International Review of Law and Economics 25 (2005) 143–168

“Whistle Blowing” Regulation and Accounting Standards Enforcement in Germany and Europe—An Economic Perspective

Matthias Schmidt *

Leipzig University; Chair of Financial Accounting and Auditing, Marschnerstr. 31, 04109 Leipzig, Germany

Abstract

Many countries regard whistle blowing by employees as a way to assure ethical conduct of firms and as a result various statutory rules have been enacted in order to fortify that behavior, such as the two provisions of the Sarbanes Oxley Act of 2002 (SOX) enacted in the US. The article takes a neo-institutional economics perspective on the phenomenon of whistle blowing and analyzes in what sense a statutory fortification is indeed legitimate. Contrasting, sophisticated regulatory models of the US, the UK and Germany are critically discussed, and an appropriate statutory approach is suggested that utilizes whistle blowing particularly to enhance the regulation of accounting standards enforcement in Germany and Europe.

JEL classification: G 38; K 22; K 42; L 51; M 41

Keywords: Accounting rule enforcement; Institutional legitimacy; Whistle blowing regulation

1. Introduction

Financial reporting scandals in Germany and in the US put discussions about the qualitative superiority of particular accounting systems into perspective. What comes to the surface in these discussions is the question of how investors can be protected against the

* Tel.: +49 341 97 33691/690; fax: +49 341 97 33699.
E-mail address: mschmidt@wifa.uni-leipzig.de.

0144-8188/$ – see front matter © 2005 Elsevier Inc. All rights reserved.
doi:10.1016/j.irle.2005.06.001

non-compliance with any accounting system by an effective enforcement of accounting rules.[1]

An interesting point in the striking accounting fraud cases of Enron and WorldCom is the relevance of employees who were not involved in and did not benefit from the financial reporting manipulations but nonetheless were suspicious of the malpractice.[2] Staff members are often the first to know of any unethical or downright illegal dealings that go on within a firm. However, they also tend to be the last to speak out, fearing the loss of their job, their friends or their future promotion. Timely "whistle blowing" by employees to institutions that can take action against the fraud, therefore, often fails to materialize despite the obvious risk to the organization and finally to the employees themselves.

Presumably in response to the significance of whistle blowers in the securities fraud cases of Enron and WorldCom, US legislation has established provisions in the path breaking Sarbanes Oxley Act of 2002 (SOX) that are intended to protect employees who blow the whistle on those involved in fraudulent and illegal acts against retaliation by public companies.[3] Furthermore, audit committees are – according to the SOX – obliged to create a way in which employees within the corporations of their cognizance can notify the committees of any wrongdoings anonymously.[4]

Common Law countries seem to regard whistle blowing as a valuable device to assure ethical conduct within organizations. In the US, statutory rules have been enacted to encourage potential whistle blowers to come forward with their suspicion, even long before the SOX.[5] From a German as well as from a European perspective, such regulatory approaches seem appealing since a higher probability for whistle blowing behavior induced by suitable regulation to protect or encourage whistle blowers might help to reduce caveats of purely reactive accounting rule enforcement. Concerns about the minor pre-emptive impact of reactive enforcement models – like, e.g. the British Financial Reporting Review Panel (FRRP) – arose in the discussion about suitable approaches to improve the enforcement of accounting standards in Germany and Europe.[6]

However, we cannot assume that whistle blowing is undoubtedly an eligible behavior. An important question is how ethical considerations to legitimize whistle blowing should be judged from an economic point of view, since statutory provisions to fortify such a behavior might have unintended effects. The article addresses this concern in a neo-institutional approach and shows that problems are specifically associated with regulatory incentives that induce whistle blowing to institutions outside an organization.

[1] See Benston, Bromwich, Litan, and Wagenhofer (2003), pp. 42–46, with respect to the US.

[2] In the Enron case, Sherron Watkins, a former Enron vice president, wrote a memo to the firm's CEO expressing suspicions of accounting malpractice more than a year before the firm collapsed. At WorldCom, Cynthia Cooper, head of the internal auditing division, notified concerns about accounting malpractice long before the successor of the former CEO actually ordered a detailed revision within the firm that finally revealed the fraud to the public. For the detailed stories of Watkins and Cooper see Morse and Bower (2002) and Ripley (2002).

[3] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745. The provision is stated in sec. 806 SOX and amends the United States Code (U.S.C.), inserting § 1514 A: Civil Action to protect against retaliation in fraud cases. The SOX can be downloaded via internet: http://www.sec.org.

[4] See sec. 301 SOX, and detailed references in Section 4.2.

[5] See the overview of whistle blowing regulations in the UK, Canada, Australia, New Zealand and South Africa in Lewis (2001). For specific US and UK regulations see in detail Section 4.

[6] For detailed references and definitions see Section 2.2.

Nevertheless, the article also considers that whistle blowing has its benefits as a devise for internal control and that credible commitments to a policy that includes drastic measures against internally reported malpractice can have advantages vis-à-vis investors. A statutory approach is suggested which fosters that firms install an efficient internal whistle blowing policy. It is argued that the approach not only avoids legitimacy concerns, but when properly applied, it helps achieve the predominant aim of efficient accounting standards enforcement: the prevention of accounting malpractice.

The subsequent sections start with a short outline of the basic economic idea of combining accounting rule enforcement and whistle blowing regulation (Section 2). Section 3 follows with an analysis of the (institutional) economics of whistle blowing, pointing out costs and benefits associated with the different whistle blowing types. Section 4 first describes how regulatory approaches could principally influence the whistle blower's calculus and than analyzes to what extent the existing, contrastingly sophisticated regulations in the US – including the SOX – in the UK and in Germany follow these approaches. This section further discusses legitimacy concerns that derive from the different regulations, thereby referring to the economics of whistle blowing types as discussed in Section 3. Section 5 eventually derives the consequences for the regulation of accounting standards enforcement in Germany and Europe. Section 6 provides final conclusions.

2. Combining accounting rule enforcement and whistle blowing regulation: the basic economic idea

2.1. Accounting enforcement regulation and the aspect of prevention

From a neo-institutional transaction cost perspective,[7] accounting rules could be understood as specific institutions that are a part of financial contracts between the management of a company and its capital providers.[8] Accounting standard setting or legislation could be regarded as an offer to those contractors to renounce the contractual regulation and thereby save transaction costs.[9] However, incomplete contractual accounting rules invoke the risk that one contracting party exploits the other ex post.[10] Investors have to assure that the management of the corporation indeed complies with the externally determined accounting rules. Although all contracting parties are aware of the risk of non-compliance and man-

[7] See fundamentally Williamson (1979); Williamson (1981). Further notable references are Grossman and Hart (1986); Hart and Moore (1990). A collection of important work with regard to transaction cost theory is provided by Williamson and Masten (1995).

[8] See Sunder (2002), p. 222. A fundamental exposition of this contractual view on all kinds of corporate law provide Easterbrook and Fischel (1991).

[9] In this regard, any statutory rule about corporate matters is an attempt to fill in gaps that must be present in complex economic contracts; see, e.g. Easterbrook and Fischel (1991), pp. 21–22, 34–35. With reference to German accounting law see Kirchner (1997).

[10] Specifically the far reaching literature on agency theory analyzes the problems associated with incomplete contracts stemming from information asymmetry and conflicting interests between the contractors ("agency costs"). Seminal work for that theory is provided by Alchian and Demsetz (1972); Jensen and Meckling (1976).

agers have incentives not to exploit the position of capital providers opportunistically,[11] those incentives might not be sufficient. Enforcement mechanisms aim at avoiding the situation where insufficient benefits cause managers not to comply with accounting rules. One way to accomplish that aim is to stipulate mechanisms that increase the expected costs of non-compliance.

Since a regulator could offer both, accounting standards and mechanisms to enforce compliance with those standards, individually negotiated enforcement rules are also potentially dispensable. In other words, accounting and enforcement legislation could enable individuals to reduce the complexity and therefore enhance the efficiency of long-term finance contracts.[12] Modern (Constitutional) Law and Economics approaches[13] utilize this fundamental understanding in order to verify the legitimacy of superior capital market regulation.[14] Two important aspects can be derived from such an individualistic contractual perspective: first, to assess whether a superior enforcement mechanism is indeed capable of substituting or supplementing contractual rules, positive as well as negative effects of the rule on the legal positions of all affected parties needs to be considered. Rules that most likely express the (hypothetical) consent of all affected parties are supposed to be legitimate.[15] And second, in any contract, the decisive objective for a stipulated enforcement mechanism is the cost-efficient ex ante prevention of accounting rule-breaking.[16]

2.2. Whistle blowing and reactive enforcement mechanisms

An important focus of the current dispute about alternative models of accounting rule enforcement in Germany and Europe is the probability of fraud detection.[17] The often favored[18] enforcement approach, which follows the British model of the FRRP,[19] is, for

[11] Since investors anticipate the risk that manager's do not comply with accounting rules, they could react by increasing the costs of the provided capital. On the other hand, a credible commitment to the accounting rules by managers could lead to lower capital costs. This aspect will be further discussed in Section 3.2.

[12] See Easterbrook and Fischel (1991), pp. 283–285.

[13] Those approaches base particularly on the work of Buchanan and Rawls; see, e.g. Buchanan and Tullock (1962); Rawls (1971); Brennan and Buchanan (1985); Buchanan (1975); Buchanan (1990).

[14] For an application of such an approach on accounting rules set by privately organized accounting standard bodies see Johnson and Solomons (1984), with reference to the U.S. Financial Accounting Standards Board (FASB), and Schmidt (2002), with reference to the German Accounting Standards Committee (GASC) and the International Accounting Standards Board (IASB).

[15] One thereby has to note that affected individuals ex ante do not know how they actually will be affected by this rule once it is stated: they are supposed to negotiate under the veil of ignorance regarding their actual future legal position; see Rawls (1971), pp. 136–142.

