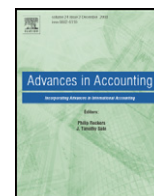




Contents lists available at SciVerse ScienceDirect

Advances in Accounting, incorporating Advances in International Accounting

journal homepage: www.elsevier.com/locate/adiac

An examination of anonymous and non-anonymous fraud reporting channels

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ARTICLE INFO

Keywords:

Whistleblowing
Anonymous reporting channels
Non-anonymous reporting channels
Retaliation
Repercussions
Fraudulent financial reporting

ABSTRACT

Interest in the role of the reporting channel on whistleblowing has been fostered by the passage of the Sarbanes-Oxley Act of 2002, which requires that audit committees of public companies establish and oversee an anonymous reporting channel for questionable accounting or auditing matters. But only limited information exists as to the likely effectiveness of such a channel as compared to a non-anonymous channel. The purpose of our paper is to report the results of an experimental study examining participants' intentions to report fraud using anonymous and non-anonymous reporting channels given information about the outcomes from a previous non-anonymous whistleblowing incident. The experiment manipulates the outcomes to both the previous whistleblower and to the transgressor. We find that while negative outcomes from the perspective of a previous non-anonymous whistleblower (either the occurrence of retaliation against that person or no negative repercussions to the previous transgressor) lowered participants' non-anonymous reporting intentions, these negative outcomes did not decrease participants' anonymous reporting intentions. But when, no such negative outcomes from the previous whistleblower's perspective have occurred, our participants' reporting intentions did not differ between the anonymous and non-anonymous channels.

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1. Introduction

In response to a series of high-profile financial statement frauds, Congress passed the Sarbanes-Oxley Act of 2002, which, in part, made several changes directed towards strengthening public companies' internal controls and expanding the responsibilities of audit committees. Under Section 301, audit committees of public companies are required to establish and oversee a reporting channel for anonymous employee reporting of questionable accounting or auditing matters. Presumably, requiring an anonymous reporting channel strengthens internal control related to fraud detection by ensuring that employees have access to a reporting channel with relatively low personal costs.

But establishing and operating an anonymous reporting channel is costly to public companies. Ordinarily, such a reporting channel is not intended to and need not displace other reporting channels, such as reporting non-anonymously and directly to a superior. Indeed, regarding reporting channels, best practices include the availability of multiple channels for employees to report their concerns about illegal and unethical behavior (e.g., ACFE 2005; The Network, Inc., 2006). Thus, even when an audit committee for a public company has established an anonymous reporting channel, informal reporting channels will generally be available which allow employees to non-

anonymously report questionable acts to a superior. Given multiple channels, circumstances in which such a channel outperforms a non-anonymous channel are uncertain and not addressed by prior research.

In this paper we present the results of an experimental study that provides new evidence on whether the availability of an anonymous reporting channel, relative to a non-anonymous reporting channel, improves reporting intentions in settings where individuals may be particularly hesitant to report fraud.¹ We specifically focus on fraudulent financial reporting as the wrongdoing incident because of the large organizational and societal costs related to fraudulent financial reporting and because the anonymous reporting provisions in SOX are specifically intended as a reporting channel for questionable accounting such as fraudulent financial reporting. Participants in the study were online MBA students who were attending a meeting on campus. They received background information about a company and a single scenario describing the discovery of another employee

¹ Much of the prior research in this area is field- or survey-based (Mesmer-Magnus and Viswesvaran, 2005). While these methods have a number of advantages, they generally are not able to control for a variety of potentially relevant factors such as the rank of the participant, the organizational and ethical culture of the organization, the opportunity for observing wrongdoing, the severity of the wrongdoing, and the available channels for reporting wrongdoing. Using an experimental approach allows us to isolate the effect of the manipulated variable of interest, while holding constant the information about the fraudulent financial reporting and the related context in which it occurs. See Maines, Salamon, and Sprinkle (2006) for an excellent discussion of advantages and disadvantages of experimental research approaches.

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engaging in a fraudulent financial reporting act. Participants, assuming they were facing the situation described in the scenario, provided their intention to report the act through (1) a non-anonymous reporting channel and (2) an anonymous reporting channel.

In a between participants design, information about the organization's follow-through outcomes from a previous non-anonymous whistleblowing incident was manipulated, as follows: (1) the presence or absence of retaliation taken against a previous whistleblower, and (2) the presence or absence of negative repercussions taken against a previous transgressor.² Consistent with our hypotheses, we find that participants' reporting intentions for the non-anonymous, but not the anonymous, reporting channel are significantly lower under either condition that discourages reporting. Furthermore, we find that when a previous whistleblower faced retaliation or when a previous transgressor did not face negative repercussions, non-anonymous reporting intentions were significantly lower than anonymous reporting intentions. But when no such negative outcomes from the perspective of the whistleblower existed, non-anonymous reporting intentions did not differ significantly from anonymous reporting intentions.³

In the next section of the paper we develop the study's hypotheses and research questions. This is followed by discussions of our research method and results. The final section of the paper addresses the study's implications as well as its limitations.

