

February 6

2014

Whistleblower Protection: Key To Transparency and Accountability

NWCC | NATIONAL
WHISTLEBLOWERS
CENTER

WWW.WHISTLEBLOWERS.ORG

Prepared by:
Stephen M. Kohn

Table of Contents

Table of Contents	2
Summary of Findings.....	3
Part I: Employee Disclosures Are Essential for the Detection of Fraud.....	4
Part II: Employees are Reluctant to Report Fraud	7
Part III: The FCA is a Successful Model for Improving the Disclosure of Fraud	11
Part IV: Monetary Incentives: Key to a Successful Whistleblower Program	14
Part V: ERC: “Retaliation Against Whistleblowers At All Time High”	15
Part VI: U.S. Whistleblower Laws that have Transnational Application should be Promoted and Utilized.....	16
Part VII: Fraud Detection Programs Should be Implemented.....	17
Conclusion: Whistleblower Protections Laws are Essential for Fraud Detection.....	18
Appendix - Fraud Checklist	19
About the National Whistleblower Center	22

Summary of Findings



- Employees or “tipsters” are the single most important source of fraud detection.
- The overwhelming majority of employees are afraid to report fraud to the appropriate authorities.
- Robust whistleblower protection programs remain the safest and most effective method of ensuring that fraud is reported and properly addressed.
- The existence of employee rewards programs have successfully increased the government’s ability to detect and punish fraud. Whistleblower reward programs that potentially pay large rewards have had a remarkably successful deterrent effect on wrongdoers and have stimulated voluntary compliance with key anti-fraud laws.

Part I:

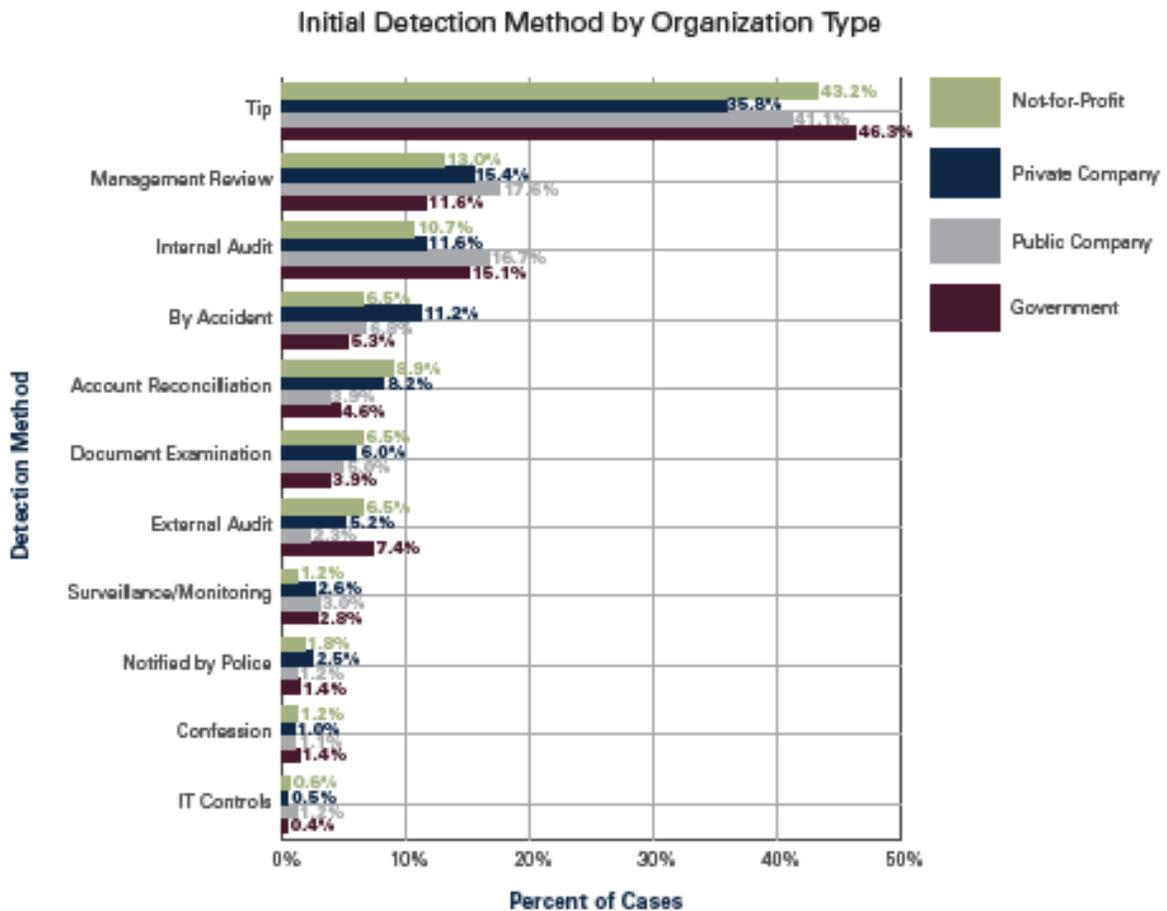
Employee Disclosures are Essential for the Detection of Fraud