[16] See, e.g. Korn (2002), p. 1500; Zimmermann (2003), p. 354. The aspect of prevention is also relevant in neo-classical Law and Economics approaches to public law enforcement. However, those approaches derive optimal enforcement models from their impact on social welfare and not from the perspective of an individualistic constitutional calculus; see Polinsky and Shavell (2000). For criticism on such approaches see in detail Kirchner (1998), pp. 681–682.

[17] See the references in Korn (2002), p. 1501, and the critical discussion in Lenz and Bauer (2002).

[18] See for Germany particularly RCG (2001), pp. 290–292. For Europe see FEE (2002).

[19] See, e.g. Alexander and Britton (1999), pp. 225–226; Peasnell, Pope and Young (2001), pp. 293–294. In depth descriptions in the German literature are provided by Böckem (2000) and Tielmann (2001).

example, mainly criticized for its reactive mode of operation.[20] The reactive enforcement procedure signifies that it does not operate until there is probable cause of wrongdoing within an organization.[21] Different from this is the US approach: The Securities and Exchange Commission (SEC) which is – inter alia – a governmental accounting standards enforcement institution operates re- and proactively. That is, financial reports could be systematically reviewed independent of precise suspicions.[22]

Ostensibly, we can assume a higher pre-emptive impact from the US approach.[23] This assumption seems to drive the latest suggestions for appropriate accounting enforcement in Europe and the recent regulation Germany, which also provide for a combination of reactive and proactive mechanisms.[24] However, in practical terms there are some doubts that a consistently applied proactive enforcement mechanism is feasible on a national German or a supranational European level. The difficulties that the comparably, amply funded SEC[25] has to face when tackling cases of an actual accounting fraud suspicion[26] show how costly it is to keep up with a consistent proactive enforcement approach. It is, therefore, important to consider additional measures that enhance the pre-emptive impact of purely or just predominantly reactive mechanisms.

A possible approach in this regard might be to utilize whistle blowing within fraudulent corporations. That is, a regulator could set direct or indirect incentives to increase the probability of hints about accounting misconduct from members of the dishonest organization. Increasing this probability imposes additional costs to conceal the fraud and might therefore help to prevent it. Several countries already utilize such regulatory approaches. The SOX in the US, for example, refers explicitly to securities fraud – and therefore to accounting fraud as well.

A rising probability of whistle blowing behavior, on the other hand, might not only restrict other organization members' doubtful activities, but could also increase the risk of, and therefore put further constraints on, a wide scope of activities. It is crucial to understand possible negative implications of such constraints on organizational efficiency – as well as possible benefits – in order to assess the legitimacy of statutory approaches to foster whistle blowing from an economic perspective. Before different regulatory approaches can be discussed in depth, it is important to define the economics of this specific form of institutional behavior.

[20] See Peasnell et al. (2001), p. 293; CESR (2003), p. 7; AKEU (2002), p. 2175; Zimmermann (2003), p. 357; Haller, Eierle and Evans (2001), p. 1676.

[21] See the description of procedures for handling cases in FRRP (2003). For a short description see Peasnell et al. (2001), p. 293.

[22] Reactive enforcement is based on procedures of notification about presumed wrongdoing to the SEC Enforcement Division; see http://www.sec.gov/divisions/enforce.shtml. Proactive reviews are conducted by the SEC Division of Corporate Finance; see Feroz, Park and Pastena (1991), pp. 110–112.

[23] See Böckem (2000), pp. 43–45.

[24] See CESR (2003); Bilanzkontrollgesetz (2004).

[25] The budget of the SEC for 2003 amounts to 467 Mio. US$; see Wüstemann (2002), p. 722, citing former SEC chairman Harvey Pitt at http://www.sec.gov/news/testimony/041702tshl.htm.

[26] See Feroz et al. (1991), p. 111, and more recently, Schroeder and Ip (2002).

3. The (institutional) economics of whistle blowing

3.1. Defining whistle blowing

Whistle blowing is a behavior pattern that has recently attracted much interest, specifically in the US,[27] and is already widely analyzed in related fields like psychology, organizational theory and business ethics.[28] A commonly applied[29] definition of whistle blowing is provided by Near and Miceli: The “disclosure by organization members (former or current) of illegal, immoral or illegitimate practices under the control of their employers, to persons or organizations that may be able to effect action”.[30]

The definition implies the assumption that whistle blowing is predominantly shown by subordinated members of an organization. A simple notification to colleagues does not fall under this definition due to the absence of the ability to affect action on the part of the addressee.[31] Furthermore, notifications by persons who were never members of the organization where malpractice is suspected are not considered to be whistle blowing.[32]

Classifications of whistle blowers might not remain within the organization. We have to distinguish between internal and external whistle blowing, that is, the report of malpractice to persons or institutions inside or outside the organization, respectively.[33] External whistle blowing is conceivable, for example, if top management is suspected of being involved in wrongdoing and/or is susceptible to conceal it.[34] Possible addressees for external whistle blowers are diverse governmental institutions, privately organized groups that help to protect certain interests or – referring to the article’s topic – serve as an (accounting) enforcement body. Eventually, whistle blowers can provoke negative publicity for their employer and notify organizational wrongdoing to the media.[35]

---

[27] The Time Magazine “Persons of the Year 2002” awards went to Sherron Watkins, Cynthia Cooper (see Section 1, footnote 2) and a further whistle blower revealing malpractice within the FBI. Even Hollywood featured that topic in major motion pictures like Erin Brokovic (Universal Pictures 2000), The Insider (Touchstone Pictures 1999) and Silkwood (Twentieth Century Fox 1983—Director: Mike Nichols).

[28] See e.g. Arnold and Ponemon (1991), p. 3, the references in the comprehensive monograph by Miceli and Near (1992) and the overview in Near and Miceli (1996). The German speaking literature, however, widely ignored the phenomenon of whistle blowing as a specific organizational behavior. Recent exceptions are Leisinger (2003), Deiseroth (2001) and Graser (2000).

[29] See e.g. Arnold and Ponemon (1991), p. 2; Dworkin and Near (1997), p. 3; Brody, Coulter and Lin (1999), p. 385; King (1999), p. 315.

[30] Near and Miceli (1985), p. 4.

[31] See Miceli and Near (1992), p. 16; King (1999), p. 316; Leisinger (2003), p. 27.

[32] See Miceli and Near (1992). While notifications by persons who were never members of the organization might help to timely prevent the consequences of malpractice, those person are not likely to suffer from the same retaliations as whistle blowers. See the discussion in Elliston (1982).

[33] See Leisinger (2003), p. 28.

[34] See King (1999), p. 315. In some earlier literature the use of internal channels to notify misconduct was not perceived to be whistle blowing; see e.g. Farrell and Petersen (1982).

[35] See specifically van Es and Smit (2003).

3.2. Economic characteristics of ethical conduct and organizational wrongdoing

As stated above, whistle blowing is widely discussed in the US business ethics literature and, therefore, related to the revelation of actions, which are supposed to be questionable from an ethical point of view.[36] At first sight, an economic reflection of ethical conduct reveals a principal dilemma: behavior patterns that are widely perceived to be unethical do not necessarily need to be inefficient.[37] For example, corruption may enable firms to avoid unreasonable regulations, accomplish an early market entry that benefits shareholders and in the end actually encourage economic development.[38] Nonetheless, it is questionable whether – in the long run – competitive forces indeed lead unethical behavior to become pervasive. Modern economic approaches therefore regard ethical conduct of or within organizations and economic calculus as being principally coherent.[39]

Since the exchange of goods and services is mostly based on institutional arrangements that are necessarily incomplete,[40] individuals have to tackle the inherent risk of ex-post exploitation.[41] In a world of incomplete contractual relations, ethical conduct in the sense of honesty, integrity and fairness constitutes an important factor to reduce that risk and make those arrangements workable.[42] Long-term relational contracts to suppliers, customers or investors depend on the reputation of the organization to commit to those virtues. Consequently, private markets could, at least in the long run, impose significant costs on organizations that engage in unethical behavior.[43]

However, an important question is why clear market incentives for ethical conduct sometimes fail. Wrongdoing often occurs in situations of necessary institutional changes in order to comply with new economic circumstances that – without the change – endanger the organizational efficiency in the long run.[44] Nonetheless, managers might ignore necessities for institutional change since a gradual loss of organizational efficiency due to institutional misfits does not yet endanger their individual short term objectives.[45] In that case, managers have incentives to conceal the true situation – e.g. through fraudulent manipulation of financial statements in order to retain the level of performance based payments.[46] In an economic sense, organizational wrongdoing therefore characterizes actions that impede necessary and/or timely institutional change[47] and lead institutional misfits to persist, which in the end harms the organizations' stakeholders.

---

36 See, e.g. the discussion in Dandekar (1990) with further references. For the difficulties to separate unethical behavior from simply illegal behavior, see Leisinger (2003), pp. 58–67.

37 See Shleifer (2004).

38 See Homann (1997); Shleifer (2004).

39 For literature that deviates from this view see Homann (1997), pp. 187–188.

40 See comprehensively Hart and Moore (1999).

41 See Section 2.1.

42 See Hayek (1988), p. 12; Homann (1997), pp. 189–191; Wieland (1994), pp. 18–19; Deiseroth (2003), pp. 5–6.

43 See Brickley, Smith and Zimmerman (2002), pp. 1829–1832; Leisinger (2003), p. 248.

44 See Hirschman (1970), p. 15.

45 See Söllner (2000), pp. 136–137.

46 See Benston et al. (2003), pp. 34–35.

47 The ability to change institutional misfits in order to adjust to varying economic circumstances is insofar a significant factor for the long-term organizational success; see Söllner (2000), p. 137.

