

Impact of Perceived Empathy and a Confidentiality Guarantee on Auditee Reporting Intentions

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Introduction

A PwC survey found that 49% of responding organizations reported experiencing fraud or economic crime in the past 24 months (PwC 2018). A contemporary EY survey found 36% of respondents believe fraud and corruption pose the greatest risk to their organization (EY 2018). PwC, surveying corporate participants, reported that 27% of initial detection came from tips (PwC 2018) while the Association of Certified Fraud Examiners (ACFE) disclosed that Certified Fraud Examiners (CFE) participating in their survey reported 40% of occupational fraud was discovered through tips (only 4% discovered through external audits). External auditors are not in the top five categories which make up 82% of all tip receivers (ACFE 2018). EY found that 52% of respondents had information or concerns about misconduct within their organizations while 56% of those ultimately decided not to report their concerns (EY 2017). KPMG's respondents suggested that 73% knew about misconduct within their organization with 56% reporting that they were aware of serious misconduct (KPMG 2013). These findings identify an area of potential opportunity for external auditors seeking to increase an auditee's willingness to disclose information in conjunction with their SAS 99 and AU Section 316 fraud inquiry requirements (AICPA 2002). This article focuses on tips that are conveyed to the external auditor through interviews that occur during the regular course of an audit.

A number of factors impact the judgment and decision-making process of the auditee, which ultimately affect the auditee's willingness to share information with the external auditor in an interview. Research has found that when auditors determined an observed act to be serious, their intentions to report were greater than when they viewed the act less seriously (Kaplan and Whitecotton 2001). Additionally, when an anonymous reporting channel was available, the likelihood of respondents reporting through non-anonymous reporting channels decreased (Kaplan and Schultz 2007).¹ Reporting intentions are also stronger for auditees who interact with an inquiring auditor versus a non-inquiring auditor (Kaplan et al. 2011).² This study extends the body of recent whistleblowing research by examining the impact of an audit firm provided confidentiality guarantee and the external auditor's level of empathy on an auditee's intention to report a potentially questionable act to the external auditor.

Our work postulates that an auditee's reporting intentions will be higher when the auditor exhibits perceived empathy than when they do not. This theory is measured by evaluating the perception of empathy that an auditee feels was demonstrated during their interaction with the external auditor. Further, we posit that a confidentiality guarantee provided by the external auditor will increase reporting intentions. We distinguish confidentiality from anonymity and, while we believe there are similarities, suggest that confidentiality is a different construct that needs researched to provide additional understanding in relation to whistleblowing. Finally, this research explores the impact of fraud type when considered in conjunction with perceived empathy and a confidentiality guarantee.³

¹ Kaplan and Whitecotton study the reporting intentions of auditors when coworkers were contemplating employment with an audit firm client and failed to comply with the ethics standards in place.

² Reporting intention is defined as the likelihood that the auditee will disclose specific information to the person(s) inquiring. For our purposes, reporting intention is the likelihood that the auditee will disclose relevant information specifically to the external auditor.

³ There are currently no regulations that would require an external auditor to provide this level of confidentiality guarantee, but if there is a significant increase in auditee willingness to share information with an external auditor when an anonymity guarantee is provided, there may be merit in pursuing such regulation.

When an auditee perceives the auditor as empathetic during an inquiry, we find an auditee's reporting intentions are stronger than when an auditee perceives that the auditor is not. Thus, the reporting intentions are affected by the level of confidentiality guarantee provided by the external auditor. The type of fraud (asset misappropriation versus financial statement fraud) also is found to play a role in the impact perceived empathy and a confidentiality guarantee has in motivating whistleblowing behavior. Specifically, when the observed act is financial statement fraud, both perceived empathy and a confidentiality guarantee significantly affect reporting intentions.

Our research contributes to research on auditee reporting intentions in at least two ways. First, it examines the effect of the external auditor's perceived empathy on the auditee's response to inquiry. Adding to the findings that the extent to which the auditor utilizes inquiry is important (Kaplan et al. 2011), we find that the auditee's willingness to share information is enhanced by the external auditor's level of perceived empathy. This fact is especially true in financial statement fraud situations, which can involve senior management of an organization and are therefore more sensitive for a potential whistleblower. Second, the results suggest that a confidentiality guarantee provided by the external auditor has a significant effect on reporting intentions. While confidentiality guarantees are not commonly used by external audit firms, the popularity of anonymous reporting by whistleblowers would suggest that the implementation of a confidentiality guarantee by the external auditor would increase a potential whistleblower's intentions. Finally, the results find that perceived empathy and a confidentiality guarantee jointly influence the reporting intentions of auditees when considering fraud type.

This study has potential implications for audit practice. The results provide insight into factors that influence the auditee's willingness to share information with the external auditor, which in turn enhances the ability of the external auditors to find possible problems beyond the limitations of traditional audit procedures. Responses obtained from auditees can impact the scope of an audit by influencing the auditor's assessment of the reliability of client-prepared documentation and the auditor's reliance on client-tested controls and walkthroughs. The reporting intentions of the auditee can become a critical component of the audit process if we are able to increase an auditee's willingness to disclose potentially fraudulent behavior.

The following section provides background literature review and also contains our development of hypotheses and research questions. The subsequent sections present the methods, the results, and a discussion of the implications and limitations of the study.

