Walking the talk

Enacted ethical climates as psychological contract venues for potential whistleblowers

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Abstract

Purpose – Based on exchange theory and the generalized norm of reciprocity, psychological contracts perceived by employees are believed to have dysfunctional consequences for organizations if breached. This paper aims to study the willingness of employees to report fraud, as such is an important aspect of internal control for organizations.

Design/methodology/approach – A 2 × 2 between-subjects experiment was conducted in which 99 participants with diverse accounting backgrounds were first asked questions about their preconceived beliefs (psychological contract) regarding how reports of unethical conduct would be managed, and their reaction if these beliefs were broken (psychological contract violation). Participants were given a hypothetical situation of fraud and then asked to indicate their likelihood of reporting fraud to a supervisor.

Findings – The main hypotheses are that employees will be less likely to report fraud when the organization fails to signal the presence of a positive ethical environment or when management reacts weakly to previous reports of unethical activity. The data and findings support these hypotheses. Additional testing also reveals that a psychological contract violation mediates the relationship between the outcome of previous reports and the intention to report fraud.

Research limitations/implications – As with any experimental study, this study’s results come with limitations. Reading an overly simplistic scenario that omits real world details and providing intention to report is very different from actually reporting fraud in one’s own place of employment. Therefore, reporting intentions may vary from actual reporting behavior. Further, reporting motivation (self-defense, altruism, etc.) and concern over retaliation are not measured.

Practical implications – Employees have expectations surrounding ethical corporate environments. Psychological contract violations occur as a result of broken expectations and are common in the workforce. In this study, a breakdown in the internal control environment because of a poor ethical culture, caused an even greater breakdown in internal controls because of employees’ decreased reporting intentions.

Social implications – Psychological contract violations impact employees’ intention to report fraud. These violations need to be understood so that additional measures and safeguards can be instituted when employees are not acting as a fraud defense or detection mechanism. During such times when there is a breakdown in this type of internal control (that is, when employees might be hesitant to report fraud), extra safeguards against fraud, additional procedures to detect fraud, and enhanced employee training encouraging reporting of suspected unethical conduct, become even more important.

Originality/value – Strong experimental methods provide a rigorous way to evaluate a problem of our day: job insecurity caused by rampant organizational turbulence. The hidden cost is expressed in terms of how less can be expected of employees as a first line of defense against fraud.

Keywords Job insecurity, Whistleblowing, Organizational change, Psychological contract, Ethics, fraud, Reporting intentions

Paper type Research paper
1. Introduction
Notwithstanding sustained efforts of criminalization, detection and punishment, economic crime is rampant, and increasing. In the USA, over half of all companies report falling victim to fraud (PwC, 2018; ACFE, 2018; Kroll, 2018). With most frauds occurring in the form of the misappropriation of assets, companies worldwide grow increasingly reliant upon whistleblowers for detection (ACFE, 2018).

Fraud's continuation as a major corporate problem could seem ironic in the context of increased attention to internal control in recent years (COSO, 2013; PCAOB, 2007; AICPA, 2002). Assets should be safeguarded in ways that make their unplanned departure much less likely. Companies have internal audit functions that are tasked with ensuring such controls are working. Nonetheless, fraudsters find ways to defeat or bypass official controls. In such a world, all employees have to be on guard for the good of the company and essentially act as an informal additional internal control against fraud.

Just about every organization encourages its employees to be “eyes and ears” on the ground against those that would misdirect company resources. However, such suggestions and policies are mostly ineffective (Jensen et al., 2010). Reporting fraud apparently is highly problematic, leading to regret for both those that do and do not (Fredin, 2012). The willingness to report fraud cannot be assumed, but instead is dependent upon a large set of situational and individual factors (Jones and Kavanagh, 1996).

To a large extent, our appreciation of fraud has been limited by the “fraud triangle” (Cressey, 1973). Fraud resulted from the confluence of opportunity to commit the act, a motivation to do such, and an ability to rationalize such behavior. Research that focuses upon those that observe fraud committed by others tends to accept the idea that the desire to steal cannot be eradicated. However, increased vigilance by honest others can reduce the fraudster’s opportunities. At the same time, we need to understand the rationalizations in play by those that see fraud but choose not to report it.