“While tips have consistently been the most common way to detect fraud, the impact of tips is, if anything, understated by the fact that so many organizations fail to implement fraud reporting systems.”

*Association of Certified Fraud
Examiners, Global Fraud Study
2010*

Association of Certified Fraud Examiners Findings: WHO DETECTS FRAUD?





Part II: Employees are Reluctant to Report Fraud

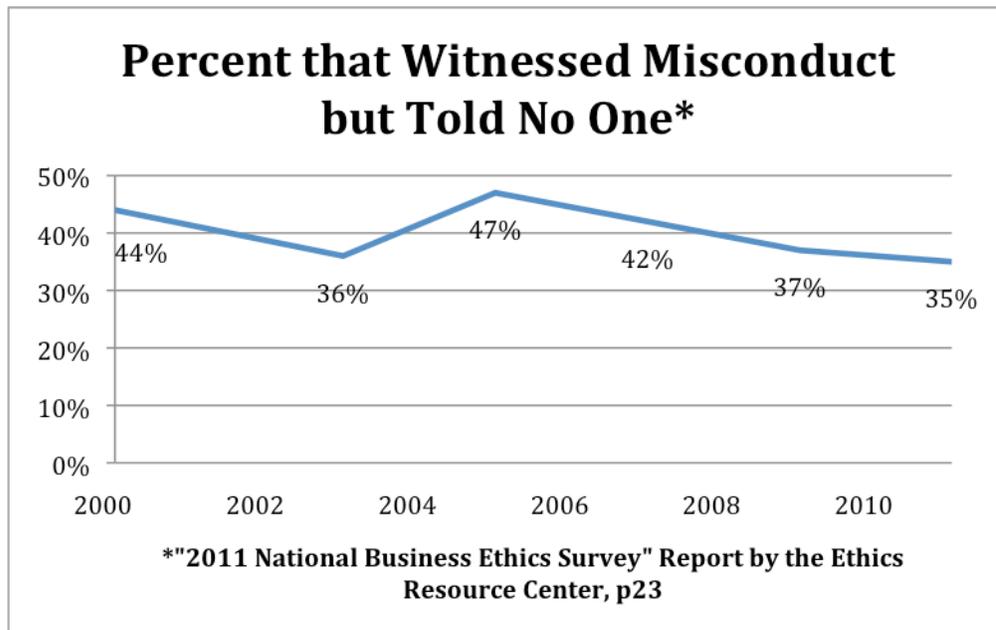
“One of the critical challenges facing both [Enforcement and Compliance] officers and government enforcement officials is convincing employees to step forward when misconduct occurs.”