3.3. Economic characteristics of whistle blowing types

It follows from the definition of whistle blowing in Section 3.1 that we have to distinguish between whether the whistle is blown internally or externally. Conceptually, both of the whistle blowing types are quite similar and likewise start with individuals observing any kind of conduct that they perceive as "wrong".[48] Economic literature on whistle blowing exclusively describes both types as active "voice" options.[49] Hirschman was the first to discuss "voice" in an economic context, that is, as an alternative reaction against institutional misfits as opposed to the option of leaving the organization – the traditionally analyzed "exit" option – or of simply doing nothing.[50] Influenced by the famous Sartre drama "Les mains sales",[51] Söllner imposed the term "dirty hands" into the economic discussion of organizational behavior that – different from the "voice", "exit" and "silence" options – implies a break of organizational rules in order to react to institutional misfits.[52]

However, whistle blowing in the sense of the definition does not aim at generally revealing institutional misfits. It is rather a mechanism to reveal a perceived organizational wrongdoing that might follow an institutional misfit. The misfits, per se, are characterized as situations of inefficient governance structures[53] that do not necessarily need to imply fraudulent, illegal or illegitimate behavior. The focus of whistle blowing is insofar narrower than the concepts discussed by Hirschman and Söllner. We could nonetheless conclude that external whistle blowing regularly implies a break of organizational (employment) rules of secrecy.[54] The behavior consequently is much more related to the "dirty hands" than to the "voice" concept.[55]

Any risk of non-compliance with organizational rules – "dirty hands" – challenges the authority structures and therefore increases the costs to enforce the institutions that form those structures.[56] Independent of the motives leading the whistle blower, we particularly have to consider that he or she might simply misjudge a situation.[57] In the external case, the consequences of such a misjudgment could be significant. Frivolous complaints to externals might lead to lawsuits or simply cause bad publicity that threatens the organizational efficiency at the expense of all organization members.[58] The potential cost of frivolous complaints could be, in other words, extremely high. Moreover, if the whistle blower mis-

[48] Empirical results seem to show that the basic process of whistle blowing tends to be the same in either case; see Near and Miceli (1996), p. 502.
[49] See King (1999), p. 316; Miceli and Near (1992), p. 16; Gobert and Punch (2000), p. 30; Leisinger (2003), pp. 22–23.
[50] See in detail Hirschman (1970). See also Williamson (1976).
[51] See Satre (1948).
[52] See Söllner (2000), particularly at pp. 147–151.
[53] See Söllner (2000), p. 134.
[54] These rules might be explicit or implicit norms which frown on the disclosure of confidential information about the firm gained as a result of a status as an insider; see Gobert and Punch (2000), p. 27.
[55] Interestingly, Söllner's institutional economic analysis of "dirty hands" never refers to the whistle blowing phenomenon and the related literature.
[56] An increased likelihood would, in other words, destroy the "capital of rule-compliance", see Söllner (2000), pp. 189–194.
[57] See Homann (1997), p. 204.
[58] See Miceli and Near (1992), p. 5.

judges a wrongdoing, a misfit might be revealed to investors although no fraudulent behavior occurred. This problem obviously has to be considered if whistle blowing should be utilized for accounting rule enforcement: is it the aim of enforcement regulation to go as far as to generally reveal any institutional misfits to investors, even if no accounting failure occurred?

In principle, internal whistle blowing could also imply some type of rule-breaking since many rules between employers and employees, managers and subordinates or employees among each other appear to be relational[59] or symbiotic.[60] Among these typically highly incomplete contracts, loyalty has an outstanding relevance. In many companies management as well as other employees tend to regard whistle blowers as disloyal.[61] It is a common myth that whistle blowers are peculiar characters; that they are often poor performers with difficulties to subordinate or to integrate into the organization.[62] No distinction is made between whether they notify inside or outside the corporation, since team spirit and commitment to the working group are perceived to be significantly eroded by internal as well as external whistle blowing.[63]

It is obvious, though, that the costs of frivolous complaints are significantly lower for internal whistle blowing since this behavior allows firms at least a chance to fix a problem before it becomes public and might cause a scandal with negative material consequences.[64] The costs would therefore be restricted to those necessary to prevent the whistle blower from making his observation known externally.[65] However, whether the perception of whistle blowers as disloyal institutional misfits indeed complies with reality is, as the following section will show, questionable. Apart from this, there are good reasons for an organization to regard internal whistle blowing as valuable.

Internal whistle blowers give the organization the chance to correct a perceived wrongdoing.[66] If managers encourage internal whistle blowing and provide internal channels to notify what is perceived to be a wrongdoing, they help to identify and eliminate such wrongdoing before it might harm the organization. Credibly communicating this willingness to abate malpractice and to commit to principle organizational objectives rather than opportunistic goals to employees, customers, sellers and investors benefits the management in various ways. Increased safety and well-being of organization members could prevent employee resignations, enhance employee's identification with organizational objectives and therefore, in the end, increase labor productivity.[67]

Moreover, a demonstrated willingness to eliminate misfits or their concealment independent of possible organizational disadvantages can have significant benefits vis-à-vis

[59] See fundamentally Macaulay (1963); Macneil (1980).
[60] See Schanze (1991, 1993).
[61] See Gobert and Punch (2000), p. 52; Dworkin and Baucus (1998), p. 1287.
[62] The "disillusioned malcontent" is a usual stereotype of whistle blowers; see Dandekar (1990), p. 95; Dworkin and Near (1997), p. 6. This view seems particularly prevalent in Germany; see Deiseroth (2003), p. 5; Müller (2002), p. 425.
[63] See Gobert and Punch (2000), p. 52.
[64] See Barnett (1992), p. 950.
[65] In many of the external whistle blowing cases, the observer did not go public until internal channels were already tried without the desired success; see, e.g. Near and Miceli (1996), p. 509.
[66] See Söllner (2000), p. 150, with respect to individuals choosing the "voice" option.
[67] See Miceli and Near (1992), pp. 5, 11–12; Miceli and Near (1994); Callahan, Dworkin, Fort and Schipani (2002), pp. 195–196; Leisinger (2003), p. 243.

other stakeholders. To – again credibly – communicate a commitment to an internal whistle blowing policy can help to reduce the reservation of contractors that opportunistic behavior by organization members might lead to an exploitation of their (contractual) position. The policy would, in other words, signal a willingness to enforce ethical conduct within the organization, and therefore could significantly increase the efficiency of incomplete institutional arrangements.[68] From this perspective, internal whistle blowing does not necessarily imply that the observer has broken any organizational rules. Since there appears to be significant incentives for management to institutionalize an internal whistle blowing policy as a part of its organizational rules, whether internal whistle blowing is seen as "dirty hands" or "voice" behavior will depend on the perception of the benefits by the organization.

4. Statutory approaches to fortify whistle blowing: US, UK and Germany

4.1. Influencing the whistle blower's calculus

Within the decision process[69] to blow or not to blow the whistle, the observer has to balance benefits of his action with the possible costs. Statutory approaches to fortify whistle blowing therefore have to consider the basic elements of the whistle blower's calculus.

Söllner theoretically derived impelling drivers for the general "voice" and "dirty hands" behavior patterns. Both of them occur when the loyalty of individuals is highly correlated with the objectives of the majority of organization members, indicated by good job performance and positive attitudes to the job.[70] Institutional misfits – or a perceived wrongdoing following the misfits – seem to endanger these objectives, and the individual feels inclined to do something against it. However, the "voice" option, which – considering the analysis in the last section – describes internal whistle blowing, only occurs if the individual is not in a "small numbers" situation.

Within contractual relations, "small numbers" or "large numbers" situations characterize the power of one party to arrange transactions in compliance with her/his interest.[71] A strong position before a contractual commitment – "large numbers" – can change into an ex post "small numbers" position if the transaction that has lead to the contractual commitment is accompanied by specific investments. Specific investments preclude the option to "exit" the contractual relation since benefits related to the investment would be lost.[72]

Within an organization, a "small numbers" situation among employees could be induced by comparatively high salaries or by side bets that are tied to a long-term membership to the

[68] See Brickley et al. (2002), p. 1822; Homann (1997), p. 189, and Wieland (1994), p. 19, all referring more generally to codes of ethical conduct for organizations.

[69] The decision to blow the whistle cannot be reduced to a single act and is regularly a long process for the observer that develops over various stages of significant struggles with an individuals own conscience; see Leisinger (2003), pp. 31–33, and comprehensively Miceli and Near (1992), pp. 48–92.

[70] See Söllner (2000), pp. 168–174, and 179–181. With respect to voice see already Hirschman (1970), p. 77.

[71] See for this term, e.g. Williamson (1985), pp. 61–63.

[72] See, e.g. Williamson (1985), p. 61.

organization (e.g. pension plans). The problem of a (non-mutual) small numbers situation is that it reduces the power perceived by employees to change something if they observe an institutional misfit or a wrongdoing following it. Since "exit" is no suitable alternative to react, many employees remain silent.[73]

However, Söllner's analysis shows that employees with a high degree of loyalty and the perception that raising the case internally ("voice") will not change a misfit are likely to choose the "dirty hands" option.[74] "Loyalty" and "small numbers" might, in other words, also increase the likelihood for external whistle blowing. Extensive empirical studies on whistle blowing characters in the US seem to confirm that most whistle blowers are indeed loyal in the described sense.[75] Predominant situational variables influencing the decision of whistle blowers to go public seem to be the availability of internal channels and the perceived chance that the wrongdoing would end when blowing the whistle internally.[76] The results insofar largely comply with Söllner's analysis.

From a regulatory perspective, two approaches could principally be derived from these findings: first, one could try to motivate individuals with less accentuated loyalty to blow the whistle. A second approach would address the perceived "small numbers" situation and fortify that companies establish an internal whistle blowing policy. The following sections describe to what extent contrasting, sophisticated models of whistle blowing regulation realize these approaches and subsequently discuss in what sense these approaches seem suitable from an economic perspective.