Based on exchange theory, the psychological contract between employees and their organization provides a template to appreciate the behavior of putative reports of fraud. To date, very little is known about how an employee’s psychological contract may impact their likelihood of reporting fraud. A psychological contract is an individual’s beliefs about the terms and conditions of a reciprocal exchange agreement between themselves and another party (such as the organization), where a promise has been made and consideration offered (Rousseau, 1989, 2001). However, these contracts are imperfect because they are based on beliefs that are often not formally written or communicated, and the consideration may be implied, making the contract easier to break.

A psychological contract violation (PCV) occurs when an individual perceives that the other party has not fulfilled their obligations (Morrison and Robinson, 1997; Coyle-Shapiro, 2002). These unmet expectations may cause a psychological contract violation and can result in a variety of negative feelings and ultimately impact both in-role and extra-role performance (Morrison and Robinson, 1997; Turnley and Feldman, 2000). Extra-role behaviors are the organizational citizenship acts that employees engage in which are not explicitly required as part of their job responsibilities, but are instead discretionary and not typically rewarded (Organ, 1988; Coyle-Shapiro, 2002). As whistleblowing is an extra-role or organization citizenship behavior, it may be negatively affected by the occurrence of a PCV.

This study examines how psychological contract violations impact employee intentions of internally reporting fraud using a $2 \times 2$ between-subjects experimental design. Participants (99) with diverse accounting backgrounds (staff accountants to senior executives) respond to a scenario in which fraud is discovered. In this experiment, a psychological contract violation is provoked through a negative control environment using
poor responses to previous reports of unethical conduct and an overall unethical climate. Outcome of previous reports of misconduct and organizational ethical climate are both manipulated as being either negative or positive, to allow for the comparison of the occurrence of a PCV to no PCV. Employees expect reports of misconduct to be handled appropriately, and when such reports are not, a PCV results. Similarly, employees anticipate organizations will have and promote a positive ethical climate, and when this is not true, a PCV could be the interpreted consequence.

The experimental results indicate that employees do have preconceived beliefs amounting to a psychological contract, regarding how they expect reports of unethical conduct to be managed as well as what type of ethical environment the organization should maintain. When these beliefs are violated, fraud reporting intentions to the supervisor significantly decrease. Further, the occurrence of a psychological contract violation mediates the relationship between outcome of previous reports and the intention to report fraud.

This study contributes to the whistleblowing, fraud triangle, and audit literatures by demonstrating the negative consequences of psychological contract violations to the organization. A PCV significantly decreases the intention to report fraud. Psychological contract violations in organization employees may be hindering fraud reporting, thereby enhancing the salience of the opportunity leg of the fraud triangle. Organization management relies on employees to act as a defense against fraud and as a mechanism to detect and report fraud. Vigilant employees can help to deter, detect, and report fraud, weakening a fraudster’s opportunity. Management and auditors also need to be aware of when it is likely that a situation has occurred which may have provoked a PCV in company employees. Once alerted that a situation has occurred that may have caused a PCV, management can then begin to take steps to repair the employees’ psychological contract and to mitigate the chance that future frauds will go undetected.

The paper consists of five subsequent sections. Section 2 provides a literature review mostly related to psychological contracts. Section 3 articulates the hypotheses that are grounded in that literature. Section 4 describes the methodology for the collection of data to test the hypotheses. Sections 5 and 6 summarize the findings and discusses both their implications and limitations, respectively.

2. Theory and literature review
Building on the standard sociological premise that behavior is normatively based, Gouldner (1960) formally articulated the norm of reciprocity as a fundamental building block of relationships. He reasoned that the repayment of others was a universal component of moral codes, seen by most as a duty to others and, on a macro-scale, that which allows for a stable society. Subsequently, reciprocity became the essence of exchange theory (Homans, 1958), which has been used by many to explain human relationships. This thinking was further developed by Blau (1964) and Adams (1965) to incorporate planned investments made in the expectation of interpersonal rewards. Thus, reciprocity promoted a rough calculus of exchange that allowed trust to form (Butler, 1991). In the context of long-term employment, the theory suggested that good employer treatment of employees would provoke extraordinary levels of employee service to the employer. (Coyle-Shapiro et al., 2004). The extent to which these norms were embraced and their origins are empirical questions (Izraeli and Jaffe, 1998).