*Ethics Resource Center Report “Blowing the Whistle on Workplace Misconduct,”
December 2010*

Employee Reporting Behaviors

The Ethics Resource Center (“ERC”) studied employee reporting behavior trends between 2000 and 2011. See ERC, “Blowing the Whistle on Workplace Misconduct,” (2012).¹

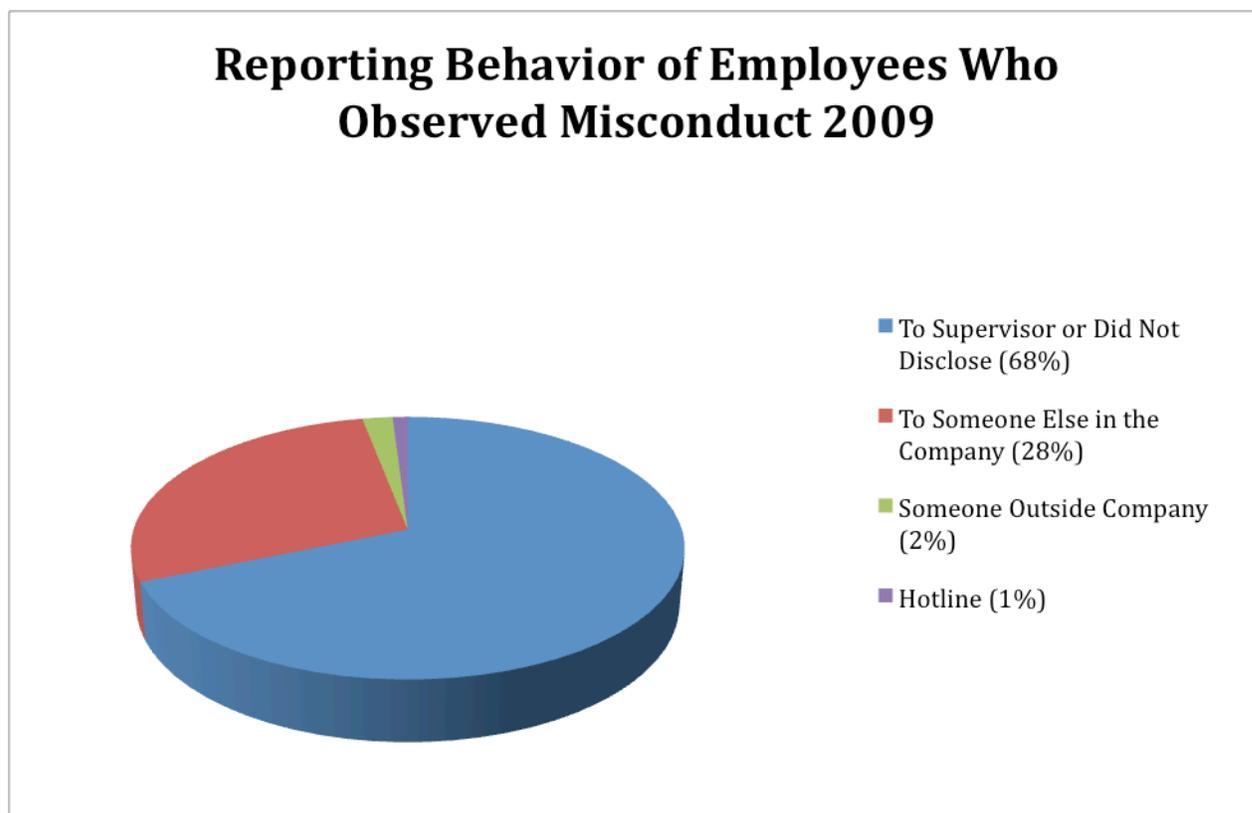
As set forth in the following chart, over a ten-year average, 40.2% of employees who witness fraud or misconduct *do not report this misconduct to anyone*. The numbers reported have remained relatively constant, even after the enactment in 2002 of section 301 of Sarbanes-Oxley Act, the law that mandated every publicly traded corporation to establish an employee concerns program that accepted confidential submissions from employees.



