit committee to establish procedures for receiving and handling complaints regarding accounting or auditing matters and confidential, anonymous submissions by employees regarding questionable accounting or auditing matters; • 18 U.S.C. § 1513(e), which prohibits retaliation, including in connection with employment, against individuals for providing information to a law enforcement officer about the possible commission of a federal offense; and • any other law rule, or regulation subject to the SEC’s jurisdiction. <p>Whistle-blowers are also protected for making disclosures to the SEC pursuant to the new Dodd–Frank whistle-blower bounty program.^b</p> |
| Statute of limitations | 180 days after the date of the violation or after the employee became aware of the violation. ^c | <p>No more than</p> <ul style="list-style-type: none"> • six years after the violation; or • three years after facts material to the right or action are known or reasonably should have been known by the employee. <p>In any event, no action may be brought more than 10 years after the date of the violation.</p> |
| Jurisdiction over complaints | Whistle-blowers must file an initial complaint with the Occupational Safety and Health Administration (OSHA) within the Department of Labor. If the Secretary of Labor fails to issue a final decision with respect to the complaint within 180 days, the whistle-blower may bring an action in federal district court. | <p>Whistle-blowers may file an initial complaint in federal district court.</p> <p>There is no preliminary OSHA adjudication of these complaints.</p> |
| Remedies | <p>Reinstatement with equivalent seniority and back pay with interest.</p> <p>Reasonable attorneys fees and related costs are also recoverable.</p> | <p>Reinstatement with equivalent seniority and two-times back pay with interest.</p> <p>Reasonable attorneys’ fees and related costs are also recoverable.</p> |
| Amendments to Sarbanes–Oxley Act by Dodd–Frank Act | <p>The Dodd–Frank Act amended the Sarbanes–Oxley Act as follows:</p> <ul style="list-style-type: none"> • increases statute of limitations from 90 to 180 days, as described above (see note 5); • eliminates an employer’s ability to enforce waivers of whistle-blowers’ rights or remedies, or to require arbitration of claims of retaliation through pre-dispute agreements; • grants parties to retaliation cases in federal district court a right to trial by jury; and | N/A |

Table 2 continued

The following table contains a comparison of the main provisions of the Sarbanes–Oxley Act and the Dodd–Frank Act.^a In some cases, the Sarbanes–Oxley Act’s protections have been amended by the passage of the Dodd–Frank Act

| Sarbanes–Oxley Act (as amended to date) | Dodd–Frank Act |
|---|--|
| | <ul style="list-style-type: none"> • clarifies that the Sarbanes–Oxley Act’s retaliation provisions cover employees of subsidiaries and affiliates of public companies whose financial information is included in the consolidated financial statements of such public company. |

^a This section summarizes the relevant provisions of the Dodd–Frank Act, as signed into law on July 21, 2010. It should be noted, however, that the SEC is required by the Act to promulgate additional regulations implementing the whistle-blower provisions of the Act within 270 days of its passage. Moreover, the Office of the Inspector General of the SEC is directed to issue a report on the efficacy of the Acts whistle-blower incentive provisions within 30 months of the Act’s passage

^b The Dodd–Frank Act also contains provisions protecting whistle-blowers from retaliation for, among other things, providing information to the Commodities Futures Trading Commission or the Bureau of Consumer Financial Protection. See Dodd–Frank Act §§ 748 and 1057. These provisions are outside the scope of this advisory

^c The Sarbanes–Oxley Act originally contained a statute of limitations of 90 days The Dodd–Frank Act increased this 90-day period to 180 days and extended the formulation to include the time period “after the date on which the employee become aware of the violation”

situational variables (i.e., variables relating to organization and wrongdoing). Our study fits into the prior literature by investigating variables that an organization can implement to encourage more internal whistle-blowing.

Examination of the whistle-blowing literature shows that research about reporting channels that may influence observer’s tendency to report and/or the effectiveness of whistle-blowing is lacking. As previously stated, SOX requires publicly held companies to establish anonymous reporting channels. The inclusion of this requirement shows the recognition of the importance of whistle-blowing to the effectiveness of corporate governance. The KPMG Integrity Survey 2005–2006 (KPMG 2006) found that nearly three out of four employees indicated that they had observed misconduct in the prior 12-month period. This finding indicates the importance of companies having reporting channels available to their employees. According to the KPMG 2003 Fraud Survey (KPMG 2003), 41 % of the frauds were discovered by anonymous letters and 63 % by notification from an employee. In addition, the Association of Certified Fraud Examiners’ 2004 Report to Nations on Occupation Fraud and Abuse (ACFE 2004) found that tips are the number one way to discover fraud. These findings reconfirm the importance of whistle-blowing in fighting frauds.