Development of Hypotheses

In an attempt to increase auditees' willingness to report questionable behavior, our research approaches the topic of reporting intentions from the perspective of the external auditor. Near and Miceli (1988a) characterized whistleblowing as identifying and bringing attention to possibly questionable practices in an attempt to 1) help the present and/or potential victims or 2) benefit the organization, as the whistle-blower believes the questionable practice is not in-line with the organization's stated values. EY found that 30% of respondents suggested that loyalty to their colleagues was a reason to report while 24% reported loyalty to their company as a consideration (EY 2017). With between 27% (PwC 2018) and 40% (ACFE 2018) of detected fraud coming from tips, research related to whistleblowing plays an important role in understanding the judgment and decision-making process related to the whistleblowing decision.

Near and Miceli (1996) reported three factors needed for whistleblowing to occur.⁴ First, someone is needed to commit a perceived wrongdoing. Second, someone is needed to observe or become aware of the perceived wrongdoing. Finally, someone is needed to receive the report of wrongdoing. The first and second factors cannot be directly controlled, but the third factor can be influenced to increase reporting intentions.

The intended recipient of the fraud disclosure influences the judgment process (Dozier and Miceli 1985; Gundlach et al. 2003; Hooks et al. 1994; Ponemon 1994). Most whistle-blower research focuses on either internal reporting to management (De George 1986) or external reporting to organizations such as the press (Callahan and Dworkin 1994; Perry 1992; Sims and Keenan 1998). While both conditions can be considered on their individual merits (Near and Miceli 1985, 1988a), the final decision is often determined by the whistle-blower's perceived assessment of the receptiveness of management and the possibility of retaliation. EY reported that 51% of respondents indicated concern over their future

⁴ In Near and Miceli (1985), the organization was identified as a fourth factor but has since been incorporated into the third factor in the revised three-factor model.

career influenced their decision while 46% identified fear for their personal safety as a consideration (EY 2017). While given these significant concerns, the largest source of tips still comes from employees (53%) (ACFE 2018). KPMG found that 53% of respondents felt comfortable reporting through a hotline while 23% reported that they would look the other way or do nothing (KPMG 2013).

Research has examined the nature of whistleblowing and assessed the underlying reasoning used by a whistleblower when contemplating reporting wrongdoing (Near and Miceli 1985, 1996; Sims and Keenan 1998; Clements and Shawver 2015). Near and Miceli (1996) attempted to identify personal and situational characteristics that would help explain why someone chooses to engage in the practice of whistleblowing. Sims and Keenan (1998) also performed research related to the organizational structure and how it might contribute to whistleblowing. They found that supervisor support of a code of formal policies, gender, and ideal values (employees with high ideals are more likely to whistle-blower) contributed to an increase in whistleblowing. Finally, Clements and Shawver (2015) examined emotional responses such as relief, satisfaction, and regret in relation to making reporting decisions.

An unanswered question is: “How do we make an auditee feel comfortable enough to report potential problems to the external auditor?” Near and Miceli (1988a) suggested that a fear of retaliation seems to be the factor that drives a whistleblower to an external reporting source. As such, an external auditor faces challenges in helping the auditee overcome the fear of retaliation and of presenting themselves as a valid external source to which perceived wrongdoing may be reported.

Inquiry and Perceived Empathy

While examining the relationship between an auditor and auditee, Kaplan et al. (2011) demonstrated that the auditee indicated an increased reporting intention when the auditor inquires as compared to when the auditor does not inquire. While inquiry increases reporting intentions, it also increases overall anxiety. Guerin and Guerin (2007) observed “tensions and anxiety about interviews and questioning” resulting from “both friendly and unfriendly” questioning. In particular, they noted that “when participants were suspicious . . . , this related to concerns that providing information might impact them” (Guerin and Guerin 2007, 155). Watson (2009) indicated that the use of empathetic inquiry, as a research tool, resulted in a deeper, richer, and more reliable set of data. The data was more creditable and trustworthy due to the candid responses obtained (Watson 2009).

Appreciative inquiry has the potential to be used to study the auditor/auditee relationship. Part of the value provided by appreciative inquiry is the rapport built between the interviewer (auditor) and the interviewee (auditee). Work by Baxter and colleagues (Bain and Baxter 2000; Baxter and Boon 2000; Baxter et al. 2002) examined the perception of the interviewer with Baxter et al. (2002), finding that participants in the friendly condition were perceived to be more “. . . friendly, understanding, respectful, positive, and warm.”

The effectiveness of inquiry depends upon the extent of appreciation exhibited by the inquirer (Whitney and Trosten-Bloom 2009; Morsillo and Fisher 2007; Liebling et al. 1999). Whitney and Trosten-Bloom (2009) posit that “Appreciative Inquiry unleashes information and commitment that together create energy for positive change.” Work by Morsillo and Fisher (2007) found that participants “reported feelings of positive identity affirmation and being able to make a difference” when appreciative inquiry was implemented. Similarly, Liebling et al. (1999) examined the impact of appreciative inquiry, finding that the relationships were better when “based on honesty, openness, clarity of purpose, . . . discretion, [and] flexibility where circumstances clearly require it.”

Emotional intelligence (EI) is using emotions effectively and can give auditors an edge in the workplace (Wotapka 2018). EI is the capacity to be aware of, understand and manage one’s own emotions and the emotions of the people around them (Salovey and Mayer 1990; Goleman 1995). The auditor with a high degree of emotional intelligence can effectively manage their own emotions, what those emotions mean, and how their own emotions can affect others. An auditor who exhibits strong EI may be better able to perceive how others regard the auditor and the situation, perceive how others perceive them, and build a trusting relationship (Wotapka 2018).