4.2. Whistle blowing regulation in the US, in the UK and in Germany

4.2.1. US regulation on whistle blowing[77]

4.2.1.1. The approach of the Sarbanes Oxley Act of 2002. The SOX provides a civil action to protect employees of publicly traded companies who blow the whistle or likewise assist in a federal fraud investigation. The provision prohibits any officer, employee, contractor, or agent of a publicly traded company from taking certain retaliatory actions. These actions include discharging, demoting, suspending, threatening, harassing, or discriminating against an employee who assists in an investigation or lawfully provides information to a federal regulatory or law enforcement agency, a member or committee of Congress, or a person with supervisory authority over the employee who has the authority to investigate or terminate the misconduct.[78] The protection, therefore, applies to both external and internal whistle blowers disclosing what they reasonably believe to be a violation of securities law. Protection includes reinstatement, back payment with interest and compensation for

[73] In this regard, Söllner opposes Hirschman, who neglects the significance of a "small numbers" situation for the decision of individuals to choose the "voice" option; see Söllner (2000), pp. 171–172.

[74] See Söllner (2000), p. 179.

[75] Whistle blowers therefore do not seem to be disillusioned malcontents as it is the conventional wisdom. See Dworkin and Near (1997), p. 6; Near and Miceli (1996), pp. 511–515, and in detail Miceli and Near (1992), pp. 93–135.

[76] See, e.g. Near and Miceli (1996), pp. 511–515, 519–523; Dworkin and Near (1997), pp. 6–8.

[77] For a presentation and critical discussion of US regulation with regard to the disclosure of corporate malpractice by a fraudulent company's auditors as well as its lawyers see Painter and Duggan (1996).

[78] See sec. 806 SOX, codified as title 18 U.S.C., § 1514A (a).

damages and expenses, including attorney fees. Retaliations against informants can lead to criminal penalties of up to 10 years in prison and significant fines.[79]

The audit committee of publicly traded companies is required to establish procedures for the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters. Further procedures have to be provided so that employees of the issuer can confidentially and anonymously submit concerns regarding questionable accounting or auditing matters.[80] In other words, the SOX explicitly obliges public companies to install an internal whistle blowing policy. However, the Act does not principally prefer any of the whistle blowing types.

4.2.1.2. State laws, False Claims Act and Corporate Sentencing Guidelines (CSG). Long before the SOX, US legislation – on the federal as well as on the state level – passed laws designed to encourage whistle blowing.[81] The primary focus of most statutes is to prohibit retaliation and provide remedies to those that suffer it. The laws vary on other issues, such as who the observer should notify, whether motive should be considered, what standard of wrongdoing should be required and what remedy should be provided to whistle blowers suffering from retaliation.[82]

Many state governments and the federal government, the latter notably with the revision of the False Claims Act in 1986, provide direct incentives to first report externally: the enacted statutes created financial awards for whistle blowers who prevented substantial damage to some portion of society.[83] Insofar, most of the laws influence the whistle blower's calculus in the sense of the first approach described in Section 4.1. Different from the SOX, none of the state or federal approaches directly oblige organizations to install procedures for internal notifications.

Nonetheless, a number of judicial decisions, particularly at the federal level, encouraged employers to establish an internal whistle blowing policy.[84] More direct incentives for creating internal procedures are included in congressional mandates such as the federal Corporate Sentencing Guidelines (CSG).[85] The CSG solely recommend internal whistle blowing policies rather than obliging firms to install them. However, one can characterize those recommendations as a "carrot and stick" approach[86]: heavy penalties for misconduct of convicted organizations, including fines, sanctions and even probation, provide the "stick". On the other hand, those penalties could be significantly reduced – the "carrot" – if organizations satisfactorily demonstrate attempts to prevent misconduct through, e.g. a meaningful and effective internal reporting system.[87]

[79] See sec. 806 SOX, codified as title 18 U.S.C., § 1514A (a)–(c), sec. 1107 SOX, codified as title 18 U.S.C. § 1513(e).
[80] See sec. 301 SOX, codified as sec. 10A (m)(4) of the Securities Exchange Act of 1934.
[81] See the overview in Miceli and Near (1992), pp. 251–25.
[82] See Callahan et al. (2002), p. 189.
[83] See Callahan and Dworkin (1992), pp. 278–283.
[84] See Callahan et al. (2002), p. 190.
[85] See Dworkin and Near (1997), p. 12.
[86] See Callahan et al. (2002), p. 191.
[87] See also Wieland (1994), pp. 17–18; Homann (1997), p. 204.

4.2.2. The British Public Interest Disclosure Act of 1998 (PIDA)

Like most of the US approaches, the British Public Interest Disclosure Act of 1998 (PIDA)[88] aims at avoiding organizational wrongdoing[89] in general. Further, the PIDA clearly focuses on the avoidance of retaliations and does not encourage whistle blowers through direct financial rewards.[90] Whether a whistle blower falls under the protection of the PIDA, however, significantly depends on the addressee of his notifications. Three levels of disclosure have to be distinguished.

The first level regards disclosures to the employer. To fall under the PIDA protection, the whistle blower must act in good faith of an observed wrongdoing when he notifies his employer.[91] The second level regards disclosures to "other responsible persons".[92] Such persons are legal advisors, a Minister of the Crown or persons explicitly prescribed by the Secretary of State. The prescribed persons are governmental enforcement authorities relevant to the notified topic, e.g. health and safety, fraud and fiscal irregularities, financial services, etc. The private FRRP, however, does not belong to the prescribed authorities.[93] A notification to a prescribed person is protected if the whistle blower reasonably believes (1) that the matter falls within the remit of the prescribed person, and (2) that the disclosure or allegation is substantially true.[94]

The third protection level regards wider external disclosures to not-prescribed persons including the media. The protection of the PIDA only applies when the whistle blower fulfils the conditions of level two and does not act for personal benefits. Additionally, one of three conditions has to be met: (1) the whistle blower has already tried internal channels or notified a prescribed person, (2) the whistle blower reasonably believes that he/she would be victimized if he/she raised his/her concern internally, and (3) no suitable prescribed person exists and the whistle blower reasonably believes that the wrongdoing will be concealed.[95]

Protection from retaliation does not differ among the levels. Contractual rules that evade the protection are unlawful; dismissals of workers who made a protected disclosure are automatically unfair if the reason for the dismissal was the disclosure. The same holds for refused promotions or disciplinary actions connected to the disclosure. Any form of retaliation can have significant disadvantages for the employer since compensation for aggrieved whistle blowers are unlimited according to the PIDA.[96]

Although the PIDA does not oblige firms to establish an internal whistle blowing policy, management's incentives to do so are expected to accrue from the three-level approach of

[88] For a brief history of the PIDA, which adds a new part to the British Employment Rights Act 1996 (ERA), and its predecessors see Gobert and Punch (2000), pp. 25–26, 36–37; Lewis and Spencer (2001), pp. 13–16.

[89] Organizational wrongdoing is defined as: criminal offence, failure of a person's legal obligations, miscarriage of justice, danger to a person's health and safety, damage to the environment, concealment of any of the mentioned; see PCAW (1999), p. 5.

[90] See Lewis and Spencer (2001), p. 17.

[91] See Gobert and Punch (2000), pp. 40–41, also for a discussion of the term "good faith".

[92] See PCAW (1999), p. 5.

[93] For a current list of prescribed persons see http://www.pcaw.co.uk/legislation/p_regulators.html.

[94] See Lewis and Spencer (2001), p. 18.

[95] See PCAW (1999), p. 5.

[96] See PCAW (1999), pp. 5–6.

protection.[97] The hurdles for whistle blowers to fall under the protection of the Act increase from level to level. Particularly the preconditions on the last level are relatively tough. When organizations prove to have an established whistle blowing policy, protection of external notifications to not-prescribed persons is virtually precluded.

4.2.3. Whistle blowing regulation in Germany

German legislation provides only a few explicit statutory rules to protect employees who notify very specific malpractice outside their company, e.g. in environmental law or labor law[98] and in two federal state data protection laws. Compared to the US, there are hardly any cases[99] of and judicial decisions[100] on whistle blowing.[101]

All judicial decisions relate to one specific form of retaliation, the dismissal of employees after blowing the whistle externally. The (scarce) legal academic literature[102] based on these decisions concludes, that implicit or explicit contractual duties of loyalty to the employer do not principally forbid external whistle blowing.[103] However, decisive for an inadmissibility of employee discharges is the balance between loyalty and individual interest of the employee. Prevailing opinion is that – different from the US and the UK approach – superior interests of the society cannot affect the duty of loyalty.[104] Furthermore, this duty clearly requires that any concern first be raised internally.[105] As a consequence, internal whistle blowing would in no case justify dismissal. This last consequence, however, results from the generally sophisticated German statutory protection against employee dismissal, which in general aggravates firing much more than, e.g. US legislation.[106]

Retaliations for whistle blowing apart from employee dismissal are neither explicitly protected nor are cases related to legal action taken against such retaliations – like, e.g. hindrances in promotion or oppression at work by colleges – so far discussed. It is argued

[97] See Gobert and Punch (2000), pp. 50–51.

[98] Those specific laws are the Gefahrstoffverordnung (statutory order for hazardous material) and the Arbeitsschutzgesetz (law on the protection of labor); see Müller (2002), pp. 431–432. Some of the nation wide labor agreements (Tarifverträge) also provide for protection of whistle blowing with regard to safety concerns at the workplace; see Graser (2000), p. 174.

[99] A significant exception is the case of Margrit Herbst, a veterinary who revealed misconduct during investigations for the mad cow disease BSE in the German state Schleswig-Holstein and got fired for her revelations; see in detail Deiseroth (2001).

[100] See in detail Müller (2002), pp. 432–434.

[101] Literature in German language did not yet find a suitable translated legal term for whistle blowing. The direct translation of the term, Trillerpfeife blasen, would not connote the phenomenon properly. Paraphrases like Alarmglocke läuten or Verpfeifen are either too prosaic or too negatively connoted to allow a mundane scientific or legal contention. See Graser (2000), p. 5; Müller (2002), p. 426; Leisinger (2003), p. 20.

[102] See the overview provided by Müller (2002), pp. 434–435.

[103] The principle right to blow the whistle is supposed to derive from constitutional rights, e.g. articles 5, 17 Grundgesetz (German Constitution): freedom of opinion and “right of petition”, i.e. the right to induce legal or similar action against malpractice; see Müller (2002), pp. 429–431.