Although some whistle-blowers claim that their decisions to whistle-blow are motivated purely by altruism, researchers consider whistle-blowing to be a prosocial behavior (Dozier and Miceli 1985; Gundlach et al. 2003), and not a pure altruistic behavior. Unlike altruism, prosocial behavior will benefit others as well as self. If whistle-blowing is motivated by pure altruism, the potential

whistle-blowers should not worry about retaliation as long as they perceive that their actions will benefit others (Dozier and Miceli 1985). Prior whistle-blowing research suggests that potential whistle-blowers go through a decision process which includes a cost-benefit analysis of their whistle-blowing decision (Miceli and Near 1985). Therefore, it is a reasonable inference that people’s intention to whistle-blow may be influenced if organizations can modify policies to minimize the costs and maximize the benefits associated with whistle-blowing.

The SOX whistle-blowing provision (i.e., the requirement of anonymous reporting channel) was the government’s attempt to encourage individuals working in the corporate sector to come forward with information regarding questionable activities. In theory, this provision was designed to provide protection to whistle-blowers by allowing whistle-blowers to report questionable acts anonymously. In terms of a cost-benefit analysis, the SOX whistle-blowing provision is trying to reduce the perceived costs (e.g., being identified as whistle-blower and being retaliated against) associated with whistle-blowing.

Offering financial bounties is also a common practice in police investigations. In terms of a cost-benefit analysis, providing financial bounties is attempting to increase the perceived benefits associated with whistle-blowing. Based on the premise that most individuals are reluctant to offer information related to crimes, Crime Stoppers specifically offers a cash incentive and offers anonymity to persons who come forward with details that lead to the arrest of suspected criminals. Founded in 1976 by Officer Greg Macaleese, Crime Stoppers uses cash rewards and anonymity as its primary incentive to promote participation.

Survey findings from the National Institute of Justice on National Crime Stopper programs reveal that these programs have been able to solve many “dead-end” cases due to widespread media coverage, the promise of anonymity and the opportunity for a monetary incentive. Rosenbaum et al. (1989) conducted a study to determine if reward size impacted Crime Stopper callers’ willingness to disclose relevant information. The results indicate that low, moderate, and moderately high reward conditions did not differ in their satisfaction with the reward, the perceived fairness, their belief in the effectiveness of Crime Stoppers, and their intentions to use the program again. In addition, the researchers further tested a hypothesis to determine if individuals with low income or criminal history or who directly attributed their participation to money (rather than anonymity) would be more disappointed by smaller rewards. Again, the results indicate that reward size did not interact with the informants’ financial status, past criminal history or initial interest in the reward money. In other words, the presence of the financial bounty and not the reward size impacted the informants’ willingness to disclose information. Given these research findings, many law enforcement officials and civic leaders still question the effectiveness and ethicality of offering financial rewards to promote participation in Crime Stopper programs. Although prior examples of incentive programs to encourage certain behaviors exist (participation in a corporate wellness programs, sales incentives programs, etc.), no empirical studies have determined if financial bounties could encourage whistle-blowing in the private sector.

There are advantages for organizations to set up financial bounties in efforts to encourage internal whistle-blowing. One advantage is it gives the organizations the opportunity to stop the wrongdoing and correct the problem early, which can help organizations avoid possible legal liabilities. Internal whistle-blowing also helps organizations avoid the negative publicity associated with fraudulent activity. If the employees do not feel that they have appropriate and safe internal whistle-blowing channels, they may be forced to go public with their information. Regardless of the outcome of the allegations, organizations’ reputation may be tarnished. A 1993 survey of 300 U.S. human resources executives show that there is a significant increase in the number of internal disclosures of possible wrongdoings by employees after companies implement internal disclosure policies. There is a corresponding significant decrease in external disclosures (Barnett et al. 1993).

Research on the effectiveness of financial bounties in the private sector is woefully lacking. Miceli and Near (1992) called for further research examining the effectiveness of financial rewards on people’s intention to whistle-blow. After eighteen years of their call for further research, our

literature search still did not yield any empirical study that examines the effectiveness of financial bounties on promoting whistle-blowing in the private sector. This study will examine whether the availability of these incentive programs will influence one’s intention to report questionable acts. This study adds to the existing academic and practitioner literature by determining which variables could improve corporate governance policies in the private sector.