¹ The ERC was founded in 1922 and describes itself as “America’s oldest nonprofit organization devoted to the advancement of highly ethical standards and practices in public and private institutions”. According to its website, ERC is predominantly sponsored by the regulated community including corporations such as BP, Raytheon, Dow, Lockheed, Martin, and Lilly. Many of these companies have been successfully prosecuted under the FCA.

Disclosing Misconduct

The ERC also studied the reporting behavior of the approximately 60% of workers who were willing to report misconduct. Based on these surveys the following picture emerges regarding the actual willingness of employees to report misconduct to *anyone*.



*Based Directly on the 2010 ERC Whistleblowing Report, See Exhibit 15

Based on these numbers the Ethics Resource Center concluded that the “critical challenge” facing both “corporate compliance programs” and “government enforcement officials” is to “convinc(e) employees to step forward when misconduct occurs.”

In other words, the overwhelming majority of employees who detected fraud and misconduct failed to report their observations to hotlines and other internal compliance programs. They also failed to report their concerns to appropriate law enforcement officials.



Failure of Employees to Disclose Misconduct Directly to the Government is a Significant Regulatory Concern

Only 2% of all employees who are willing to report misconduct eventually disclose that misconduct “outside” their company. It is unclear from the ERC statistics as to how many of the 2% reported their concerns to the appropriate regulatory agencies, or simply when to non-governmental organizations or employment discrimination agencies.



Part III: The False Claims Act is a Successful Model for Improving the Disclosure of Fraud

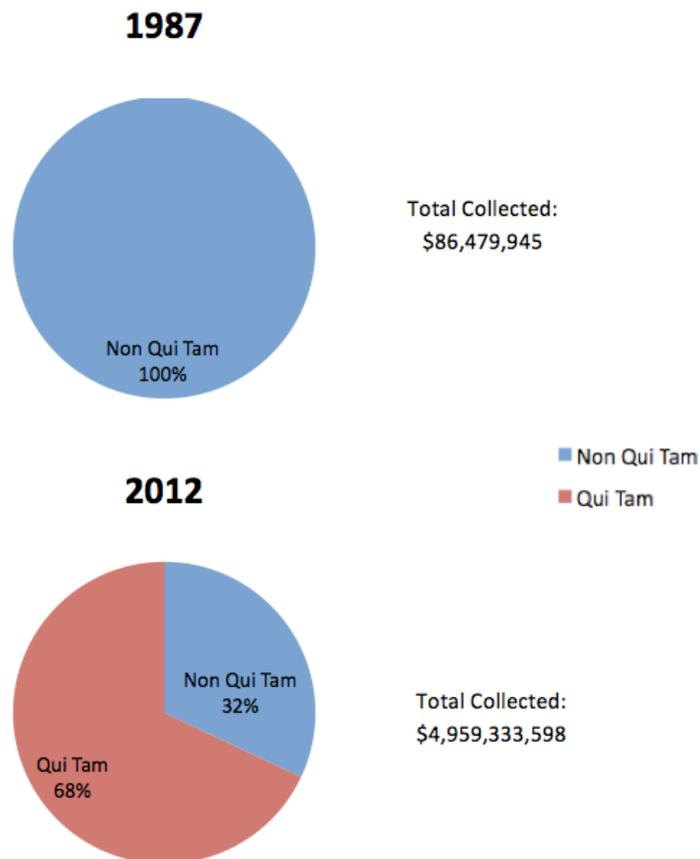
The False Claims Act was originally enacted in 1863. In 1943, it was amended and the ability for employee whistleblowers to utilize the law was effectively eliminated. In 1986, the FCA was amended again, resurrecting the *qui tam* provisions in the original 1863 act. The Act was further strengthened in 2009 and 2010.