Argyris (1960) is believed to have coined the phrase “psychological contract” to apply exchange theory to the workplace. Notwithstanding those relatively few expectations recognized by law, employees come to anticipate certain benefits and considerations from the organizations that employ them. The psychological contract suggests that the services
and other behaviors forthcoming from the employee have to be continually balanced by the
delivery of valued compensations of many different kinds by the organization.

The mutuality of the psychological contract belies its implied and quite subjective
nature. In accordance with its name, the psychological contract exists in the mind of the
employee and has not been formally agreed upon by the organization. In fact, discrepancies
about its terms should be anticipated (Sherman and Morley, 2015) and organizations' views
about its elements are only infrequently heard (Guest and Conway, 2002). Its power exists as
a stable mental model that filters the reception of new information by the employee
(Rousseau, 2001).

Psychological contracts are usually sourced in the early socialization experiences of
workers. Kotter (1973) suggests that the outlines of this contract are critical to the “joining
up” process, as both employee and employer explore their fit. Early experiences with the
company, tempered perhaps by previous employment experiences, are critical (Rousseau,
2001). The employee adjusts expectations to a discovered reality, as well as to their self-
conceptions of ability to perform for the organization (De Vos et al., 2003).

Within the psychological contract, employees are believed to distinguish employee
inducements from subsequently assumed obligations, with the former of greater
consequence (Coyle-Shapiro and Conway, 2005). Although most writers agree that terms of
the contract must be based on employer promises, how specific those promises need to be is
debatable (Robinson, 1996). For example, that services have to be provided for wages is
clear, but the extent to which loyalty is implied by the provision of services is not (Coyle-
Shapiro, 2002). Over time, jobs tend to enlarge, making that which was extra-role into
internal-role (Coyle-Shapiro et al., 2004).

Psychological contracts become particularly interesting to researchers when they are
breached. These violations are generally defined as the non-fulfillment of an obligation owed
by the organization as perceived by the employee (Morrison and Robinson, 1997) or by the
discrepancy between organizational promise and organizational delivery (Coyle-Shapiro,
2002). These situations are commonplace, reported by a majority of all workers (Robinson
and Rousseau, 1994) and are made more likely if the organization experiences significant
external pressure (Coyle-Shapiro and Kessler, 2000). Robinson and Morrison (2000) find that
the likelihood of perceived contract violation to be correlated with inadequate socialization.

Trust serves as an important mechanism that both creates and gives expression to
violations of psychological contracts. How much trust an employee is willing to vest in an
employee relationship is not constant (Butler, 1991). Employees who trust their employers
more tend to show large and more severe reactions upon psychological contract breach
(Coyle-Shapiro, 2002) but are also less likely to perceive the occurrence of breaches
(Robinson and Rousseau, 1994). The loss of trust is perceived as a betrayal that gives import
to the breach (Turnley and Feldman, 2000), or as the impetus for feelings of loss that
challenge one's sense-making (Morrison and Robinson, 1997).

Violations in and of themselves are not much interest. How employees react to those
situations are the usual object of attention. As an effort to essentially re-balance the
exchange with the employer, the employee predictably reduces their contribution to the
pursuit of employers' goals, perhaps as simply as reducing their overall effort (Rayton and
Yalabik, 2014; Robinson et al., 1994). The employee loses commitment perhaps to the point
of engaging in various withdrawal behaviors (Guest, 1998; Coyle-Shapiro and Kessler, 2000).

Some studies have sought to differentiate the employee’s reaction to psychological
contract violations. If we should expect that the reaction will reflect the intensity of the
violated assumption (Guest, 1998), a range of possibilities exist. Typically, the literature has
contented itself with a cataloguing of the distancing and de-identification of the individual
from the organization (Zagenczyk et al., 2013). This follows the predictable pathway through diminished levels of job satisfaction and organizational commitment, and may include elevated turnover intentions. Some studies have been more specific, perhaps by distinguishing in-role and extra-role behaviors. The general consensus is that the former is most at risk but the latter is not immune (Turnley and Feldman, 2000). The high emotional states sometimes involved (Morrison and Robinson, 1997) suggest that contra-productive behavior may go further, perhaps into criminal and deviant zones (Fayyazi and Aslani, 2015). However, employees wishing to “get even” with organizations has to be an infrequent case (Turnley and Feldman, 1999). Researchers should bear in mind that reactions to the same PCV are not homogeneous. Whereas many are willing to choose a difficult-to-detect passive strategy, an active one creates other considerations for the organization.