Hypotheses Development

We will examine two potential ways that may encourage whistle-blowing. First, we will examine whether the availability of an anonymous reporting channel increases the overall reporting intention. The biggest concern for potential whistle-blowers is the possibility of retaliation. SOX’s provision to require public companies to have anonymous reporting channels is to battle whistle-blowers’ fear of retaliation by protecting their identities. Kaplan and Schultz (2006) examine how the presence of an anonymous reporting channel required by SOX affects one’s intention to report questionable acts using non-anonymous internal reporting channels (i.e., to management or to the internal audit department). Their results show that the availability of an anonymous reporting channel decreases one’s intentions to report using non-anonymous reporting channels (i.e., management and internal audit department). However, it is still unclear whether the availability of an anonymous reporting channel improves people’s overall intention to whistle-blow. While Kaplan and Schultz (2006) focus on one’s intention to report through non-anonymous reporting channels, we will focus on one’s overall intention to report, regardless of which channel is used. This issue is important because it is still uncertain whether the SOX’s requirement is effective in promoting whistle-blowing in general, regardless of the channel used. When people observe wrongdoing or questionable acts, they have options as to whether to remain silent or to report the observed acts. The decision depends on their evaluations of the perceived potential costs and benefits associated with whistle-blowing. The perceived potential costs primarily are in the form of retaliation such as loss of job. The perceived potential benefits include increased self-esteem, satisfaction resulting from “doing the right thing,” promotion, and financial rewards. Several studies found that threatened retaliation reduces the likelihood of whistle-blowing (e.g., Arnold and Ponemon 1991; Schultz et al. 1993). If people do decide to blow the whistle, they are more likely to report anonymously to reduce the possibility of being retaliated (Miceli et al. 1988; Near 1988). The availability of anonymous reporting channels may reduce the perceived potential costs associated with whistle-

blowing, thereby increasing one's intention to whistle-blow. This discussion leads to the first hypothesis:

H1 The availability of an anonymous reporting channel will increase one's overall intention to whistle-blow.

Second, we will examine whether the availability of a financial bounty affects one's overall intention to report. Both the Dodd–Frank Act and the False Claims Act permit a person with knowledge of fraud against the government to file a lawsuit on behalf of the government against the person or business that committed the fraud.² If the action is successful, the plaintiff receives a %age of the recovery, usually ranging from 15 to 30 %. The financial reward can be substantial, depending on the amount recovered by the government. The intention of the financial bounty is to encourage whistle-blowers to come forward to report questionable acts. Some research suggests that a cash incentive is not effective in encouraging whistle-blowing because a cash incentive is not perceived to be very important in one's decision to blow the whistle (Miceli and Near 1992). Using the False Claims Act as an example, this belief that financial bounties may be ineffective at increasing whistle-blowing may not be completely accurate. Before the 1986 revision of the False Claims Act, cases reported under the False Claims Act averaged ten per year. After the Act's revisions included a substantial financial bounty, the number of cases increased to 198 by 1,989 (Wartzman and Barrett 1989), inferring that the False Claims Act incorporates a rather effective financial bounty. In 2009, the Department of Justice recovered more than \$2.4 billion, with the majority of these claims coming from FCA whistle-blower initiated claims.

Based on the anecdotal evidence, we do expect financial rewards will increase one's overall intention to report questionable activity. Therefore, the following hypothesis is presented.

H2 The availability of a financial bounty will increase one's overall intention to whistle-blow.

In order to claim a financial bounty, a person must reveal their identity. Revealing one's identity not only increases the potential benefits but it also increases the potential costs. We are unsure how people will evaluate this trade-off. This issue is important because it is believed that non-anonymous reporting is more effective than anonymous reporting (Near and Miceli 1995). If one reports a questionable act through an anonymous reporting channel without giving his identity, it may be impossible for the whistle-blower to be contacted again to seek more information. As a result, an investigation may be delayed or terminated. We reason that if one is

motivated by the financial bounty to report questionable acts (after the cost-benefit analysis), then one's willingness to reveal his/her identity will be increased. Otherwise, the chance of getting the bounty (the perceived benefits of whistle-blowing) diminishes. Therefore, we advance the following hypothesis:

H3 The availability of a financial bounty will increase one's willingness to reveal his/her identity when an anonymous reporting channel is available.