A key component of EI is empathy (Salovey and Mayer 1990; Goleman 1995). Empathy has been defined as the ability to understand and share the feelings of another (www.merriam-webster.com/dictionary). It is the capacity to ‘walk a mile in another person’s shoes,’ or to feel what the other person is experiencing from their frame of reference. Perceived empathy represents the degree to which a respondent identifies empathy being displayed by another in a given situation (Plank et al. 1996).

Empathy captures many of the components contained in the concept of appreciative inquiry, such as rapport building, fostering positive change, and increasing compassion (Troxel 2002; Cooperrider 2013, Waddington 2017). In this study, empathy represents a combination of human factors exhibited in emotional intelligence such as appreciation, receptiveness, respectfulness, and courtesy. Using the perceived empathy scale developed by Plank and colleagues, we can relate the appreciative inquiry work to perceived empathy, positing that empathy changes the outcome for what an auditee reports (Plank et al. 1996).

In recent literature, perceived empathy has been studied in a variety of contexts and disciplines. For example, a review of positive empathy that bolsters individual well-being and relationship strength was conducted by Morelli, et al. (2015). The purpose of the review was: 1) to study basic evidence suggesting that positive empathy is related to, but independent from, general positivity and empathy for the distress of others; and 2) a review of the evidence that positive empathy correlates with prosocial behavior, social closeness and well-being, (Morelli et al. 2015). Jones et al. (2016) further enriched the topic of perceived empathy in their study of empathy and active listening by analyzing and discussing the cost of providing support in the form of empathy.

Linking the components of appreciative inquiry as applied to the auditor/auditee relationship and perceived empathy, our research considers how empathy exhibited by the auditor and perceived by the auditee affects the auditee's intention to report a questionable behavior. Based on the foregoing, we posit that during an audit inquiry, an auditee will be more likely to report a questionable behavior when the external auditor demonstrates perceived empathy than when they do not. Thus, the first hypothesis is as follows:

- H1: An auditee's intention to report a questionable behavior will be stronger when the external auditor displays perceived empathy than when they do not.

Confidentiality

Research suggests that anonymity influences the intention to report wrongdoing (Near and Miceli 1988a, 1988b, 1996; Kaplan and Shultz, 2007; Kaplan et al. 2009). Risk of identity disclosure has been found to negatively affect reporting intention (Andrews and LeBlanc 2013). This problem has led to third-party managed hotlines as the preferred reporting method due (Hess and Cottrell 2016). Direct reporting is avoided as social confrontations result in the loss of anonymity (Kaplan et al. 2010). This perspective is supported by Maulidi (2016) who found that in-person reporting ranked last in their survey of preferred reporting venues.

Anonymity has been shown to encourage whistleblowing behavior as it reduces the perceived personal costs associated with whistleblowing (Johannson and Carey 2016). When anonymous reporting channels are available, the likelihood of reporting through non-anonymous reporting channels decrease (Kaplan and Shultz 2007). Internal versus external anonymous reporting channels were compared to determine if there was a difference in reporting intention (Kaplan et al. 2009). It was found that when both reporting avenues were anonymous, participants were more likely to report using an anonymous internal reporting channel. This study extends current literature related to reporting venue choice as an external auditor would be viewed as an external reporting channel.

Confidentiality is similar to anonymity but distinctly different. With anonymity, no one knows the personal identity of the whistleblower (i.e., an anonymous reporting hotline, a tip to the media, or anonymous disclosure to the SEC). With confidentiality, the person the whistleblower reports to is aware of the identity of the whistleblower (i.e., reporting to a superior, the internal auditor, or the external auditor). While anonymity has been previously researched, the concept of a confidentiality guarantee provided by a third party (in this case the external auditor) has yet to be explored.

Reprisal or retaliation is a significant concern when considering whether to report a questionable behavior. This results in a common fear of retribution experienced by some whistle-blowers (Near and Miceli 1988a, 1988b, 1996; Kaplan et al. 2010; Pope and Churyk 2014). In addition, research has reported that whistle-blowers often did not expect reprisal and would not have reported if they had properly estimated the outcome (Near and Miceli 1996).

Major government whistleblowing incentives such as the False Claims Act, the IRS Whistleblower Program, and the SEC Whistleblower Program all contain some level of confidentiality incentive when reporting to the US government (Archambeault and Webber 2015). More recently, the whistleblower program established by the Dodd-Frank Act also has provided a confidentiality incentive when reporting to the Securities and Exchange Commission (Brink et al. 2013; Guthrie and Taylor 2017; Moberly 2018).

The effect of anonymity and confidentiality on reporting intentions is of enough concern to a potential whistleblower that 95% of North American companies included in their study disclosed provisions related to anonymity and confidentiality (Lee and Fargher 2013). As such, it is expected that if the external auditor provides confidentiality, the auditee would be more willing to disclose sensitive information to the external auditor than if a guarantee is not present. Based on the foregoing, our second hypothesis is as follows:

- H2: An auditee's intention to report a questionable behavior will be stronger when the external auditor guarantees confidentiality than when they do not.