Several writers have observed the conceptual overlap between psychological contracts and organizational citizenship behavior (Coyle-Shapiro, 2002). Organ (1997) defines these behaviors to be strictly voluntary acts that transcend role expectations and could not be enforced by the organization, but benefit the organization in material ways. These acts produce more job satisfaction for employees than do regular work accomplishments (Organ and Ryan, 1995). Whereas the organizational citizenship literature seeks antecedents for such extra-ordinary acts, psychological contract violations may result in their absence. In general, such breaches produce negative emotional states not conducive to generous behavior (Suazo and Stone-Romero, 2011). More specifically, psychological contract violations erode one’s tendencies toward civic virtue (Robinson and Morrison, 1995). When employees are inclined toward withdrawal, the disinclination to protect the organization will also show in reduced enthusiasm for group-based effort (Podsakoff et al., 1997).

Without subscribing to the magical power of organizational leadership (Meindl et al., 1985), some writers have offered these attributes to our understanding of psychological contracts. An unstated premise here might be the extent to which leaders personify organizational culture (Victor and Cullen, 1988). Dulac et al. (2008) finds that the quality of leadership exchange reduces the tendency of breaches to have adverse consequences. Furthermore, the quality of relationship with a leader reduces the tendency for workers to even perceive the existence of breaches (Suazo et al., 2008). These results are mitigated only somewhat by the Mayer et al. (2013) finding that leadership can be an additive influence toward satisfactory coworker relationships.

No behavioral area of study would be complete without the search for individual-based differences. Without question, an intuitive case exists that the reaction to broken workplace expectations might reside in personality or socialization differences. Several researchers have identified the relevance of locus of control (Miceli et al., 2008). Taking a different tact, Zagenczyk et al. (2013) suggest the unique reactions of those with Machiavellian tendencies. However, other researchers suggest that personality differences are minor in their explanatory power (Jensen et al., 2010; Ahmed et al., 2012). The general consensus supports the conclusion that men and women are likely to react differently to a contract violation. This finding follows the same logic and direction as many whistleblowing studies (Seifert et al., 2010; Bernardi and Guptill, 2008).

Although the idea of psychological contracts did not develop in the accounting literature, many studies in this field are consistent with and supportive of it, as it is applied to the domains problematized by this paper. This field is generalized well by Reiss Nitkin (2012) who asserts that relatively stable governance cultures exist for businesses. Within this field, the encouragement of ethical behavior presents a priority challenge (Koumbiadis, 2014) with others pointing to several sociological dimensions of deviance (Ramamoorti, 2008). This ties together a few studies on the general nature of trust in accounting (Chong and Law, 2016;
Nitzi, 2017) with more specific attention given to whistleblowers (Erkmen et al., 2014). Quite appropriately, some authors focus our attention on organizational justice (Rae and Subramaniam, 2008) and dynamic environments (Davis and Pesch, 2013), both of which conditions have reciprocal and comparative aspects similar to psychological contracts.

The accounting literature has consistently nominated “tone at the top” as a key factor that would moderate the extent of fraud (Rezaee, 2005; Hogan et al., 2008; Trompeter et al., 2012). The notion that organizations are well advised to assert ethical propriety permeates the practitioner literature (Castellano and Lightle, 2005) and the international literature (Law, 2011) in accounting. Although a disproportionate amount of this work is focused upon its auditing implications (Wang and Fargher, 2017; Schmidt, 2014), studies are beginning to observe that words and policies themselves are insufficient (Pickerd et al., 2015). However, the accounting literature leans heavily upon how ethical ideas need to be embedded in internal controls or reinforced by regulation (Rae and Subramaniam, 2008; Rezaee, 2005).