Method

Participants

The participants for this study were ninety-seven evening part-time MBA students. One advantage of using evening MBA students is that they typically have substantial work experience. It is assumed that evening MBA students, through their work experience, have directly or indirectly seen or confronted many wrongdoings or questionable acts (Kaplan and Schultz 2006). We believe they are reasonable participants for the study that examines the intention to whistle-blow. Participants (mean age of 28 years; 51 % male) were from a large Midwestern urban university. Participants have an average of 6.19 years of working experience.³ Fifty percent of participants indicated that they have discovered a colleague engaging in wrongful behavior and 32 % of participants indicated that they have discovered a person of greater authority engaging in wrongful behavior. Forty-eight percent of our participants indicated for their current position they are evaluated, in part, by whether they meet financial or non-financial targets. These statistics lend support for our use of MBA students.

General Task

Participants were presented with materials containing general instructions and background information about a hypothetical company. The background information also included information about the availability of the anonymous reporting channel and the financial bounty, which were manipulated between subjects. Participants were randomly assigned to the four treatment groups. Next, participants were presented with the case scenario. Phil, the head accountant in an electronic manufacturing company, discovered that his superior altered the financial statements and sent them to the corporate headquarter office. Participants were asked to indicate their reporting intentions from the perspective of the employee of the case, Phil (third-

² An individual can only continue with a case under the Dodd–Frank Act if the government is interested in pursuing the alleged fraud.

³ Only two participants indicated that they do not have working experience.

person intention), and from the perspective of the first person (first-person intention). In addition, participants were asked how likely they are willing to reveal their identity.

Independent Variables

This study contained two independent variables: reporting channel (anonymous vs. non-anonymous) and financial rewards (yes vs. no). Both variables were manipulated between subjects. To manipulate the anonymous reporting channel, participants were either told; (1) it is the employees' obligation to report questionable acts to their supervisors or managers, or (2) that in an effort to go public, the company adopted the SOX's requirement to establish an anonymous reporting channel. Besides having an anonymous reporting channel option, employees still have the traditional reporting channels such as reporting to their supervisors or managers, and internal auditors. To manipulate the availability of the financial bounty, participants were either told; (1) nothing about the financial bounty, or (2) employees are able to receive a financial bounty up to 20 % of their annual salary if they report a questionable act or misconduct and the report is found to be accurate as a result of an investigation. The financial bounty program is monitored by the company's chief compliance officer (CCO).

Dependent Variable

After reading the case material, participants were asked to indicate their reporting intentions in two ways. One is to offer the response if they were the employee of the case. Participants were asked: "how likely would Phil (the employee of the case) be to report the instance of questionable behavior?" The other is to ask participants to offer their response in the first-person perspective. The question is: "How likely are you to report the instance of questionable behavior?" The reason for asking for two responses is that we are concerned about the social desirability effect. Through the use of the third-person perspective, participants may be more willing to share honestly. Prior research indicates that individuals' desire to maintain a positive self image seem to evaluate themselves in more favorable terms than they evaluate others (Brown 1986; Duck et al. 1995; Gunther and Thorson 1992).

A seven-point scale was used to measure reporting intention (1 = extremely unlikely, 7 = extremely likely).

Under the anonymous reporting and non-anonymous reporting channels, participants have the options to reveal or conceal their identity. For example, when the anonymous reporting channel is unavailable, the employee can

write a letter but not include his/her name on the letter. Likewise, when the employee reports through the anonymous reporting channel, he or she can still reveal his/her identity to increase the credibility of the report or claim the reward. Therefore, we include a question asking participants how likely they will reveal their identity (on a 7-point scale with 7 indicating extremely likely).

Validation of the Case

To validate the case, participants were asked to indicate their perceived seriousness of the questionable act described in the case on a 9-point scale (1 = not serious at all, 9 = very serious). The mean for their responses is 7.52 with standard deviation of 1.45.

Results

Effective randomization among the four treatments suggests similarity among the treatments in terms of demographic variables. No significant differences among treatments were detected regarding age ($F = 1.24$, $p = .31$), working experience ($F = 1.43$, $p = .24$), and gender ($\chi^2 = 1.13$, $p = .77$). The post-experimental questionnaire asked participants to rate the seriousness of the questionable act described in the case, how angry they feel after learning about the questionable act, assess personal costs when employees identify themselves when informing the company of the questionable act described in the case, and employees' personal responsibility to proactively inform the company of the questionable act on a 9-point Likert scale (with 9 indicating very high). There are no significant differences among treatment groups. These results are consistent with effective randomization.