The False Claims Act: It Works

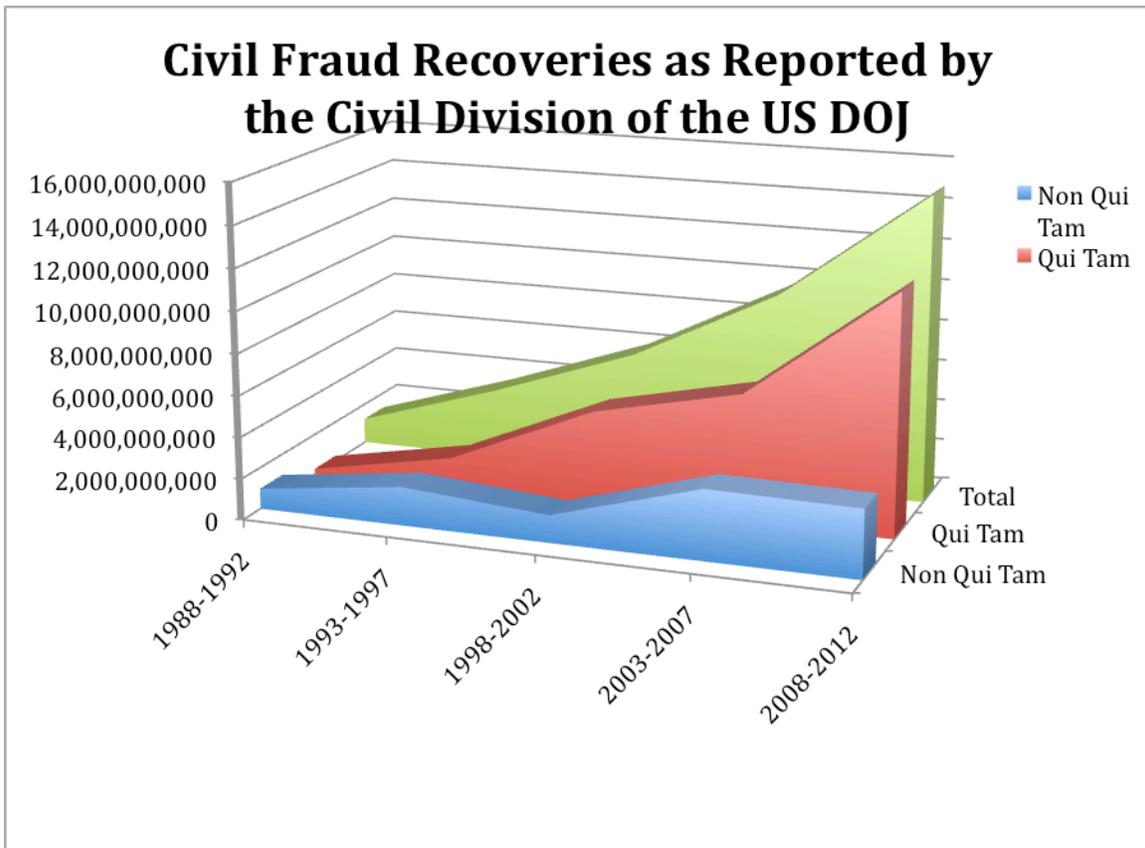
Objective statistics published every year by the US Department of Justice Civil Fraud Division² unquestionably demonstrate that whistleblowers have actually recovered billions of dollars for taxpayers and that whistleblowers are the single most important source of information permitting the United States to recover funds from corrupt contractors.

As can be seen from the above charts, since the enactment of the FCA, the amount of overall civil recoveries obtained by the United States has dramatically increased from 89 million in 1986 (prior to whistleblower rewards program) to the \$4.95 billion dollars in 2012.

FCA Recoveries: 1987 and 2012



² Justice Department Statistics, *See Exhibit 19*



The Act's statistics actually undervalue the contribution of whistleblowers. The threat that an employee will report fraud under the FCA to the government creates a powerful incentive for companies to ensure compliance with the law. The deterrent value of the FCA is not subject to objective quantification.

Part IV:

Monetary Incentives: Key to Successful Whistleblower Program

The University of Chicago Booth School of Economics conducted the most comprehensive and objective study into whether whistleblower reward programs work.³ Their study was based on an “in depth” study of “all reported fraud cases in large U.S. companies between 1996 and 2004.”

There conclusions clear:

“Employees clearly have the best access to information.”