In sum, the idea of the psychological contract appears to be a good framework for the study of the employment relationship. First, it is solidly grounded in established theory. Second, psychological contracts have a basis in the micro-level of interaction but possess clear implications for higher levels of analysis. One should not forget however that any template based on perceptions of fairness will be highly dependent upon the specific context that is created.

3. Hypothesis development

Many specific elements of the psychological contract could have been selected for research attention. We sought one that could be influenced by both individualistic and situational circumstances. We also preferred a corporate performance that was important to the entity but extra-role for the individual. We thought it important to find some issue that bore upon corporate culture, since that is highly relevant to what the entity purports to be (Reidenbach and Robin, 1991).

Recognizing that upper management of a company establishes and validates a certain ethical culture has been often referred to as “tone at the top” (Soltani, 2014). These pronouncements contain explicit value statements that bear upon what should work and pattern many outcome preferences (Reidenbach and Robin, 1991). The literature clearly establishes the potential impact upon individual employees (Ford and Richardson, 1994; Martin and Cullen, 2006). In general terms, the establishment of different types of ethical climates can increase or decrease employee commitment (Cullen et al., 2003). Ethical positioning done by those at the apex of the firm represents purposeful behavior that strategizes what is best for the organization in the long run (Schwartz et al., 2005).

Individuals who observe efforts by the company to take the proverbial “high road” when confronting difficult conflicts should understand the intention to have them fall into line. Despite the fact that employees usually have no direct contract with these policymakers, psychological contracts are being forged (Miller and Thomas, 2005; Grimmer and Oddy, 2007). Individuals are being told in essence, that ethical action will be rewarded and unethical action will not be tolerated (Chen et al., 1997). At its furthest reaches ethical behavior includes the willingness to report the deviance of others (Kaptein, 2011). In sum, the whistleblowing literature (Miceli and Near, 1988; Berry, 2004) can be folded into psychological contract terms.

Whistleblowing provides an interesting, if not ideal application for observation of psychological contract ideas. In that reporting the deviance of others has to be taken as an action desired by the organization, and supportive of organizational well-being, we possess an opportunity to see a higher than usual ethical level. Rather than merely doing no harm in
the absence of a breach in the psychological contract, we wonder if positive ethical messaging can essentially bring forth a level of behavior beyond normal expectations. Here, we expect that employees would prefer to work for organizations that behaved responsibly and proactively. But whether this tone affects individual behavior is mostly untested in psychological contract terms.

Very few employees work for criminal enterprises. Very few organizations broadcast their intention to be low ethics actors. Therefore, we contrast companies that make strong efforts to establish their high ethical posture with those that do not. This situation raises the prospect that the failure to establish oneself as an ethical organization might be more noteworthy than those that at least try. The absence of ethical signaling might serve as a very subtle contract violation if individuals have come to value and expect very positive organizational ethics profiles. In other words, saying the right things may be part of an institutionalized environment where emulation is the rule (DiMaggio and Powell, 1983).

H1 therefore tests the consequences of “talking” the ethics talk that individuals may expect. We cannot predict whether employees will embrace the idea that the organization’s preferred position applies to them. Many employees adopt an “us” versus “them” attitude about their organizations, and cannot be expected to fall into step if the matter is perceived as outside their job description. Moreover, employees may discount such noble expressions as merely conforming to societal expectations (Meyer and Rowan, 1977) and probably lacking substance. Therefore, the following comprises the first empirical question:

H1. Individuals will be less likely to report fraud when the organization fails to signal the presence of a positive ethical environment than when it does signal the presence of a positive ethical environment.

The translation of ethical intention into consistent ethical action presents other empirical questions. Some writers have studied various forms of role modeling by boards of directors and other leaders (Soltani, 2014) perhaps through its own behavioral codes (Schwartz et al., 2005). Perhaps more importantly, those who observe the “talk” of ethics, are expecting to see consistent enforcement of those directives. Observing certain results could be characterized as the “walk” of the ethical positioning discussed above.