Hypotheses one and two test whether the availability of an anonymous reporting channel (H1) and a financial bounty (H2) will influence participants' propensity to report questionable acts. Anonymous reporting channels and financial bounties are between subject variables at two levels each. Participants' reporting intention (first-person response or third-person response) was analyzed separately using an analysis of variance (ANOVA). The analysis was conducted using the general linear models program of SAS. Table 3 presents the descriptive statistics on the reporting intentions by the two variables of study. Panel A presents the means and standard deviations of the third-person reporting intention (employee of the case). Participants in the non-anonymous reporting channel and financial reward group (non_A + FR) indicated the highest intention to report the questionable behavior. Table 4 Panel A represents the ANOVA result for the third-person reporting

Table 3 Descriptive statistics on third-person (employee of the case) reporting intentions

| | Non-anonymous reporting | Anonymous reporting |
|---|-------------------------|---------------------|
| Panel A: Mean (and standard deviation) by treatment for third-person (employee of the case) reporting intention | | |
| No financial rewards | 4.20 (1.44) | 4.27 (1.80) |
| Financial rewards | 5.23 (1.34) | 4.67 (1.47) |
| Panel B: Mean (and standard deviation) by treatment for first-person reporting intention | | |
| No financial rewards | 5.68 (1.29) | 5.50 (1.29) |
| Financial rewards | 5.84 (1.28) | 5.62 (1.58) |

Table 4 ANOVA results

| | <i>F</i> value | <i>p</i> |
|---|----------------|----------|
| Panel A: ANOVA results on the third-person (employee of the case) reporting intention | | |
| Reporting channel | .62 | .43 |
| Financial rewards | 5.22 | .03 |
| Report*Reward | 1.02 | .32 |
| Panel B: ANOVA results on first-person reporting intention | | |
| Reporting channel | .53 | .47 |
| Financial rewards | .24 | .63 |
| Report*Reward | .006 | .94 |

F value for the overall model is 2.22, *p* = .09, *R*² = .07

F value for the overall model is .26, *p* = .85, *R*² = .008

intention and the financial rewards which is statistically significant at the 0.01 level. Therefore, participants were more likely to report questionable acts when there are financial rewards available. However, the results for the first-person reporting intention were not consistent with the results for the third-person reporting intention. Table 3, Panel B presents the descriptive statistics on the first-person reporting intention. Participants in the non-anonymous reporting channel and non-financial-reward group (non_A + non_FR) indicated the highest intention to report the questionable behavior. Table 4, panel B presents the ANOVA result for the first-person reporting intention and none of the variables are statistically significant. Based on the ANOVA results, H1 is not supported. The availability of an anonymous reporting channel has no effect on people's intentions to report questionable acts.

Hypothesis 2 is partially supported. When participants were asked to indicate the third-person intention to report questionable acts, the availability of financial rewards increased their intention to report. However, when they were asked to indicate the first-person intention, there was

Table 5 Mean (and standard deviation) by treatment for the likelihood to reveal identity

| | Non-anonymous reporting | Anonymous reporting |
|---|-------------------------|---------------------|
| Panel A: Third-person's likelihood to reveal identity | | |
| No financial rewards | 3.13 (1.88) | 2.67 (1.41) |
| Financial rewards | 3.23 (1.72) | 4.22 (1.80) |
| Panel B: First-person's likelihood to reveal identity | | |
| No financial rewards | 3.26 (2.12) | 3.11 (1.53) |
| Financial rewards | 3.64 (2.06) | 4.72 (1.87) |

no effect. These findings are consistent with the research on third-person effect and social desirability. Participants were more willing to accept the financial reward when they viewed the third person accepting the money than how they would personally respond to the financial reward.