2. Development of hypotheses and research questions

The 2010 Association of Certified Fraud Examiners (ACFE) *Report to the Nations on Occupational Fraud and Abuse* (2010, 16–17) states that tips, most frequently from employees, are the single most frequent source leading to the detection of fraud. Yet, research results suggest that only about half of all employees who observe wrongdoing report it (Miceli et al. 2008, 22). One approach to increase fraud reporting is to provide employees with more than one reporting method. To the extent that an individual's decision on whether to report wrongdoing is based upon a consideration of the costs and benefits (Gundlach, Douglas, & Martinko, 2003; Hooks, Kaplan, & Schultz, 1994; Miceli and Near, 1985), analyzing reporting alternatives, which trigger different costs and benefits, represents an important topic for research.

Mesmer-Magnus and Viswesvaran (2005) perform a meta-analysis of previous research and conclude that in general the threat of retaliation is negatively associated with intentions to report wrongdoing. Miceli et al. (2009, p. 380) speculate that increases in the threat of retaliation may influence whether whistleblowers report internally (e.g., to a reporting channel within the company) or externally (e.g., to a reporting channel not under the company's control).

Concerning anonymous vs. non-anonymous reporting channels, Ayers and Kaplan (2005) report that reporting intentions were similar across two cases, each involving ethical problems related to an enterprise resource planning software implementation. Kaplan and Schultz (2007) find that the availability of an anonymous reporting channel tended to reduce the likelihood of reporting to non-anonymous channels. While both of these studies considered

multiple types of wrongdoing, neither explicitly considered situations where individuals, based on the specific contextual factors, may be especially hesitant to report wrongdoing.

We contend that the follow-through outcomes on a previous whistleblowing incident will change either the expected costs or expected benefits to employees as they consider using either an anonymous or non-anonymous reporting channel and that this will affect the likelihood of whistleblowing. This is consistent with Mesmer-Magnus and Viswesvaran (2005, p. 281) who suggest that, "It is assumed that a whistleblower's experiences (perceived or actual, reward or retaliation) following a whistleblowing event will have strong effects on others' willingness and likelihood to blow the whistle in the future."

In our study, participants receive information about the outcomes to the whistleblower and transgressor from a previous whistleblowing incident. Specifically, participants received information that retaliation against a previous whistleblower either did or did not occur and that the transgressor of the previous incident either suffered or did not suffer negative repercussions. Because it was important to provide outcome information about a previous whistleblower, the previous incident involved the use of non-anonymous reporting. That is, it may seem unrealistic that retaliation would be taken against a previous whistleblower who reported anonymously.

2.1. Information about retaliation against previous whistleblower

Rehg, Miceli, Near, and Van Scotter (2008, 222) define retaliation against whistleblowers to be "the undesirable action taken against a whistle-blower – and in direct response to the whistle-blowing – who reported wrongdoing internally (i.e., within the organization) or externally (i.e., outside the organization)." ⁴ While limited, the available data suggests that retaliation against whistleblowers occurs frequently. For example, Miceli et al. (1999) report that 17% to 38% of whistleblowers in random samples of federal employees have faced retaliation. A more recent study places the percentage at 37% for employees of a military base (Near et al., 2004). Dyck, Morse, and Zingales (2007 62–63), in examining extremely large corporate fraud cases (companies with over \$750 million in assets), report that in 13 of 16 non-anonymously reported cases, the individual involved was fired, resigned, or had significantly reduced responsibilities, although in 14 other cases the resolution was unknown.

We expect that information about whether a previous whistleblower, reporting non-anonymously, suffered retaliation will influence reporting intentions for a subsequent fraudulent act. Specifically, we suspect that whether retaliation has been suffered by a previous whistleblower will be used as a signal of whether subsequent potential whistleblowers face an elevated prospect of retaliation. Retaliation represents a potential cost of whistleblowing. Other things equal, increases in one's personal costs should decrease one's likelihood of whistleblowing. If a previous whistleblower has suffered retaliation, this signals that one's personal costs from non-anonymous reporting are likely to be very high. Consequently, we expect that information about a previous whistleblower who has suffered retaliation will decrease non-anonymous reporting intentions.

But will retaliation against a previous whistleblower who used a non-anonymous channel also affect a subsequent potential whistleblower's anonymous reporting? To the extent individuals believe that anonymous reporting offers a mechanism to protect one's identity, thus minimizing one's exposure to retaliation, retaliation against

² The overall study also includes a fifth form of the research instrument, not crossed with this design, which is used as a control to describe a situation in which the participant has no information on a previous whistleblower or transgressor. Results relating to that form of the instrument ($n = 20$) are presented in the "Supplemental Analysis" section of the paper.

³ Miceli et al. (2009) also suggest that increases in the threat of retaliation may influence whistleblowers' reporting channel. In this regard, they suggest that threats of retaliation increases the tendency for whistleblowers to report to the media or others outside the company. Results from Rehg et al. (2008) indicate that the increases in the threat of retaliation increase the external whistleblowing among women but not men. Neither paper, however, discusses the potential relation between threat of retaliation and anonymous internal reporting.

⁴ In a similar vein, Rehg (1998, p. 17) states, "retaliation against whistleblowers represents an outcome of conflict between an organization and its employee, in which members of the organization attempt to control the employee by threatening to take, or actually taking, an action that is detrimental to the well-being of the employee, in response to the employee's reporting, through internal or external channels, a perceived wrongful action."

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