The connection between policy and action is often assumed without overt manipulation. Some define that which is “effective” with that results in action (Near and Miceli, 1995). To expect that the organization means what it says is more intuitive than to believe that it does not. Others however have put this expectation to a test. For example, Taylor and Curtis (2013) measured the extent to which internal auditors believed that findings would be followed by actions. Similarly, Greenbaum et al. (2015) tried to capture undesirable leader hypocrisy.

Ethics may be a particularly susceptible area for “talk-walk” discrepancies. As noted by McCuddy et al. (1993), ethical codes require strong support structures to have power and effect. That a penalty exists for deviants evokes a sense of distributive justice (Seifert et al., 2010). When individuals are asked to report the bad behavior of others, resultant consequences for those misfeasors and other corrective organizational actions is conceived as a benefit for the reporter that needs to outweigh costs (Zhang et al., 2013; Mayer et al., 2013). Reports of this nature that do not result in such action feed the general pessimism reported by Near et al. (2004). Without doubt, such a disconnect will deter the same employee from making similar reports in the future (Mesmer-Magnus and Viswesvaran, 2005; Curtis and Williams, 2014). However, such an effect was not found by Kaplan et al. (2016).
For employees reporting fraud and other undesirable acts, the organization should be very grateful. Although one could characterize this behavior as the implicit job of all employees, its empirical frequency suggests that employees see it as an extra-role event. An example of outstanding organizational citizenship, reporting fraud exists on the precarious margin in psychological contract terms. As individuals rarely experience any loss or penalty for failing to report, individuals who perceive psychological contract violations may be easily discouraged from reporting. Just as individuals might not believe the “talk” of the organization being ethical, they also might not take the organization’s past actions as indicative of its normative positions. Just as fraud has unique dimensions, so does organizational response to it. If organizations weigh the cost and benefits of actions, different resolutions are possible, if not likely. Without a full disclosure, differing details of past cases render official reactions in the present hard to predict. The treatment of past cases certainly creates no guarantees for employees that are invited to take chances when a validating organizational response is not mandated. This supports the need for a second hypothesis:

H2. Individuals will be less likely to report fraud when management has failed to forcefully respond to previously reported similar acts than when it has forcefully responded to previously reported similar acts.

Many perspectives combine that would have us depart form the belief that the judgments made on fraud reporting are linear or monotonic. Many writers including Zhang et al. (2013) conjure the whistleblower as performing a cost/benefit analysis. Such interesting balancing suggest multiple factors simultaneously in consideration. Wimbush and Shepard (1994) make this more specific by pinpointing the potential combination of general ethical climate and the demands of an immediate supervisor. Such conflict also is implicit in the hypocrisy concept developed by Greenbaum et al. (2015). As heavily interaction-oriented as fraud reporting is, there should be no surprise that its outcome lacks normative consensus (Near and Miceli, 1987).

Employees know that talk is cheap and that management always possesses incentives to say the “politically correct” thing whether or not such is meant. Sometimes what looks like inconsistencies to outsiders like employees is a legitimate response to exceptional circumstances. However, for sensitive areas such as fraud, with no shortage of criminal overtones, full communication of these idiosyncrasies is often not possible. Employees are left with the impression that the organization never intended to do what it said it would. Pursuing one’s values involves high costs and difficult interactions that, when pushed, many would prefer to avoid.

Despite the intuition that the ethical climate that is espoused must also be consistently enacted for employees to believe that organizations are serious, untested empirical questions exist. When “talk” and “walk” are in the same positive direction, how much more credibility exists than can be obtained with the less expensive “talk” alone? If employees tend to believe what they are told about organizational ethical intentions, seeing it come true should have no information content. On the other hand, employees may seriously discount the importance of a high-minded “tone at the top” when they fail to see it materialize in consistent consequences for good and bad behaviors. We also puzzle over the company that does the “right thing” without the advance ideology that so many others wish to take credit for. Would such a firm be rewarded for its simple justice approach, or would employees believe that without enough policy statements, the company might not be able to sustain such good conduct? Without question, the nexus between ethical intentions and ethical actions can be formulated as an interaction hypothesis.
Observations of management’s response to past reports and ethical environment signaling will interact such that a diligent response from management to past reports of unethical behavior will strengthen fraud reporting intentions in environments where proactive signaling is absent to a greater extent than when proactive signaling is present.