Joint Effect of Perceived Empathy and Confidentiality

As this study predicts positive main effects for both perceived empathy (H1) and confidentiality guarantee (H2), we anticipate that there is an additive effect of combining these two variables of interest. Literature does not currently investigate the interaction effects of perceived empathy coupled with a confidentiality guarantee, which makes it difficult to posit a directional hypothesis. Given that each of the variables independently are anticipated to increase the likelihood of whistleblowing, we are interested in observing and understanding the impact of combining both variables on whistleblowing intentions. Specifically, are the effects of perceived empathy and confidentiality on reporting intentions additive in nature, such that the reporting intentions will be strongest when the auditor shows both perceived empathy and guarantees confidentiality? Conversely, does perceived empathy or a confidentiality guarantee individually influence an auditee to the extent that the other variable is not as influential? Finally, if both variables are implemented, does one cancel out the other and essentially nullify the positive impact of the other?

As literature does not support a directional hypothesis related to the interaction effect of perceived empathy and confidentiality, the following research question is proposed:

- RQ1: Does the joint effect of perceived empathy and confidentiality have a significant effect on the reporting intentions of auditees?

Fraud Type

PwC reports asset misappropriation as making up as much as 48% of disruptive fraud while not reporting on the prevalence of financial statement fraud (PwC 2018). EY highlighted the changing dynamics of digital technology and its potential impact on fraud in the future (EY 2018). Currently, asset misappropriation represents the most common but smallest average fraud while financial statement fraud represented the least common but largest average fraud respectively (ACFE 2018). As such, most fraud related research focuses on asset misappropriation and financial statement fraud as they represent the two extremes with results being mixed as to the significance of fraud type when examining whistleblowing behavior (Kaplan et al. 2009; Kaplan et al. 2010; Kaplan et al. 2011; Scheetz and Wilson 2019).

Due to the lack of research that would predict a directional hypothesis and consistent with the approach taken by Kaplan et al. 2009 and Kaplan et al. 2011, we propose the following research question:

- RQ2: Will the effect of perceived empathy and a confidentiality guarantee on the reporting intentions of auditees differ across types of fraud?

Method

Design

The experiment implemented a two (level of perceived empathy: absent/present) x two (confidentiality guarantee: not given/explicitly provided) x two (fraud type: asset misappropriation/financial statement fraud) between subjects design⁵.

Participants⁶

Data were collected from two hundred and thirty-five Amazon Mechanical Turk (MTurk) participants who were

⁵ The design for this study is consistent with recent behavioral whistleblowing research (Kaplan, Pany, Samuels, and Zhang 2009 (2x2 design), Kaplan, Pope, and Samuels 2010 (2x2 design), Kaplan, Pope, Samuels 2011 (2x2x2 design), Robertson, Stefaniak, and Curtis 2011 (2x2 design), Wilson, McNellis, and Latham 2018 (4 x 2 design), Rose, Brink, and Norman 2018 (2 x 2 design), Scheetz and Wilson 2019 (2x2 design)).

⁶ This study is in full compliance with IRB standards and requirements. IRB approval was obtained for this study.

offered financial compensation for participation⁷. As reported in the demographic information provided in Table 1, the participants are relatively reflective of the work force. The mean age was 36.1 years old while the male/female participation rate was 56/44 percent. The participants also reported a mean work experience of 15.2 years. Of participants, 50.5 percent reported they had experience working with an external auditor⁸. Finally, the average number of years of work experience with an external auditor was 5.2 years. Prior research has used a range of participants to proxy for entry level auditees such as undergraduate students (Brink et al. 2015) and both undergraduate and graduate students (Fayard et al. 2014). These participants appear to be valid proxies, as our research is attempting to examine whistleblowing responses from average employees who would interact with the external auditor over the course of an audit. [See Table 1. Pg. 330]

Task

The participants were provided an instrument describing a fictitious company, which contained background information explaining that this company was a public company requiring an annual audit. It described some of the process the auditing firms use in their audit, which includes meeting with various employees to discuss their roles and the tasks for which they are responsible. Participants were then asked to read and respond to a scenario describing a potentially fraudulent situation. Roughly half of the participants were exposed to a scenario depicting an asset misappropriation situation while the other half were exposed to the financial statement fraud situation.

Following the fraud scenario, the participants were asked a series of questions to evaluate their judgment and decision making related to potential whistleblowing. Next, the participants completed manipulation check questions, which were used to determine whether they were influenced by the variables being evaluated. Finally, the participants completed a series of demographic questions at the conclusion of the survey.

Independent Variables

Perceived Empathy

The first independent variable was the level of perceived empathy demonstrated by the external auditor in their interaction with the auditee. This variable was manipulated at two levels: absent versus present. In the perceived empathy absent condition, the external auditor was described as being late to client meetings, not being respectful by significantly running over the communicated time and demanding immediate attention for requested supporting documents. In contrast, in the perceived empathy present condition, the external auditor was described as being punctual to client meetings, respectful of the auditee's time by not taking more time than communicated, and by being aware of demands on the auditee when requesting supporting documents.

Confidentiality

The second independent variable was the confidentiality guarantee. This variable was manipulated by either not mentioning a guarantee to the auditee or explicitly providing a guarantee to the participant that the external auditor would protect their identity by keeping their involvement confidential (confidentiality guarantee: not given/ explicitly provided). To manipulate the confidentiality guarantee not given condition, there was no mention in the scenario provided to the participants of the auditor discussing confidentiality. In contrast, to manipulate the confidentiality guarantee explicitly provided condition, the instrument identified a senior member of the audit team discussing the confidentiality guarantee in an opening meeting and stating that the firm's policy was to keep identities confidential.