“[W]e find that in 82 percent of cases, the whistleblower was fired, quit under duress, or had significantly altered responsibilities.”

“Not only is the honest behavior not rewarded by the market, but it is penalized.”

“A strong monetary incentive to blow the whistle does motivate people with information to come forward.”

“[M]onetary rewards [have] a significant impact on the probability a stakeholder becomes a whistleblower.”

“Monetary incentives seem to work well, without the negative side effects often attributed to them.”

³ *Who Blows the Whistle on Corporate Fraud*, by professors Alexander Dyck (University of Toronto), Adair Morse (University of Chicago) and Luigi Zingales (University of Chicago).

Part V:

Ethics Resource Center: “Retaliation Against Whistleblowers at All-Time High”



The ERC's conclusion was direct and blunt: *“Retaliation against whistleblowers at all-time high.”*

Part VI:

U.S. Whistleblower Laws that have Transnational Application should be Promoted and Utilized

Three United States whistleblower laws have transnational application. Citizens of foreign countries should be educated in these laws and encouraged to use them, where appropriate.

U.S. laws with potential transnational application:

- * False Claims Act: Fraud in contracts, grants and/or goods and services paid for by U.S. government funds. This includes foreign aid grants and U.S. government contracts awarded to foreign companies.
- * Foreign Corrupt Practices Act: Permits foreign nationals to qualify for monetary rewards for reporting illegal bribes paid by U.S. companies (and corporations that trade stock in the U.S. market) to foreign government officials.
- * Tax Whistleblower Law: Permits foreign nationals to obtain rewards for disclosing American taxpayers who have illegal foreign bank accounts and/or U.S. taxpayers who illegally shelter monies in foreign banks and other entities.

All three of these laws provide monetary rewards for whistleblowers.

Part VII:

Fraud Detection Programs Should be Implemented

“Do employees trust that they can report suspicious activity anonymously and/or confidentially and without fear of reprisal?”

ACFE,

2010 Global Fraud Study

The Association of Certified Fraud Examiners has created a highly respected “Fraud Prevention Checklist.” This Checklist is based on input from the Association’s 60,000 members (most of whom are Certified Fraud Examiners).

The ACFE Checklist consists of eleven general categories of programs, including a total of 28 sub-categories. ACFE, *Report to the Nations on Occupational Fraud and Abuse: 2012 Global Fraud Study*, pp. 70-71.

The ACFE Fraud Prevention Checklist is reprinted in the Appendix to this Report.

Conclusion:

Whistleblower Protection Laws are Essential for Fraud Detection

The United States Senate Committee on the Judiciary carefully studied the most important whistleblower protection law in the United States, the False Claims Act.⁴ The Judiciary Committee report unanimously concluded as follows:

- ⇒ “[I]nsiders who are willing to blow the whistle are the only effective way to learn that wrongdoing has occurred.”
- ⇒ “Information from insiders is the only way to effectively and efficiently piece together what happened and who is responsible.”
- ⇒ “Insiders can provide invaluable assistance during an investigation by identifying key records and witnesses, interpreting technical or industry information, providing expertise, and explaining the customs and habits of the business or industry.”
- ⇒ [T]he presence of effective qui tam provisions [i.e. the whistleblower reward provisions] in the FCA has a deterrent effect on those who seek to defraud the Government.

Michael Hertz, the U.S. Deputy Assistant Attorney General, summarized the importance of whistleblower protections in his testimony before the Senate Committee: **“Whistleblowers are essential to our operation. Without them, we wouldn’t have cases.”**

⁴ Senate Report 110-507 (2d Session), “The False Claims Act Correction Act of 2008, Committee on the Judiciary, September 25, 2008 (legislative day, September 17, 2008).

APPENDIX
Association of Certified Fraud
Examiners
“Check List”
for Effective Anti-Fraud
Programs

Fraud Prevention Checklist

The most cost-effective way to limit fraud losses is to prevent fraud from occurring. This checklist is designed to help organizations test the effectiveness of their fraud prevention measures.