The hypotheses are grounded in rather ambitious aspects of exchange theory. Without direct benefits coming to the person who observes fraud, the reciprocity that might be triggered (or not triggered) by purported ethical pronouncements and consistent reactive behaviors is a generalized one. The exchange that may be occurring is based upon the common benefits that the observing individual would have to see existing in shared moral norms (Cropanzano and Mitchell, 2005; Sak, 2006). The observer is witnessing the first step, whereas the organization positions itself regarding ethical behavior invites the individual toward a similar plateau accomplishable only by virtue of that person reporting fraud.

In sum, this paper has made some assumptions in the selection of hypotheses to test. Most notably, the importance of organizational values as announced, and as materialized in action upon individuals, are asserted. This premise evokes various tensions for the individual that balance the power distance between those that manage the organization against the interactions that such a person is likely to have with other similarly situated organizational members. When circumstances suggest that loyalty to the organization may create lower harmony with other employees, the power of the psychological contract is put at issue (Larmer, 1992; Grimmer and Oddy, 2007).

4. Research methodology
4.1 Design
The experiment uses a $2 \times 2$ between-subjects design to investigate the effect of a psychological contract violation on the internal reporting of fraud. The between subjects factors (independent variables) are outcome of previous reports of corporate behavior (strong or weak company response) and organization ethical environment (positive or neutral). The dependent outcome variable is the intention to report to a supervisor.

4.2 Task
Participants were given an experimental instrument describing the innovative bicycle company (IBC), a hypothetical developer, manufacturer and seller of cutting-edge bicycles and related accessories. Background information about the company indicated that the company has a code of business conduct and an ethics policy, which employees are required to sign on their first day of employment. The next portion of the instrument described the company’s ethical environment (discussed below under Variables). This was followed by information about Taylor, and Taylor’s co-worker Sam, both senior accountants and CPAs. The participants next read a scenario in which Taylor discovers that Sam is engaging in a check cashing scheme, in which Sam stole nearly $10,000 in just the previous month. Sam appears to be taking the checks made out to “IBC” and depositing them into an alternative account under his control with the name “Irresistible Bike Co.” The narrative concludes with how the company has responded to previous reports made by employees of unethical conduct (also discussed below in the Variables section).

After reading the scenario, participants responded to a series of questions designed to measure their likelihood of reporting the fraud. Participants also respond to manipulation check questions, questions about the ease of the case and the morality of the unethical act,
and a psychological contract violation measure. The instrument then concludes with demographic questions.

### 4.3 Variables

The independent variables are organizational ethical climate and outcome of previous reports. Organizational ethical climate was manipulated between participants. Two levels represent relatively positive and negative ethical climates. To help develop the scenarios, research was conducted to determine the factors that contribute to an ethical environment (Sims and Brinkman, 2003; Ruiz-Palmino and Martinez-Canas, 2011; Murphy et al., 2012). In addition, corporate materials were consulted to determine how organizations maintain strong, positive, ethical environments. Under the positive ethics manipulation, the company was described as not only having and enforcing an ethics policy, but required yearly ethics training, and using ethical adherence as a factor in employee performance review. Under the negative ethics manipulation, the company was described as having an ethics policy but not adhering to it. Here the manipulation also described a highly competitive, results-at-any-cost environment that cast doubts on top management’s honesty and integrity (e.g. aggressive earnings management). Outcome of previous reports of unethical conduct was also manipulated between participants. Two levels represent a relatively strong and weak response to reports of unethical conduct. Under the strong response condition, the company was described as having a formal process to deal with such reports. The company also was given a history of swift action which had included disciplinary action and employee dismissal. Under the weak response condition, the company was described as having a history of mishandling such reports, often resulting in either no action or inappropriately light punishments.

The dependent variables sought to measure intention to report in a similar manner to previous research (Ayers and Kaplan, 2005; Brink et al., 2013; Kaplan et al., 2011; Kaptein, 2011). Here, participants are asked both for how they believe the individual in the scenario would respond as well as how they personally would respond if in the same situation. The dependent variables were both measured on a 0 to 100 scale anchored with "not at all likely" and "very likely".