Fraud Type

The final independent variable was fraud type. It was manipulated at two levels (asset misappropriation or financial statement fraud). The asset misappropriation scenario depicts another employee from accounts payable creating false invoices in order to steal money from the company. The financial statement fraud scenario depicts a scenario where

⁷ A number of studies have validated the use of Mechanical Turk participants by showing participants to be highly reliable and participant demographics to be diverse and representative of U.S. diversity (Paolacci, Chandler, and Ipeirotis 2010; Horton, Rand, and Zeckhauser 2011; Buhrmester, Kwang, and Gosling 2011; Farrell, Grenier, and Leiby 2015).

⁸ The subsample of participants that has experience with an external auditor was separately analyzed. Findings suggest similar behavior when compared to the full sample (For asset misappropriation: Perceived empathy ($p > 0.05$) and confidentiality guarantee ($p > 0.05$) and financial statement fraud: Perceived empathy ($p < 0.05$) and confidentiality guarantee ($p < 0.01$). As such, the full sample was used for the remainder of the analysis.

inventory was being shipped at period end to customers that had not placed orders to boost revenue to meet quarterly earnings estimates.

Dependent Variable

Participants' intention to report the questionable behavior was recorded in two ways. First, they were asked to indicate the probability that the employee in the case would report the issue to the external auditor (third-person reporting). Second, they were asked to indicate the probability that they would report the issue to the external auditor (first-person reporting). Both responses were recorded on a seven-point scale labeled from very unlikely (1) to very likely (7).

Covariate

Responses to the two measurements of the dependent variable were compared to determine the extent of social desirability bias (Cohen et al. 1996; Chung and Monroe 2003; Cohen et al. 1998, 2001; Kaplan et al. 2011; Robinson et al. 2012). Social desirability bias is a concern, as the responses obtained may not truly reflect an honest response. Social desirability predicts that responses will be inflated related to questions measuring positive behavior and deflated related to questions measuring negative behavior. Social desirability bias was significant ($p = 0.000$) for both the asset misappropriation and financial statement fraud cases. The mean reporting intention was significantly higher for the participants (first-person reporting) than for the individual identified in the case (third-person reporting). Consequently, consistent with prior research (Chung and Monroe 2003; Cohen et al. 1998, 2001; Kaplan et al. 2011; Robinson et al. 2012; Kaplan et al. 2015), social desirability bias is controlled by calculating the difference between third-person and first-person responses and using the calculated difference as a covariate in the remainder of the analysis.

Results

Manipulation Checks

Manipulation questions were asked to verify the effectiveness of the manipulations of the three dependent variables. Participants were asked to indicate yes/no in response to whether the external auditor was friendly and appreciative of their time. They were then asked to indicate whether the external auditor promised not to tell anyone who had provided the information. Participants were finally asked to indicate whether the scenario depicted asset misappropriation or financial statement fraud. The results were examined with the full sample and the subsample that only contains participants that passed the manipulation check questions. The results were significantly different between samples. As a result, participants that failed the manipulation checks were excluded from subsequent analysis resulting in a sample of 184 participants.

To further examine the manipulation of empathy, perceived empathy was measured using the (Plank et al. 1996) six question scale. The average of the responses was compared and participants in the empathy present condition ($M = 4.92$, $s.d. = 1.146$) reported significantly higher evaluation ($t = -9.074$, $p = 0.000$) of perceived empathy when compared to the empathy absent condition ($M = 2.64$, $s.d. = 1.354$).

Test of Hypotheses

To test the hypotheses, a two (perceived empathy: absent/ present) x two (confidentiality guarantee: not given/ explicitly provided) x two (fraud type: asset misappropriation/financial statement fraud) between subjects test was performed with reporting intention as the dependent measure. The results are shown in Table 2 with the mean values for the perceived empathy and confidentiality manipulations displayed in Figure 1. [See Table 2, pg. 331] [See Figure 1, pg. 329]

H1 predicts a main effect of the external auditor's level of perceived empathy on the participants' intention to report the questionable behavior. As shown in Table 2, the mean response for the perceived empathy present condition ($M = 4.19$, $s.d. = 1.558$) was significantly ($F = 5.731$, $p = 0.018$) higher than the mean response for the perceived empathy absent condition ($M = 3.74$, $s.d. = 1.566$). Therefore, we find that H1 was supported, indicating a main effect of perceived empathy on reporting intentions. This support is informative as it shows that perceived empathy is both recognized (as demonstrated with the perceived empathy scale) and acted upon by the receiver. An auditor displaying empathy in fraud inquiry interviews will result in significantly higher cooperation when compared to inquiries where the auditor does not display empathy.

H2 predicts the main effect of a confidentiality guarantee on the participants' intention to report the questionable behavior. Table 2 shows that this effect was significant ($F = 7.686$, $p = 0.006$). The mean response for the confidentiality guarantee explicitly provided condition ($M = 4.191$, $s.d. = 1.493$) was significantly higher than the mean response for the confidentiality guarantee not given condition ($M = 3.676$, $s.d. = 1.648$). Therefore, we find that H2 also was supported,

indicating a main effect of a confidentiality guarantee on reporting intentions. These findings suggest that in situations where the external auditor explicitly informs the auditee that their responses will be kept confidential, the auditee will be significantly more likely to engage and share information. Our research also shows that inquiry by the auditor is not automatically assumed to be confidential which hinders the sharing of necessary information.

Our research questions examined the interaction between perceived empathy and confidentiality guarantee (RQ1) as well as the impact of fraud type (RQ2). While Table 2 indicates that the interaction is not significant ($F = 0.913$, $p = 0.341$), we find that the interaction of fraud type, confidentiality, and perceived empathy is significant ($F = 5.203$, $s.d. = 0.024$). With these conflicting results, each fraud type was examined separately in order to tease out the interaction observed between fraud type, confidentiality, and perceived empathy.