[104] See Graser (2000), p. 266; Müller (2002), p. 437.

[105] See Müller (2002), pp. 434–435.

[106] See Müller (2000), pp. 170–171. In the US, employee dismissal for internal notifications was quite common prior to statutory protection of whistle blowers; see Miceli and Near (1992), pp. 232–250. Some state statutes offering whistle blower protection actually excluded internal notifications from this protection; see Dworkin and Callahan (1991), p. 268.

that those forms of employee reprisal are of minor relevance in Germany due to a rather collectivistic approach in labor law, which provides for a sophisticated representation of employees' interests in firms.[107] Internal notifications could mostly be channeled by workers' councils, which are compulsory for firms reaching a (comparably small) size. However, for whistle blowing that does not directly concern employee grievances like, e.g. accounting fraud, it is questionable whether such councils are suitable addressees.[108]

Explicit rules to establish an internal whistle policy do not exist in Germany. Nonetheless, recent legislation requires firms to set up a monitoring system to identify at an early stage developments constituting a risk to the existence of the company.[109] An interesting question is, in what sense an internal whistle blowing policy is suitable to enhance such a risk management.

4.3. Economic discussion of the different statutory approaches

4.3.1. Fortifying external whistle blowing?

When loyalty to organizational objectives is low, the likelihood for "voice" as well as for "dirty hands" behavior is low. If such disloyalty falls together with a "small numbers" situation, a behavior pattern not yet discussed is most likely to occur: "opportunism".[110] One has to distinguish between opportunism as an attitude and as an actual behavior since opportunistic behavior depends on the circumstances. That is, it only occurs when it is worthwhile for the individual.[111]

The US False Claims Act and other state regulations incorporate financial rewards as incentives for whistle blowers and therefore utilize opportunism to reveal fraudulent acts. If structured properly, such approaches are principally likely to work.[112] The approaches further reflect an attitude that is not uncommon for public policy and legislation in the US: if information is beneficial to the public good, it is irrelevant whether it was provided out of greed or conscience. As long as wrongdoers are prosecuted and therefore the law is properly enforced, the information of the whistle blower is valuable, independent of his motives.[113] Referring to the German political, legal and social culture, such "citizen enforcement" is rather abstruse.[114] Apart from that, one has to consider clear caveats from an economic standpoint.

State approaches that incorporate large rewards as incentives necessarily focus on encouraging external whistle blowing since, in order to get the reward, the whistle blower must file

---

[107] See Graser (2000), pp. 222–223.
[108] See Graser (2000), p. 267.
[109] See sec. 91 par. 2 AktG (Stock Corporation Act), which follows from the Law on Control and Transparency in Business of 1998 (Gesetz zur Kontrolle und Transparenz im Unternehmensbereich, KonTraG); Theisen (2003), p. 1426.
[110] See Söllner (2000), p. 177.
[111] See Söllner (2000), pp. 178–179.
[112] See Callahan and Dworkin (1992), pp. 283–302, referring to a wide range of social psychological literature. The history of cases relying on the False Claims Act shows that files after the amendments of the Act increased significantly; see Dworkin and Near (1997), p. 9.
[113] See Callahan and Dworkin (1992), p. 320; Dworkin and Near (1997), p. 10.
[114] See Graser (2000), p. 227; Müller (2002), p. 425.

a lawsuit.[115] A first objection is that large rewards could principally spur false or groundless claims. Although intentional false claims incur risks for the whistle blower and therefore might not be likely,[116] one has to consider that reasonable people may differ on what actually constitutes illegal, immoral or illegitimate practices.[117] As described in Section 3.2, even whistle blowers acting in good faith but simply misinterpreting a situation can cause extremely negative consequences. And "Machiavellian" whistle blowers who have nothing to lose but a lot to win might be sensible enough to let their notification appear to be in "good faith".[118]

Many authors criticise the organizational consequences of encouraging "snitching". A system that potentially nourishes a climate of suspicion, hostility and defensiveness can have significant negative effects on organizational efficiency due to a loss of group identity or loyalty.[119] However, this criticism does not only apply to statutory approaches explicitly rewarding external whistle blowers. It similarly holds for any approach that fortifies this whistle blowing type.

The SOX offers external whistle blowers a wide range of protection from retaliation. The same holds for the PIDA that protects employees from retaliation caused by straight notifications to prescribed (external) persons. Protection from retaliations aims at motivating employees to blow the whistle through the control of his expected "costs". Reprisals of whistle blowers could, as various case studies show, indeed be quite severe[120] and go far beyond prosecution for breaking contractual rules of confidentiality.[121] However, while rewards are not provided, controlling for such retaliation might nonetheless induce opportunistic behavior.

Protection from retaliation could be utilized by employees to fend off legitimate criticism or disciplinary measures since they are principally able to claim the status of a whistle blower.[122] Although the PIDA establishes hurdles for protection on the second level, Machiavellian whistle blowers might still be sensible enough to let their action appear to be in "good faith" with a "strong belief of truth". Different from Germany, it is not exclusively the personal interest that is balanced with the duty of loyalty. Since "good faith" and "strong belief of truth" also apply to a somewhat obscure superior social interest, both concepts are, in the end, highly subjective.[123] (Potential!) external whistle blowing may become a normal opportunity to avoid discharges or disciplinary proceedings since it might not be too difficult to prove acting from "higher ideals".[124] It is, therefore, likely that PIDA and

115 See Dworkin and Near (1997), p. 10.
116 Punishment for false claims can be quite significant; see Callahan and Dworkin (1992), pp. 325–326.
117 See Near and Miceli (1996), p. 509.
118 See the case scenarios drawn by Gobert and Punch (2000), pp. 30–33.
119 See the references in Dworkin and Near (1997), p. 10.
120 See Dworkin and Near (1997), p. 2. Gobert and Punch (2000), pp. 33–36, describe many cases where retaliation ranged from physically, mentally or emotional suffering due to a trouble-maker reputation with employers and co-workers to even threats of their lives. Whistle blowing at least became a form of professional suicide, effectively ending careers.
121 See Leisinger (2003), pp. 252–259.
122 See Gobert and Punch (2000), p. 32.
123 See Gobert and Punch (2000), p. 49.
124 See Anechiarico and Jacobs (1996), pp. 67–68, showing that a lot of municipal employees in New York City chose the option to blow the whistle in order to fall under state protection as a pure pre-emptive or defensive act.

similar regulatory approaches may contribute to further rationalize opportunistic external whistle blowing.[125]

Facing that risk, it becomes rational for a manager to tolerate even ineffective employees, given the enormous trouble he can cause if he blew the whistle.[126] If – referring to the PIDA – a prescribed person checks on a corporation, reactions of shareholders are near at hand if even rumors about such a check occur – with all the negative implications for the corporation and its stakeholders independent of an actual wrongdoing.[127]

Since relational and/or symbiotic intra-organizational contracts, therefore, might become less workable, the costs to enforce such contracts could significantly increase at the expense of organizational efficiency. As a consequence, one has to question the legitimacy of any regulation that fortifies external whistle blowing if the interests of all parties who are in the end affected by the regulation are considered.[128]

4.3.2. Fortifying internal whistle blowing – but how?

What follows from the last section is that a statutory focus on the loyalty dimension of the potential whistle blower's calculus[129] – either through adding benefits or reducing costs of the whistle blowing act – has caveats as long as external notifications are fortified. On the other hand, focusing on the "small numbers" dimension, that is, exclusively fostering internal whistle blowing, has the apparent problem that wrongdoing might not be revealed and therefore sanctioned by an enforcement institution.

However, the value of this second approach is its potential pre-emptive effect, provided the wrongdoing is indeed timely terminated by the organization. The idea behind that approach is to aggravate the described incentives that anyway exist for organizations to utilize "voice" as a device for internal control.[130]

The SOX simply obliges firms to establish an internal channel for anonymous notifications to the audit committee. Whether an obligation to install internal whistle blowing procedures indeed signifies that firms regard the behavior as valuable and therefore intensify the commitment to a whistle blowing policy is rather questionable.[131] Without such a policy, the perceived "small numbers" situation will hardly change. Observers need to understand that their "voice" can induce institutional change and stop wrongful conduct. Procedures or mere "lip services" alone have little impact on conduct, and encouraging internal disclosures needs substantial (top!) management effort.[132]

An ostensible argument is that the risks associated with a higher probability of external whistle blowing serves as an incentive for firms to indeed encourage their employees to come forward with any suspicion.[133] While there is some truth in that point, one still cannot disregard legitimacy concerns that derive from enhancing the probability of external whistle

[125] Gobert and Punch (2000), p. 49.
[126] See Anechiarico and Jacobs (1996), pp. 69–71.
[127] See Gobert and Punch (2000), p. 44.
[128] See above, Section 2.1.
[129] See Section 4.1.
[130] See Section 3.2.
[131] See Lewis and Sargeant (2001), p. 59.
[132] See examples and references in Section 5.2.
[133] See Callahan and Dworkin (1992), pp. 333–335; Lewis (2002), p. 202.

blowing through regulatory measures. The third level approach of the PIDA therefore seems – at first sight – more appropriate.

At this level, protection from retaliation for external notifications is in the end only provided when firms cannot prove to have a workable procedure for internal notifications. "Merging" the second and third levels could insofar reduce legitimacy concerns since external notifications to prescribed persons would only be protected if internal whistle blowing policies did not exists or were likely to be useless. Incentives to change corporate culture[134] might indeed be more accentuated than in Germany, since the German approach requires employees to first internally notify, independent of established policies.

