Study says financial awards can actually discourage whistleblowers from reporting fraud

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Financial awards can unintentionally discourage a whistleblower from reporting fraud in a timely manner by hijacking their moral motivation to do the right thing, according to a new study by researchers at Florida Atlantic University, Wilfrid Laurier University and Providence College.

"When you mention financial incentives to potential whistleblowers, you change the decision frame from 'doing the right thing' to that of a cost-benefit analysis," said James Wainberg, Ph.D., assistant professor of accounting at FAU's College of Business and co-author of the study with Leslie Berger, Ph.D., assistant professor of accounting at Wilfrid Laurier University and Stephen Perreault, Ph.D., associate professor at Providence College School of Business. "As a result, when the perceived risks of reporting are greater than the potential rewards, people will be much less likely to report frauds than had they not been told about the existence of an incentive program to begin with."

A number of companies and regulatory agencies either currently offer, or are considering to offer, financial incentives to encourage whistleblowers to report unethical behavior, with many applying minimum value thresholds for reward eligibility. For example, the Securities and Exchange Commission only offers financial incentives if the whistleblower's reporting leads to a recovery of $1 million or more and for the Internal Revenue Service, that threshold is as high as $2 million.

The researchers looked at the psychological theory of motivation crowding to examine whether the inclusion of minimum thresholds can unwittingly increase the likelihood that certain identified frauds will go unreported.

Participants in the experiment, which included auditors and accountants, were provided with a vignette describing the discovery of fraud committed by a superior and were asked to assess the likelihood that a potential whistleblower would report the fraud through a whistleblower hotline. Their responses indicate that when incentives were available, but the size of the fraud was less than the prescribed minimum threshold, participants assessed a lower likelihood that the fraud would be reported in a timely manner.

"What's going on is this hijacking of the moral decision frame by the financial incentives," Wainberg said. "Once that happens, whether or not to report the fraud will largely become a function of an individual's perceptions of reward adequacy in light of the perceived risk of reporting. So that's a caution to regulators, compliance professionals and others in corporate governance who are interested in understanding the strengths and weaknesses of offering financial incentives to whistleblowers."

The study, recently published in *Auditing: A Journal of Practice & Theory*, also found that when minimum thresholds for rewards are employed, there was a greater likelihood that the whistleblower would strategically delay reporting the fraud (i.e., wait for the fraud to grow in size before reporting). This finding is particularly problematic since the early detection of fraud is a critical factor in minimizing potential damages and securing access to evidence.

"What our study finds is that people may unlawfully wait for the fraud to increase in size before reporting it," Wainberg said. "The question we need to ask is do we really want to incentivize whistleblowers to delay reporting frauds in order to maximize their rewards?"

Provided by Florida Atlantic University

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