Asset Misappropriation

When examining asset misappropriation, as reported in Table 3 and depicted in Figure 2, the main effect of confidentiality ($F = 0.813$, $p = 0.369$) and the main effect of perceived empathy ($F = 0.143$, $p = 0.706$) are not significant. This finding is contrary to the results observed when evaluating the overall data. The interaction between the confidentiality guarantee and perceived empathy, on the other hand, is significant ($F = 4.604$, $p = 0.035$). This finding suggests that an interaction effect is observed in the asset misappropriation scenario. The disclosure of asset misappropriation to the auditor, while possibly informative, is often not material in and of itself (ACFE 2018). Data suggests that for this particular fraud type, there is not a main effect of empathy nor confidentiality and, while an interaction effect is observed, it does not significantly increase reporting intentions across conditions. [See Table 3, pg. 332] [See Figure 2, pg. 329]

Financial Statement Fraud

As shown in Table 4, the main effects of confidentiality guarantee ($F = 9.536$, $p = 0.003$) and perceived empathy ($F = 10.657$, $p = 0.002$) are significant. Contrary to the interaction observed in the asset misappropriation scenario, the interaction of confidentiality guarantee by perceived empathy in the financial statement fraud scenario ($F = 0.782$, $p = 0.379$) is not significant. As such, while both empathy and confidentiality guarantee display positive main effects, an interaction effect is not observed in the financial statement fraud scenario. The means are displayed in Figure 3. It is noted that the highest reporting cell ($M=4.96$) is the empathy present/confidentiality guarantee given condition while the lowest reporting cell ($M=3.07$) is the empathy absent/no confidentiality guarantee given condition which supports incorporating both empathy and confidentiality guarantee into SAS 99 fraud inquiry interviews. [See Table 4, pg. 333] [See Figure 3, pg. 330]

In light of these findings, we see that fraud type has a significant influence on the effects of perceived empathy and a confidentiality guarantee on reporting intentions (RQ2). SAS 99 requires the external auditor to perform fraud inquiry during the course of the audit (AICPA 2002). Our findings suggest that, even though an interaction effect was not observed, incorporating empathy and a confidentiality guarantee into the fraud inquiry process will result in a greater likelihood of financial statement fraud disclosure (RQ1). This finding is directly applicable to practice as it enhances the outcome of the regulatory mandated fraud inquiry process.

Discussion

The present study extends whistleblowing literature on factors that influence individuals' intention to report questionable behavior. The results suggest that in audit inquiries, the level of perceived empathy displayed by the external auditor and confidentiality guarantee influence the reporting intention of the auditee. This fact is important to the extent that Kaplan, et al. 2011 found that auditees had a higher reporting intention when the auditor inquires about fraud compared to when the auditor does not inquire. Coupled with the findings of Kaplan and colleagues, adding the variables of empathy and confidentiality into auditor fraud inquiry would possibly result in greater auditee willingness to report wrongdoing.

This study distinguished a confidentiality guarantee from anonymity in an attempt to contribute to practice. If the external auditor is performing their required SAS 99 fraud inquiries as part of their regular financial audit procedures, anonymity is not a construct that is applicable. The auditor knows the identity of the employee they are talking to and, as such, the confidentiality construct is the appropriate one to explore in this particular situation. Confidentiality is based on trust and is, in practice, the variable the external auditor has to offer. The findings of this study related to both perceived empathy and confidentiality are directly applicable to external auditors and their required SAS 99 fraud inquiries.

When evaluating the two fraud scenarios separately, we identified that financial statement fraud is overly sensitive to the perception of empathy and confidentiality guarantee. We also observed that auditees are most willing to report a questionable issue when the external auditor both displays perceived empathy and provides a guarantee of confidentiality. Inversely, while asset misappropriation was not impacted by perceived empathy or confidentiality, an interaction effect was observed.

The results of our study should be interpreted in light of its limitations. One limitation is the hypothetical fraud scenarios. Since they were hypothetical and not real situations, the participants may have reacted differently than they would have in an actual situation. Furthermore, for the sake of time, limited information was provided in the instrument to the participants. If more detailed or alternative information was provided, it is possible that their responses may have varied. Finally, participants were accessed via an online platform. While we feel that they are a satisfactory sample due to their demographic responses, as with any anonymous sampling approach, it is possible that the information provided was not accurate.

In a world of ever-changing technology, it would be of interest to evaluate how perceived empathy can be communicated via alternative media such as emails or text messages. Future research could assess the differences in perceived empathy when requests for financial information or fraud inquiry are performed electronically versus in person. Future research could focus also on the auditor's self-perception of empathy displayed to the client and how training can improve actual empathy displayed to the client. In addition, the concept of empathy in the inquiry process could specifically be expanded to fraud investigation or legal interrogations as those settings would be specifically asking the wrongdoer questions versus the potential whistleblower scenario used in this study. Future research also could explore the impact of perceived empathy if the interaction with the external auditor occurred with the perpetrator of the fraud, as the dynamics would be different than the interaction of the external auditor and potential whistleblower explored in this study. Finally, the concept of perceived empathy has been subdivided to include both cognitive and affective constructs that measure the degree to which a respondent perceives empathy from another in a given situation (Plank et al. 1996). Further exploration into how these two components influence an auditee's willingness to share information with the external auditor could yield beneficial results for strengthening the fraud inquiry ability of the auditor.