However, there are still some aspects associated with the principal approach of controlling for retaliations that have to be questioned. A point that is often discussed deals with doubts as to whether controlling the "costs" for the whistle blower is per se effective. Empirical evidence on the perception of actual retaliation by whistle blowers in carefully conducted analyses of various cases in the US is rather mixed.[135] Neither did fear for retaliation significantly influence whistle blowers nor was retaliation after a filed complaint the rule – except for striking cases, which caused a lot of publicity.[136] Retaliations are hardly comprehensible[137] and highly subject to personal interpretation of the whistle blower.[138] Statutory approaches could barely tackle the whole range of possible reprisals. Dismissals, relocations or disciplinary action obviously qualify, but never the more subtle forms of detriment. An employer is surely not responsible for co-workers regarding the whistle blower as a troublemaker and refusing to associate with her or him. Further, it might be difficult to prove that, e.g. future promotions or job opportunities do or do not appear as a consequence of the whistle blowing.[139]

More important from a regulatory perspective is the still prevalent problem of opportunism at the expense of organizational efficiency if controlling for retaliations did work. To blow the whistle internally as an act of self-defence is not unlikely. Gobert and Punch draw the hypothetical case of an employee who suspects that operational dismissals might affect his department. In order to effectively exclude him from dismissal for redundancy, he blows the whistle internally on a case that might yet be malpractice but that he would never have notified in other circumstances. While dismissals are inescapable for the firm, it is unlikely that the whistle blower will be affected since he could fall under PIDA protection. The employee might even be excluded from necessary salary cuts in order to avoid that such a cut is misinterpreted as retaliation.[140]

If rules interfere with the freedom to (re)organize, as in the above example, the claim that they are legitimate is doubtful from an economic perspective. The key to a legitimate

[134] See Lewis and Sargeant (2001), p. 57.
[135] See Miceli and Near (1992), pp. 153–156, 202, 224–228.
[136] See Near and Miceli (1996), p. 523; Dworkin and Near (1997), p. 6.
[137] See Miceli and Near (1992), p. 202.
[138] See Near and Miceli (1996), p. 523.
[139] See Gobert and Punch (2000), p. 46–48, who argue that the PIDA can simply provide a trap for employees who naively believe to be protected and appear on "black lists" of potential future employers.
[140] See Gobert and Punch (2000), pp. 40–41. The cases analysed in Anechiarico and Jacobs (1996) show how employees who became virtually "untouchable" due to their whistle blower status negatively affect the efficiency of the whole working group.

statutory approach is to effectively aggravate the incentive for organizations to establish an internal whistle blowing policy without inducing adverse incentives. In other words, legitimate rules should not induce any direct influence on the whistle blower's calculus. Rules closest to such an approach are the US CSG.

Like the PIDA, the CSG do not oblige firms to establish an internal whistle blowing policy. Nonetheless, a meaningful reporting system – including hotlines for anonymous notifications, written codes of ethics and a proven policy of intra-organizational protection from reprisals – are explicitly stated key characteristics required in order to receive a "carrot": significant reductions of fines in the case of a revealed wrongdoing. The important point is that judges handling fraud cases not only have to find that appropriate procedures existed, they also have to consider whether the procedures were sincerely used.[141] Mere "lip services" would, in other words, not avoid the "stick".

In this regard the CSG directly affect the calculus of the management to aggravate the "large numbers" perception of potential whistle blowers. The whistle blower's calculus is not directly influenced by the CSG since those rules neither award nor protect whistle blowers. The CSG therefore avoid adding value to opportunistic whistle blowing.

5. Consequences for accounting standards enforcement regulation in Germany and Europe

5.1. The appropriate lever to utilize whistle blowing for enforcement purposes

As stated in Section 2.1, the decisive objective for legitimate enforcement mechanisms is the prevention of accounting fraud. Fraud is likely to occur if it is beneficial for the manager to conceal institutional misfits. That is, the costs of a long-term reduction of organizational efficiency do not sufficiently affect the manager's benefits.[142] Furthermore, the expected costs of the malpractice per se, expressed as the product of the probability to be detected and the expected sanctions, in case of detection,[143] are low. In principle, enforcement mechanisms that aim at preventing managers from committing fraud, therefore, could address three factors of the manager's calculus: insufficient benefits, probability of detection and expected sanctions.

With regard to the probability of detection, it was already noted that reactive enforcement procedures might suffer from deterrence failure.[144] Successfully detecting malpractice in reactive accounting rule enforcement models significantly depends on individuals who notify wrongdoing to a prescribed enforcement institution. External whistle blowers are indeed a valuable source. Statutory approaches to fortify such behavior are, for the reasons discussed, nonetheless questionable. To enhance the detection risk of fraudulent managers, therefore, inevitably requires proactive mechanisms.

[141] See Callahan et al. (2002), p. 191; Dworkin and Near (1997), p. 12.
[142] See Section 3.1.
[143] See Polinsky and Shavell (2000); Böckem (2000), pp. 41–42.
[144] See Section 2.2. See Xu and Pistor (2003) for an analytical approach to prove the superiority of proactive mechanisms to enforce financial market rules – which are supposed to serve as an example for incomplete law.

The Commission of European Securities Regulators (CESR) consequently provides independent regulatory bodies within the EU member states, recommending an approach that combines a reactive mechanism with a rotation and/or sampling based model of monitoring financial reports.[145] The recent legal act in Germany provides for a two-step approach which likewise combines reactively and proactively operating bodies.[146] Independent of the actual implementation within the member states, one has to note that the methodology creates sometimes costly efforts for the responsible enforcement institutions.[147] The example of the SEC shows that cost or other barriers can cause proactive enforcement institutions to predominantly operate in a reactive manner.[148] If firms are not consistently and randomly screened, we have to consider possible adverse effects as soon as any enforcement institution actually deviates from this habit. Since public expectations are – given the predominant behavior – that wrongdoing at least has to be suspected when the institution checks on a corporation, adverse reactions of shareholders are again near at hand.[149]

Effective proactive enforcement consequently requires reducing the burden of enforcement bodies. Important in this regard are measures that enhance the efficiency of the organization's corporate governance, including monitoring of auditors and better incentives for those who conduct audits to carry them out properly.[150] Discussions on establishing internal safeguards so far focus on direct obligations or requirements to declare compliance with codices.[151] Among the discussed safeguards, internal whistle blowing policies are not mentioned. Nonetheless, the analysis so far indicates that fortifying this behavior can significantly enhance internal control procedures. Utilizing whistle blowing for the enforcement of accounting standards is therefore not a question of enhancing the detection risk. The suitable regulatory approach is to integrate the idea of internal whistle blowing with the discussion of aggravating self-regulation through properly applied codes of corporate governance. What can be derived from the last section is that such an approach is most promising if it addresses the other components of the manager's calculus: the possible sanctions and the insufficient benefits from eliminating institutional misfits rather than concealing them.

5.2. *Internal whistle blowing as part of (governance) codes of conduct*

As stated above, establishing a workable internal whistle blowing policy requires considerable (top) management effort. Necessary organizational measures are, e.g. clearly stating the attitude towards malpractice, clearly indicating what is regarded as malpractice, explicitly protecting internal whistle blowers from any form of retaliation, continuously teaching employees, implementing hotlines, denominating ombudspersons, etc.[152]

---

145 See CESR (2003), pp. 7–8.

146 See Bilanzkontrollgesetz (2004).

147 See Page (2001), p. S38.

148 See Section 2.2.

149 The FRRP guaranties anonymity as long as it checks on a company; see Peasnell et al. (2001), p. 293. Anyway, rumors might occur in spite of a regulatory body's best efforts to maintain confidentiality of its investigation; see Gobert and Punch (2000), p. 44.

150 See Benston et al. (2003), pp. 66–79.

151 See the references in Section 5.2.

152 See, e.g. Miceli and Near (1992), pp. 280–301; Miceli and Near (1994); Lewis and Sargeant (2001), pp. 59–69; Callahan et al. (2002), pp. 202–215; Leisinger (2003), pp. 190–199.

Apart from being obliged to establish such a policy, one can consider integrating suggestions for a proper whistle blowing policy into the already widely discussed codes of corporate governance stated by privately or quasi-privately organized institutions. The German statutory approach requires a compliance statement with a corporate governance code that is elaborated by a governmental commission.[153]

Direct sanctions for non-compliance are not provided. Nonetheless, the interesting aspect of compliance statements is their signaling effect. Different from the situation without such a statement, managers refusing to notify compliance explicitly signal to their capital providers that they do not commit to the code.[154] If suggestions for a workable internal whistle blowing policy were integrated into the code, a refused compliance statement would directly express that managers disregard the benefits of "voice" as a device to assure long-term organizational efficiency. The probability that capital markets impose cost on such a non-commitment is, in other words, likely to rise. The compliance statement approach therefore seems suitable to address the insufficient benefit component of the manager's calculus.

Concerns whether an induced market pressure is sufficient to discipline managers are near at hand,[155] and compliance statements might be, in the end, pure lip services. However, one should not underestimate the effect that capital markets react more sensitively to firms that try to surpass benchmarks explicitly formulated by a code.[156] Apart from this, the discussion in Section 4.3 has shown that further rules to foster management incentives are possible by addressing the sanction component of the manager's calculus.

The need for adequate penalties to deter managers from accounting malpractice is addressed in the current discussion about suitable enforcement mechanisms.[157] Still, the possibility of flexible sanctioning so as to aggravate manager's benefits from providing internal mechanisms to avoid accounting fraud – the US CSG paradigm – is so far not discussed. However, to combine proactive enforcement and compliance statements with such a "carrot and stick" approach indeed considers all components of the manager's calculus and is therefore most likely to fortify the pre-emptive impact of the whole enforcement mechanism. Since such an approach avoids inducing adverse incentives for other individuals, it is most likely to be legitimate in the sense described in Section 2.1.

For the implementation of the approach at the supranational European level one could consider to separate the enforcement process into (1) reviewing or assessment and (2) sanctioning. (Proactive) reviewing could be a matter of a national supervising institution.[158]

[153] See sec. 161 AktG as amended by the Transparency and Disclosure Law (Transparenz- und Publizitätsgesetz, TransPuG) in 2002. For details of the German Corporate Governance Code (Deutscher Corporate Governance Kodex) see http://www.corporate-governance-codex.de. At . . ./seite5.htm, the site provides a comprehensive literature overview with respect to the code.