Hypothesis three states that participants may be more willing to reveal their identities when reporting questionable acts when the financial rewards are available. Participants were asked to indicate how likely they would reveal their identity. Table 5, Panel A and Panel B report the means and standard deviations of the likelihood that participants will reveal their identity. For both first-person and third-person reporting, the results are qualitatively similar so only the third person *t* test results are reported here. The mean likelihood level for the anonymous reporting channel and financial bounty (A + FR) was greater than the mean likelihood level of the anonymous reporting channel and non-financial bounty (A + non_FR) (*t* = 2.66, *p* < .01), the non-anonymous reporting channel and financial reward (non_A + FR) (*t* = 1.79, *p* < .08), and the non-anonymous reporting channel and non-financial-reward (non_A + non_FR) (*t* = 2.19, *p* < .03). Participants are most likely to reveal their identity for a financial bounty. This result suggests that the potential financial rewards outweigh the potential cost associated with being identified as a whistleblower. In other words, the participants were more likely to choose to reveal their identities to receive the financial bounty than to remain anonymous and not receive a financial reward. Although additional studies are needed, these findings suggest that the incorporation of a financial bounty within the Dodd-Frank Act could potentially increase employees' propensity to report questionable activity.

Discussion

In anticipation for an increase in alleged fraud tips, the SEC has set aside \$450 million towards a whistle-blower fund as a result of the Dodd-Frank Act. The ACFE's 2004 Report to the Nation indicates that 60 % of the fraud cases, were detected by tips from employees, 20 % came from

customers and only 13 % came from anonymous sources. Although many companies have devoted a significant amount of resources in establishing anonymous reporting channels, the results from this study indicate that anonymous reporting channels may be an ineffective mechanism for encouraging whistle-blowing. Dyck et al. (2007) find that monetary incentives for detection in frauds against the government significantly increase detection without increasing frivolous suits. Accordingly, a joint report by the CSO Executive Council, The Network and the ACFE indicate that employees reporting corruption and fraud incidents were less likely to remain anonymous than any other reporting incident category. Therefore, the presence of an anonymous reporting channel embedded in SOX may be ineffective at encouraging employees to come forward with questionable acts. Our findings indicate support for this statement and further research is needed in determining the reasonableness of anonymous reporting channels.

Although some organizations may be reluctant to incorporate a financial bounty program, this is not an uncommon practice for many organizations. The Centers for Medicare and Medicaid Services began their Incentive Reward program in 1998 to recover funds from health care providers, who engaged in fraud and against the Medicare program. Kohn (1993) cites the monetary incentive programs encourage compliance. Given that researchers have cited whistle-blowing as being a prosocial behavior (Dozier and Miceli 1985; Gundlach et al. 2003), and not only a pure altruistic behavior but also financial bounties may be a cost-effective governance tactic to promote the reporting of questionable acts. In addition, the passage of the Dodd–Frank Act further exacerbates the need for all organizations to maintain a sound compliance culture. Given that the Dodd–Frank Act whistle-blower-protection provisions apply to all employers, not just public companies, it is imperative that organizations establish internal reporting mechanism that encourages whistle-blowing policies.

Read (2005) argues that monetary incentives have their effect on one of the following factors; (1) cognitive exertion, (2) motivational focus, and (3) emotional triggers. Cognitive exertion means that the incentive increases the amount of thought put in the task; motivational focus means that the incentive changes the agent's goals; and emotional triggers mean that the incentive is a prerequisite for the agent to predict their response. We believe that our findings show that participants viewed the receipt of the financial bounty as something that would moderate the impact of being classified as a whistle-blower. Furthermore, empirical studies are needed to investigate employees' perception of the incorporation of financial bounty programs to improve organizational governance.

Incentive programs may also improve the “tone at the top” and signal to employees that upper-level management

values the knowledge and insight employees have. Many employees fail to report misconduct because they feel that their reporting will not make an impact. However, formal compliance programs that incentivize whistle-blowing may decrease employees feeling of futility.

Although our findings have corporate governance implications, our study does have some common limitations of research of this nature. First, it is difficult to replicate the real-world pressures and rewards in an experimental setting. While we attempted to create a realistic dilemma, it is difficult to incorporate the true impact of the receipt of a financial bounty in the case.

A second limitation is the use of evening part-time MBA students as participants. Although a large percentage (53 and 34 % observed colleagues and superiors engaging in wrongful behavior) of our participants have experienced someone engaged in wrongful misconduct, we are sensitive to the fact that our student participants may react to the case material differently in an actual scenario. Lastly, the generalizability of our findings may be limited to the fact that we only incorporated one case to form the basis of our analysis.

We believe that our findings from this study answer the Miceli and Near (1992) call of 18 years ago to provide additional work in the financial incentives area. Potentially, compliance officers, audit committees and boards of directors could find the results of this research useful in drafting internal policies that can motivate beneficial employee behavior.

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