Finally, further research into the practical implementation of a confidentiality guarantee is needed. With confidentiality being significant in the financial statement fraud scenario, it appears that higher risk reporting may benefit from auditors exploring the legality and practicality of implementing such a guarantee.

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www.merriam-webster.com/dictionary

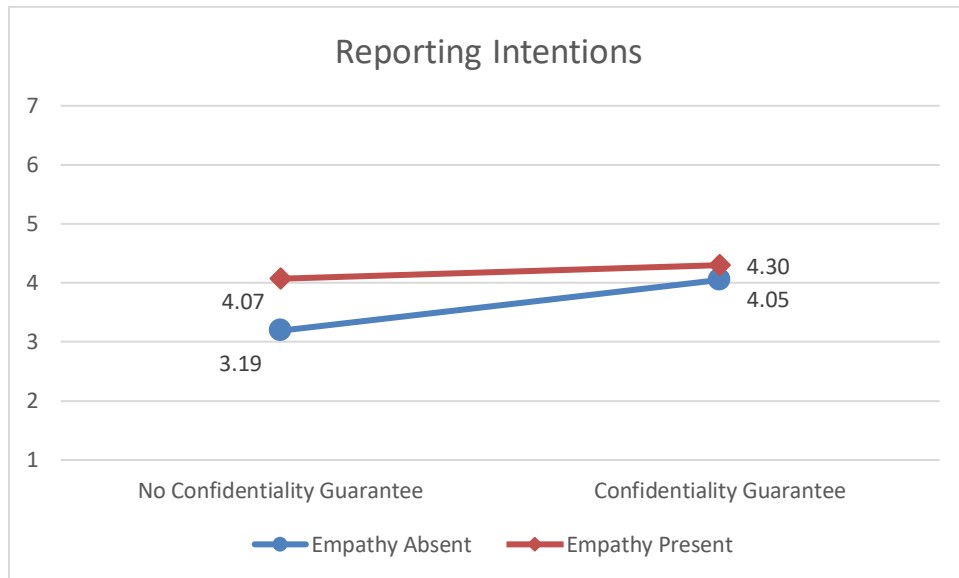
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Figure 1



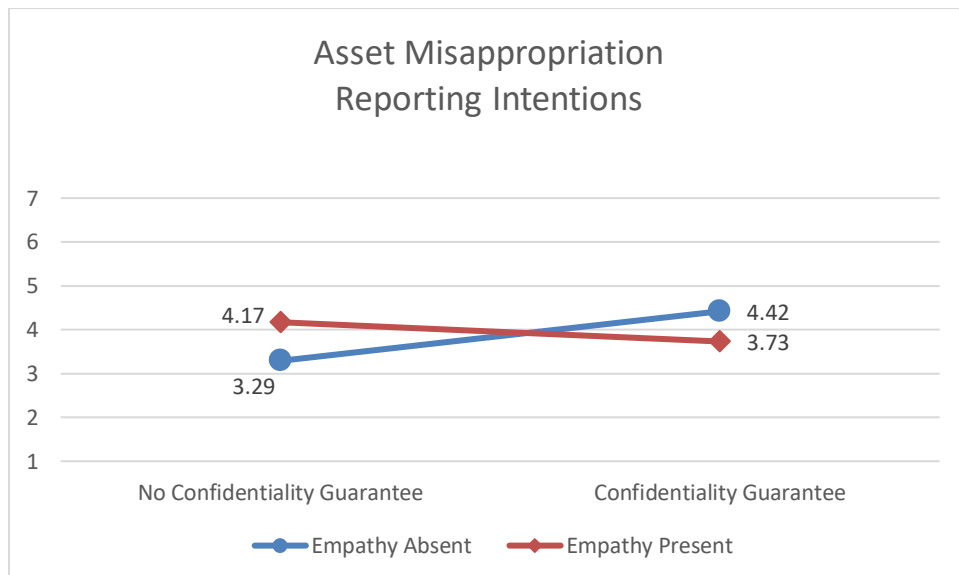
Variable Definitions:

Perceived Empathy = participants indication of the likelihood that they would report the questionable behavior (1 = very unlikely, 7 = very likely).

Confidentiality = two-level factor manipulating the confidentiality provided by the auditor.

Perceived Empathy = two-level factor manipulating the empathy displayed by the auditor.

Figure 2



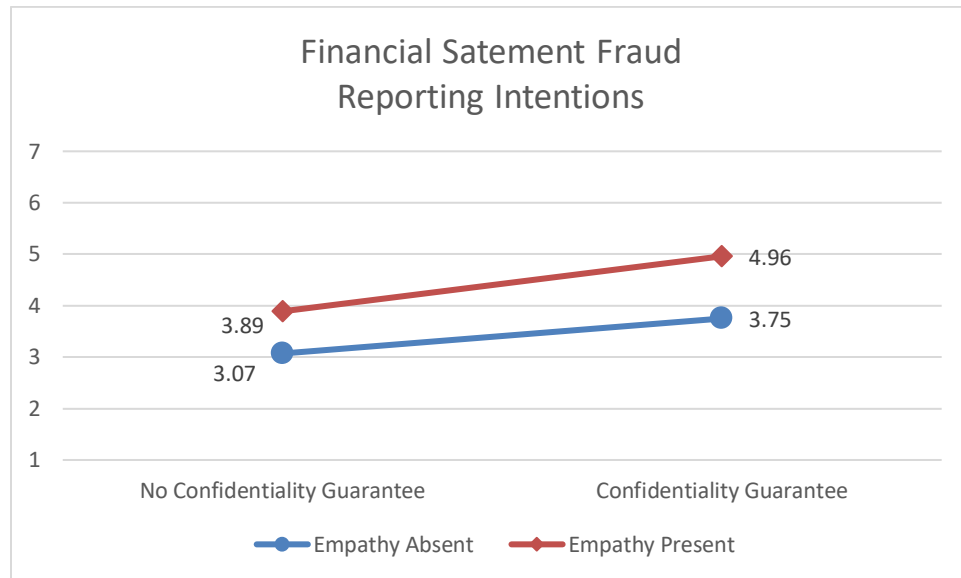
Variable Definitions:

Perceived Empathy = participants indication of the likelihood that they would report the questionable behavior (1 = very unlikely, 7 = very likely).

Confidentiality = two-level factor manipulating the confidentiality provided by the auditor.

Perceived Empathy = two-level factor manipulating the empathy displayed by the auditor.

Figure 3



Variable Definitions:

Perceived Empathy = participants indication of the likelihood that they would report the questionable behavior (1 = very unlikely, 7 = very likely).

Confidentiality = two-level factor manipulating the confidentiality provided by the auditor.

Perceived Empathy = two-level factor manipulating the empathy displayed by the auditor.

Table 1: Participant Demographic Information

		Full Sample: n = 235	Successful Participants: n = 184
Age		35.4	36.1
Gender			
	Male	56%	56%
	Female	44%	44%
Years of Work Experience		14.7	15.2
Worked with external auditor			
	Has work experience	50.2%	50.5
	Does not have work experience	49.8%	49.5
Years worked with external auditor		4.9	5.2

Table 2: ANOVA Results
(Auditee's Probability to Report)

Panel A: Fraud Type x Confidentiality x Perceived Empathy ANOVA (n=184)					
Source of Variation	df	Sum of squares	Mean squares	F	p-value
Intercept	1	2031.040	2031.040	966.770	0.000
SDB	1	30.332	30.332	14.438	0.000
Confidentiality	1	16.146	16.146	7.686	0.006
Empathy	1	12.039	12.039	5.731	0.018
Fraud Type	1	0.010	0.010	0.005	0.944
Confidentiality * Empathy	1	1.919	1.919	0.913	0.341
Fraud Type * Confidentiality	1	4.110	4.110	1.956	0.164
Fraud Type * Empathy	1	7.234	7.234	3.444	0.065
Fraud Type * Confidentiality * Empathy	1	10.931	10.931	5.203	0.024
Error	175	367.649	2.101		
Total	184	3373.000			

a. R Squared = .188 (Adjusted R Squared = .151)

Panel B: Cell Means

Perceived Empathy	Confidentiality Guarantee		
	No Guarantee	Guarantee	Total
Absent	3.19 (1.533) n = 32	4.07 (1.503) n = 54	3.74 (1.566) n = 86
Present	4.05 (1.652) n = 42	4.30 (1.488) n = 56	4.19 (1.558) n = 98
Total	3.68 (1.648) n = 74	4.19 (1.493) n = 110	3.984 (1.573) N = 184

**Table 3: ANOVA Results—Asset Misappropriation Case
(Auditee's Probability to Report)**

Panel A: Confidentiality x Perceived Empathy ANOVA (n=96)					
Source of Variation	df	Sum of squares	Mean squares	F	p-value
Intercept	1	1114.752	1114.752	463.248	0.000
SDB	1	26.066	26.066	10.832	0.001
Confidentiality	1	1.957	1.957	.813	0.369
Empathy	1	0.345	0.345	0.143	0.706
Confidentiality * Empathy	1	11.078	11.078	4.604	0.035
Error	91	218.981	2.406		
Total	96	1757.000			

a. R Squared = .160 (Adjusted R Squared = .123)

Panel B: Cell Means

	Confidentiality Guarantee		
Perceived Empathy	No Guarantee	Guarantee	Total
Absent	3.29 (1.724) n = 17	4.42 (1.554) n = 26	3.98 (1.696) n = 43
Present	4.17 (1.696) n = 23	3.73 (1.596) n = 30	3.92 (1.639) n = 53
Total	3.80 (1.742) n = 40	4.05 (1.600) n = 56	3.948 (1.657) N = 96

**Table 4: ANOVA Results—Financial Statement Fraud Case
(Auditee's Probability to Report)**

Panel A: Confidentiality x Perceived Empathy ANOVA (n=88)					
Source of Variation	df	Sum of squares	Mean squares	F	p-value
Intercept	1	910.109	11.306	6.395	0.000
SDB	1	6.204	910.109	514.814	0.000
Confidentiality	1	16.857	16.857	9.536	0.003
Empathy	1	18.840	18.840	10.657	0.002
Confidentiality * Empathy	1	1.383	1.383	0.782	0.379
Error	83	146.731	1.768		
Total	88	1616.000			

a. R Squared = .236 (Adjusted R Squared = .199)

Panel B: Cell Means

	Confidentiality Guarantee		
Perceived Empathy	No Guarantee	Guarantee	Total
Absent	3.07 (1.335) n = 15	3.75 (1.404) n = 28	3.51 (1.404) n = 43
Present	3.89 (1.629) n = 19	4.96 (1.038) n = 26	4.51 (1.408) n = 45
Total	3.53 (1.542) n = 34	4.33 (1.374) n = 54	4.02 (1.485) n = 88