[154] See Borges (2003), p. 538. See similarly Painter and Duggan (1996), p. 269.

[155] See Ehrhardt and Nowak (2002).

[156] See Borges (2003), pp. 537–539.

[157] See particularly Korn (2002), pp. 1503–1504. However, many authors focus on criticizing the FRRP for only penalizing organizations through adverse publicity; see Böckem (2000), pp. 99–101; Haller et al. (2001), p. 1677; Küting and Wohlgemuth (2002), p. 269; Zimmermann (2003), p. 357.

[158] The suggestion to basically separate an enforcement process into reviewing and sanctioning was first articulated by Hommelhoff (2001). However, he exclusively referred his proposal to a possible enforcement process in Germany.

Concurrently, it is possible to delegate elaborating codes of conduct to national agencies and leave companies the option as to which code they intend to commit. Since the agencies would have to compete for companies, and capital market pressure should lead companies to express compliance with those codes mostly appreciated by capital markets, the permanent evolution of "marketable" codes is assured.[159] Providing and creating advance rules for an appropriate internal whistle blowing policy might be the decisive competitive advantage for an agency offering a code.

The flexible sanctioning of firms convicted of accounting malpractice could remain on the supranational level, with the US CSG approach as a suitable paradigm. Decisions of a supranational court that consider the suitability of internal whistle blowing policies additionally force agencies that offer codes of conduct to reconsider their "products" in this regard. With such a sentencing approach, it is unlikely that the agencies completely ignore the issue of internal whistle blowing.

In sum, the suggested regulatory model most likely intensifies firms' incentive to declare a commitment to the most sophisticated code on the market. At the same time, the approach is likely to assure the evolution of codes that best utilize internal whistle blowing for accounting enforcement purposes.

6. Conclusions

The primary aim of the article was to discuss in what way whistle blowing of employees could be – from an economic perspective – legitimately utilized for the regulation of accounting standards enforcement in Germany and Europe. The ostensible appeal of assigned enforcement agencies fostering whistle blowing is an enhanced efficacy of purely or predominantly reactive accounting enforcement. However, the analysis of the institutional economics of whistle blowing has shown that notifications to institutions outside an organization have ambivalent effects on organizational efficiency. To fortify external whistle blowing by regulation – either through direct rewards or through explicit protection from retaliation – can aggravate negative effects since one cannot preclude the incentive for individuals to blow the whistle for purely opportunistic reasons. Respective existing statutory approaches like the US SOX, the US False Claims Act, certain US state legislation, and in part the British PIDA, therefore, cannot claim to be legitimate. To enhance the pre-emptive impact of national and supranational enforcement mechanisms via such approaches is consequently not suitable.

Internal whistle blowing, on the other hand, avoids ambivalent effects on organizational efficiency. A credible commitment to an internal whistle blowing policy can principally tie the interests of an organization's managers to those of its stakeholders. However, statutory approaches that support internal whistle blowing via a protection of employees from retaliation – such as a large portion of the British PIDA – can also initiate opportunistic whistle blowing that negatively affects organizational efficiency. Such effects are only avoidable if statutory approaches do not directly address the whistle blower's calculus and exclusively enhance manager's incentives to establish an internal whistle blowing policy.

[159] See Kirchner (2002), pp. 19–20.

The approach suggested here is to first provide for an obligation of the management to signal a (non-)commitment to an internal whistle blowing policy via a compliance statement so as to enhance capital market pressure to install internal safeguards against accounting malpractice. Additionally, sanctioning of revealed accounting malpractice should be connected to the existence and suitability of internal whistle blowing policies. The approach combines actual legal measures to utilize self-regulation via governance codes of conduct – which so far do not address the issue of whistle blowing – and flexible sanctioning according to the paradigm of the US CSG. In particular, the idea of flexibly sentencing firms, as well as further suggestions for the implementation of the approach on the national and supranational level, also considerably reduce concerns with regard to the efficacy of self-regulation in corporate law.

Fortifying internal whistle blowing policies within organizations cannot substitute proactive accounting enforcement regulation. However, it can significantly relieve assigned enforcement agencies and help to accomplish the actual aim of rule enforcement: the ex ante prevention of (accounting) malpractice.

Acknowledgements

The author thanks Christian Kirchner and an anonymous referee for some helpful comments.

References

Alchian, A. A., & Demsetz, H. (1972). Production, information costs, and economic organization. *The American Economic Review*, *62*, 777–795.

Alexander, D., & Britton, A. (1999). *Financial reporting* (5th ed.). London.

Anechiarico, F., & Jacobs, J. B. (1996). *The pursuit of absolute integrity: How corruption control makes government ineffective*. Chicago.

AKEU (Arbeitskreis Externe Unternehmensrechnung). (2002). Enforcement der Rechnungslegung: Stellungnahme des Arbeitskreises Externe Unternehmensrechnung der Schmalenbach-Gesellschaft für Betriebswirtschaft. *Der Betrieb*, *55*, 2173–2176.

Arnold, D., & Ponemon, L. (1991). Intenal auditors' perceptions of whistle-blowing and the influence of moral reasoning: An experiment. *Auditing: A Journal of Practice & Theory*, *10* (2), 1–15.

Barnett, T. (1992). A prelimnary investigation of the relationship between selected organizational characteristics and external whistleblowing by employees. *Journal of Business Ethics*, *11*, 949–959.

Benston, G., Bromwich, M., Litan, R. E., & Wagenhofer, A. (2003). *Following the money: The enron failure and the state of corporate disclosure*. Washington.

Bilanzkontrollgesetz. (2004). Gesetz zur Kontrolle von Unternehmensabschlüssen (BilKoG) vom 15, Dezember 2004. *Bundesgesetzblatt, Part I*. (No. 69, pp. 3408–3415).

Böckem, H. (2000). *Die Durchsetzung von Rechnungslegungsstandards, (Betriebswirtschaftliche Studien Rechnungs- und Finanzwesen, Organisation und Institution: 47)*. Frankfurt/Main.

Borges, G. (2003). Selbstregulierung im Gesellschaftsrecht: zur Bindung an Corporate Governance-Codizes. In *Zeitschrift für Unternehmens- und Gesellschaftsrecht, 32. Jg* (pp. 509–540).

Brennan, G., & Buchanan, J. M. (1985). *The reason of rules: Constitutional political economy*. Cambridge.

Brickley, J. A., Smith, C. W., Jr., & Zimmerman, J. L. (2002). Business ethics and organizational architecture. *Journal of Banking and Finance*, *26*, 1821–1835.

Brody, R. G., Coulter, J. M., & Lin, S. (1999). The effect of national culture on whistle-blowing perceptions. *Teaching Business Ethics*, *3*, 385–400.

Buchanan, J. M., & Tullock, G. (1962). *The calculus of consent: Logical foundations of constitutional democracy*. Ann Arbor.

Buchanan, J. M. (1975). *The limits of liberty: Between anarchy und Leviathan*. Chicago.

Buchanan, J. M. (1990). The domain of constitutional economics. *Constitutional Political Economy*, *1*, 1–18.

Callahan, E. S., & Dworkin, T. M. (1991). Internal whistleblowing: Protecting the interests of the employee, the organization, and society. *American Business Law Journal*, *29*, 267–308.

Callahan, E. S., Dworkin, T. M., Fort, T. L., & Schipani, C. A. (2002). Integrating trends in whistleblowing and corporate governance: Promoting organizational effectiveness, societal responsibility, and employee empowerment. *American Business Law Journal*, *40*, 77–215.

CESR (Commission of European Securities Regulators). (2003). *Standard No. 1 on Financial Information: Enforcement of Standards on Financial Information in Europe, Ref.: CESR 03-073*. Available from http://www.europefesco.org.

Dandekar, N. (1990). Can whistleblowing be fully legitimated? A theoretical discussion. *Business and Professional Ethics Journal*, *10*, 89–108.

Deiseroth, D. (2001). *Whistleblowing in Zeiten von BSE*. Berlin: Der Fall der Tierärztin Dr. Margrit Herbst.

Deiseroth D. (2003). *Whistleblowing: Zivilcourage am Arbeitsplatz*. Available from http://www.ethikschutz.de/Deiseroth.htm.

Dworkin, T. M., & Near, J. P. (1997). A better statutory approach to whistle-blowing. *Business Ethics Quarterly*, *7*, 1–16.

Dworkin, T. M., & Baucus, M. S. (1998). Internal vs. external whistleblowers: A comparison of whistleblowering processes. *Journal of Business Ethics*, *17*, 1281–1298.

Easterbrook, F. H., & Fischel, D. R. (1991). *The economic structure of corporate law*. Massachusetts/London: Cambridge (third print 1996).

Ehrhardt, O., & Nowak, E. (2002). Die Durchsetzung von Corporate-Governance-Regeln. *Die Aktiengesellschaft*, *47*, 336–345.

Elliston, F. (1982). Anonymity and whistle-blowing. *Journal of Business Ethics*, *1*, 167–177.

Farrell, D., & Petersen, J. C. (1982). Patterns of political behavior in organizations. *Academy of Management Review*, *7*, 402–412.

FEE (Fédération des Experts Comptables Européens). (2002). *Discussion Paper on Enforcement of IFRS within Europe*. Available from http://www.fee.be/.

Feroz, E., Park, K., & Pastena, V. S. (1991). The financial and market effects of the SEC's accounting and auditing enforcement releases. *Journal of Accounting Research*, *29*(Suppl.), 107–142.

FRRP (Financial Reporting Review Panel). (2003). *Procedures for handling individual cases*. Available from http://www.frrp.org.uk.

Graser, D. (2000). *Whistleblowing. Arbeitnehmeranzeigen im US-amerikanischen und deutschen Recht, (European University Studies: Series II: Law: 2916)*. Frankfurt am Main.

Gobert, J., & Punch, M. (2000). Whistleblowers, the Public Interest, and the Public Interest Disclosure Act, 1998. *The Modern Law Review*, *63*, 25–54.

