Study Supports Claim that Whistleblowing Improves Business Practices

By Michael A. Filoromo, III
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Many people have strong opinions about employees who speak out about wrongdoing or illegal activity in the workplace. To some, whistleblowers are heroes whose courage against corporate misconduct is a public service that benefits all of us. To others, whistleblowers are mercenaries who seek fame or fortune at the expense of their employers. The question that is often overlooked in thinking about the value of whistleblowing is whether whistleblowers actually improve the way companies do business? A researcher at the University of Iowa decided to study the effect of whistleblowing on corporate financial reporting and tax practices to see if any lasting benefits follow from employee disclosures.

The Wilde Whistleblower Study

In an article entitled “The Deterrent Effect of Employee Whistleblowing on Firms’ Financial Misreporting and Tax Aggressiveness,” published in The Accounting Review, Professor Jaron H. Wilde reported the results of a study of how companies have responded to whistleblowing allegations. Wilde focused primarily on whistleblowers who asserted retaliation claims under the Sarbanes-Oxley Act (SOX), a law that applies to public companies, as well as their subsidiaries and contractors. SOX prohibits an employer from taking an adverse employment action against an individual who reports one of six categories of misconduct, including mail fraud, wire fraud, bank fraud, securities fraud, any Securities and Exchange Commission (SEC) rule or regulation, or any federal law pertaining to fraud against shareholders.

To assert a claim under SOX, an employee must file a charge with the Occupational Safety and Health Administration (OSHA) within 180 days of the adverse action. To determine which companies had been subject to SOX retaliation claims, Wilde submitted a Freedom of Information Act (FOIA) request to OSHA for charges submitted between 2003 – the first full year SOX was in effect – and 2010. Of these charges, he analyzed allegations relating to 317 public companies in the United States.

Wilde then looked to the financial reporting, including SEC filings, of these 317 public companies and compared them to control data from public companies that had not faced retaliation allegations under SOX. Wilde found that the companies that had been named in SOX retaliation charges experienced a decrease in the number of accounting irregularities after the charges were filed and were less likely to be aggressive in tax avoidance, as compared to the control group. Based on the available data, Wilde could not say how long these effects lasted but observed that, for the companies studied, the effects lasted for at least two years.

Limitations of the Study

Wilde’s study provides important insight into the effect of holding companies accountable for retaliation against whistleblowers, but the findings do have some limitations. Wilde studied just the first seven years of SOX enforcement, for example, and only examined retaliation cases that were
filed with OSHA. By looking at formal complaints alone, Wilde’s data omits information about cases where employees settled potential SOX claims privately without filing a charge or where workers have blown the whistle internally and opted not to pursue legal action of any kind. Thus, some of the companies in the control group might also have been subject to SOX whistleblower allegations that did not come to light. Additionally, companies in both the experimental and control groups may have been targets of other enforcement actions or allegations based on whistleblower tips submitted to the SEC, the Internal Revenue Service, or the Commodity Futures Trading Commission.

While more research remains to be done, Wilde’s preliminary findings suggest that, regardless of negative stereotypes about their motives, whistleblowers who speak up against financial misconduct may have a meaningful impact on how companies operate and how transparent they are with regulators and the investing public. The protections and incentives afforded to whistleblowers under the law are thus critical to ensuring that we are able to keep companies honest and accountable.