1. Is ongoing anti-fraud training provided to all employees of the organization?

- Do employees understand what constitutes fraud?
- Have the costs of fraud to the company and everyone in it — including lost profits, adverse publicity, job loss and decreased morale and productivity — been made clear to employees?
- Do employees know where to seek advice when faced with uncertain ethical decisions, and do they believe that they can speak freely?
- Has a policy of zero-tolerance for fraud been communicated to employees through words and actions?

2. Is an effective fraud reporting mechanism in place?

- Have employees been taught how to communicate concerns about known or potential wrongdoing?
- Is there an anonymous reporting channel available to employees, such as a third-party hotline?
- Do employees trust that they can report suspicious activity anonymously and/or confidentially and without fear of reprisal?
- Has it been made clear to employees that reports of suspicious activity will be promptly and thoroughly evaluated?
- Do reporting policies and mechanisms extend to vendors, customers and other outside parties?

3. To increase employees' perception of detection, are the following proactive measures taken and publicized to employees?

- Is possible fraudulent conduct aggressively sought out, rather than dealt with passively?
- Does the organization send the message that it actively seeks out fraudulent conduct through fraud assessment questioning by auditors?
- Are surprise fraud audits performed in addition to regularly scheduled audits?
- Is continuous auditing software used to detect fraud and, if so, has the use of such software been made known throughout the organization?

4. Is the management climate/tone at the top one of honesty and integrity?

- Are employees surveyed to determine the extent to which they believe management acts with honesty and integrity?
- Are performance goals realistic?
- Have fraud prevention goals been incorporated into the performance measures against which managers are evaluated and which are used to determine performance-related compensation?
- Has the organization established, implemented and tested a process for oversight of fraud risks by the board of directors or others charged with governance (e.g., the audit committee)?

5. **Are fraud risk assessments performed to proactively identify and mitigate the company's vulnerabilities to internal and external fraud?**
6. **Are strong anti-fraud controls in place and operating effectively, including the following?**
 - Proper separation of duties
 - Use of authorizations
 - Physical safeguards
 - Job rotations
 - Mandatory vacations
7. **Does the internal audit department, if one exists, have adequate resources and authority to operate effectively and without undue influence from senior management?**
8. **Does the hiring policy include the following (where permitted by law)?**
 - Past employment verification
 - Criminal and civil background checks
 - Credit checks
 - Drug screening
 - Education verification
 - References check
9. **Are employee support programs in place to assist employees struggling with addictions, mental/emotional health, family or financial problems?**
10. **Is an open-door policy in place that allows employees to speak freely about pressures, providing management the opportunity to alleviate such pressures before they become acute?**
11. **Are anonymous surveys conducted to assess employee morale?**

**2012 Report to the Nations on Occupational Fraud and Abuse, p70-71, Association of the Certified Fraud Examiners*

About the National Whistleblower Center

The National Whistleblower Center (NWC) is a non-partisan, non-profit organization based in Washington, DC. Its website is located at www.whistleblowers.org. For twenty-five years the NWC has advocated for the protection of employees to lawfully disclose fraud and violations of law to the appropriate authorities.

Stephen M. Kohn serves *pro bono* as the Executive Director of the NWC. He is a partner in the Washington, D.C. law firm of Kohn, Kohn and Colapinto, LLP (www.kkc.com). Mr. Kohn has represented whistleblowers for nearly 30 years. Most recently he successfully represented the first major tax whistleblower, Mr. Bradley Birkenfeld, whose documentation of illegal Swiss banking practices has resulted in the recovery of billions of dollars for the U.S. taxpayers. Mr. Kohn is the author of the first legal treatise on whistleblower law. His seventh book on whistleblowing is, *The Whistleblower's Handbook: A Step-by-Step Guide to Doing What's Right and Protecting Yourself* (Lyons Press, 3rd ed. 2013).

For further information please email: whistle@whistleblowers.org.

© 2014 National Whistleblower Center and Stephen M. Kohn