Grossman, S., & Hart, O. (1986). The costs and benefits of ownership: A theory of vertical and lateral integration. *Journal of Political Economy*, *94*, 691–719.

Haller, A., Eierle, B., & Evans, E. (2001). Das britische Financial Reporting Review Panel – ein Vorbild für ein deutsches Enforcement-Gremium. *Betriebs-Berater*, *56*, 1673–1680.

Hart, O. D., & Moore, J. (1990). Property rights and the nature of the firm. *Journal of Political Economy*, *98*, 1119–1155.

Hart, O. D., & Moore, J. (1999). Foundations of incomplete contracts. *Review of Economic Studies*, *66*, 115–138.

Hayek, F. A. v. (1988). In W. W. Bartley, III (Ed.), *The fatal conceit: Errors of socialism, collected works of F.A. Hayek* (Vol. 1). London.

Hirschman, A. O. (1970). *Exit, voice and loyalty: Responses to decline in firms, organizations, and states*. Cambridge.

Homann, K. (1997). *Unternehmensethik und Korruption Schmalenbachs Zeitschrift für betriebswirtschaftliche Forschung* (Vol. 49, pp. 187–209).

Hommelhoff, P. (2001). Für ein spezifisch deutsches Durchsetzungssystem: Schaffung einer Kontrollinstanz zur Sicherstellung der internationalen Wettbewerbsfähigkeit des deutschen Enforcement-Systems. *Die Wirtschaftsprüfung, Sonderheft, 54*, S39–S50.

Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics, 3*, 305–360.

Johnson, S. B., & Solomons, D. (1984). Institutional Legitimacy and the FASB. *Journal of Accounting and Public Policy*, *3*, 165–183.

King, Granville, III. (1999). The implications of an organization's structure on whistle blowing. *Journal of Business Ethics*, *20*, 315–326.

Kirchner, C. (1997). Bilanzrecht und neue Institutionenökonomik: Interdisziplinäre Überlegungen. In W. D. Budde, A. Moxter, & K. Offerhaus (Eds.), *Handelsbilanzen und Steuerbilanzen* (pp. 267–283). Düsseldorf.

Kirchner, C. (1998). A European Civil Code: Potential, conceptual and methodological implications. *U.C. Davis Law Review*, *31*, 671–692.

Kirchner, C. (2002). *Regulierung durch Unternehmensführungskodizes (Codes of Corporate Governance)* (Working Paper). Berlin.

Korn, E. (2002). Enforcement von Rechnungslegungsstandards: Welche Wirkung hat das Strafmaß? *Deutsches Steuerrech*, *40*, 1500–1504.

Küting, K., & Wohlgemuth, F. (2002). Internationales enforcement: Bestands-aufnahme und Entwicklungstendenzen. *Zeitschrift für kapitalmarktorientierte Rechnungslegung, 2*, 265–276.

Leisinger, K. M. (2003). *Whistle blowing und corporate reputation management* [Schriftenreihe für Wirtschafts- und Unternehmensethik] (Vol. 6). München/Mering.

Lenz, H., & Bauer, M. (2002). Die Durchsetzung von Rechnungslegungsnormen bei kapitalmarktorientierten Unternehmen. *Betriebswirtschaftliche Forschung und Praxis*, *54*, 246–262.

Lewis, D. (2001). Whistleblowing at work: On what principles should legislation be based? *Industrial Law Journal*, *30*, 169–193.

Lewis, D., & Spencer, M. (2001). The law relating to whistleblowing. In D. Lewis (Ed.), *Whistle blowing at work* (pp. 10–24). London/New Brunswick.

Lewis, D., & Sargeant, M. (2001). Whistleblowing and human resource management. In D. Lewis (Ed.), *Whistle blowing at work* (pp. 57–69). London/New Brunswick.

Lewis, D. (2002). Whistle blowing procedures at work: What are the implications for human resource practitioners? *Business Ethics: A European Perspective*, *11*, 202–209.

Macaulay, S. (1963). Non-contractual relations in business: A preliminary study. *American Sociological Review*, *28*, 55–67.

Macneil, I. R. (1980). *The new social contract: An inquiry into modern contractual relations*. London: New Haven.

Miceli, M. P., & Near, J. P. (1992). *Blowing the whistle: The organizational and legal implications for companies and employees*. New York.

Miceli, M. P., & Near, J. P. (1994). Whistleblowing: Reaping the benefits. *Academy of Management Executive*, *8*, 65–72.

Morse, J., & Bower, A. (2002). *Persons of the Year 2002: [Sherron Watkins:] The Party Crasher*. Available from http://www.time.com/time/personoftheyear/2002/poycooper.html (as published in *Time Magazine*, December Issue).

Müller, M. (2002). Whistle blowing – Ein Kündigungsgrund? *Neue Zeitschrift für Arbeitsrecht*, *19*, 424–437.

Near, J. P., & Miceli, M. P. (1985). Organizational dissidence: The case of whistleblowing. *Journal of Business Ethics*, *4*, 1–16.

Near, J. P., & Miceli, M. P. (1996). Whistle-blowing: Myth and reality. *Journal of Management*, *22*, 507–526.

Page, C. (2001). Erfahrungsbericht über die Tätigkeit des Financial Reporting Review Panel. *Die Wirtschaftsprüfung Sonderheft, 54*, S34–S38.

Painter, R. W., & Duggan, J. E. (1996). Lawyer disclosure of corporate fraud: Establishing a firm foundation. *SMU Law Review, 50*, 225–276.

PCAW (Public Concern At Work). (1999). *Public Interest Disclosure Act 1998: An introduction to the legislation with authoritative notes on it's provisions, section by section*. To be downloaded via the internet homepage of Public Concern At Work: http://www.pcaw.co.uk/legislation/legislation.html.

Peasnell, K. V., Pope, P. F., & Young, S. (2001). The characteristics of firms subject to adverse rulings by the Financial Reporting Review Panel. *Accounting and Business Research*, *31*, 291–311.

Polinsky, A. M., & Shavell, S. (2000). The economic theory of public enforcement of law. *Journal of Economic Literature*, *38*, 45–76.

Rawls J. (1971). *A theory of justice*. London.

RCG (Regierungskommission Corporate Governance). (2001). In Baums, Theodor, & Köln (Eds.), *Unternehmensführung, Unternehmenskontrolle, Modernisierung des Aktienrechts*.

Ripley, A. (2002). *Persons of the Year 2002: [Cynthia Cooper:] The night detective*. Available from http://www.time.com/time/personoftheyear/2002/poycooper.html (as published in *Time Magazine*, December Issue).

Satre, J. -P. (1948). *Les mains sales*. Paris.

Schanze, E. (1991). Symbiotic contracts: Exploring long-term agency structures between contract and corporation. In C. Joerges (Ed.), *Franchising and the law: Theoretical and comparative approaches in Europe and the United States* (pp. 67–103). Baden-Baden.

Schanze, E. (1993). Symbiotic contracts. *Journal of Institutional and Theoretical Economics*, *149*, 691–697.

Shleifer, A. (2004). *Does competition destroy ethical bejavior?* (NBER Working Paper No. 10269). Available from http://www.nber.org/papers/w10269.

Schmidt, M. (2002). On the Legitmacy of accounting standard setting by privately organized institutions in Germany and Europe. *Schmalenbach Business Review*, *54*, 171–193.

Schroeder, M., & Ip, G. (2002, July 17). For overburdened SEC, big budget increases are just the first step. *Wall Street Journal Europe*, pp. A1, A3.

Söllner, A. (2000). *Die Schmutzigen Hände*. Tübingen.

Sunder, S. (2002). Regulatory competition among accounting standards within and across international boundaries. *Journal of Accounting and Public Policy*, *21*, 219–234.

Theisen, M. R. (2003). Risikomanagement als Herausforderung für die Corporate Governance. *Betriebs-Berater*, *58*, 1426–1430.

Tielmann, S. (2001). *Durchsetzung ordnungsmäßiger Rechnungslegung: Ein Beitrag zur aktuellen Enforcement-Diskussion*. Düsseldorf.

van Es, R., & Smit, G. (2003). Whistleblowing and media logic: A case study. *Business Ethics: A European Review*, *12*, 144–150.

Wieland, J. (1994). Organisatorische Formen der Institutionalisierung von Moral in der Unternehmung: Empirische Resultate, theoretische Reflexionen. In W. Buchholz et al. (Eds.), *Wirtschaftsethische Perspektiven II: Unternehmen und Organisationen. Philosophische Begründungen. Individuelle und kollektive Rationalität* (pp. 11–33). Berlin.

Williamson, O. E. (1976). The economics of internal organization: Exit and voice in relation to markets and hierarchies. *The American Economic Review*, *66*, 369–377.

Williamson, O. E. (1979). Transaction-cost economics: The governance of contractual relations. *Journal of Law and Economics*, *22*, 233–261.

Williamson, O. E. (1981). The modern corporation: Origins, evolution, attributes. *Journal of Economic Literature*, *19*, 1537–1568.

Williamson, O. E. (1985). *The economic institutions of capitalism*. New York.

Williamson, O. E., & Masten, S. E. (Eds.). (1995). *Transaction cost economics: Vols. I and II (The International Library of Critical Writings in Economics: 54)*. Hants/Brookfield.

Wüstemann, J. (2002). Normdurchsetzung in der deutschen Rechnungslegung – Enforcement nach dem Vorbild der USA? *Betriebs-Berater*, *57*, 718–725.

Xu, C., & Pistor, K. (2003). *Law Enforcement Under Incomplete Law: Theory and Evidence from Financial Market Regulation, Columbia Law School, The Center for Law and Economic Studies* (Working Paper No. 222). Available from http://ssrn.com/abstract_id=396141.

Zimmermann, J. (2003). Beurteilungskriterien für enforcement-Modelle: Eine Analyse und Darstellung anhand des britischen Financial Reporting Review Panels. *Steuern und Bilanzen*, *5*, 353–360.