Similar to many whistleblowing studies (Brink et al., 2017; Patel, 2003; Kaplan et al., 2011), reporting intentions are measured from both the first and third person perspectives so that social desirability bias can be computed as the difference and then included as a covariate. The tendency of individuals to answer questions in the way they believe will be viewed favorably by others (when asked what they personally would do) in an effort to present themselves positively (Chung and Monroe, 2003; Fisher and Katz, 2000; King and Bruner, 2000), and must be anticipated in studies of the unmitigated deviance of hypothetical parties. Krumpal (2013) states that, “survey questions about taboo topics such as […] social fraud […] often generate inaccurate survey estimates which are distorted by social desirability bias” (p. 2025). Ahmad et al. (2014) argue that a method should be used to account for social desirability bias so that the validity and reliability of study results are not weakened, and argue for the use of the first/third person method (as we use here).

### 4.4 Participants

Participants are individuals with bookkeeping or accounting experience who were recruited through social networks, including Facebook and LinkedIn. Participants were not paid. All individuals who clicked on the survey link were required to pass a five-question accounting quiz (financial statements, debit/credit exercises) to proceed on to the actual experiment. Several individuals were not able to pass the quiz and were excluded from the experiment at
that point. Restricting participants in this manner added external validity to the request that the situation be judged by a knowledgeable individual who could imagine themselves in the role of the person who discovers the fraud. Participants took an average of 13 min to complete the entire instrument.

A total of 99 participants completed the entire instrument. Table I summarizes the background information about these participants. Participants’ mean age was 39, 51.5 per cent were female and 97.9 per cent had an undergraduate degree or higher. Nearly 77 per cent of participants had five or more years of full-time work experience, with 43 per cent currently employed as an analyst, staff, corporate or tax accountant, 27 per cent as accounting controllers or managers, and 18 per cent as auditors. Statistical analysis applied to the provided demographic information did not reveal any differences between the groups formed by these conditions.

5. Results

5.1 Manipulation checks
To check the ethics manipulation, participants were asked “What was the overall impression given of the company’s ethical culture?” and responded on a scale from 0 to 100, anchored with “weak ethical culture” and “strong ethical culture.” The mean score for participants in the less articulated ethical culture condition was 36.24 (SD = 28.36). The mean score for participants in the more articulated ethical culture condition was 54.35 (SD = 33.73). Although, 23 participants failed this manipulation check, t-test results show that the two ethical culture groups indicated significantly different scores (t = 2.730, p < 0.01).

To check the outcome of previous reports manipulation, participants were asked “What impression did you get about how the company has previously responded to reports of unethical behavior?” This asked respondents to respond on a scale from 0 to 100, anchored with “no response” and “strong response.” The mean score for participants in the bad outcome of previous reports condition was 18.38 (SD = 17.51). The mean score for participants in the good outcome of previous reports condition was 70.80 (SD = 27.53). Although 21 participants failed this manipulation check t-test results show that the two outcome of previous reports groups indicated significantly different scores (t = 11.326, p < 0.001).

In total, 40 participants failed one of the manipulation checks. However, when the analysis was limited to only successful participants whose responses were within one standard deviation of the mean, the results are strengthened (p-values decrease). Because the group-based manipulation tests were successful, the conservative approach to conduct the hypotheses tests using the entire participant sample was taken.

5.2 Tests of hypotheses
Following a successful assessment of the linearity and error term characteristic assumptions, an ANCOVA is used to test H1-H3. Participants’ reporting intention to the supervisor serves as the dependent variable. The organizational ethical environment and the outcome of previous reports made about unethical conduct are the independent variables of interest. As shown in Table II, the model explains a strong 32.6 per cent of the variance in the dependent variable. Social desirability bias is a significant covariate (Pearson correlation of 0.537, p < 0.001) and is retained in the model.

H1 pertained to the direct effect of the company’s ethical climate. The main effect of company ethics is significant for likelihood of reporting to the supervisor (F(1, 94) = 4.348, p < 0.05, one-tail), where participants in the positive ethics condition indicated a higher intention to report, with a mean of 87.81 (SE = 4.62), than those participants in the negative
<table>
<thead>
<tr>
<th></th>
<th>All participants</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Age</strong></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>38.97</td>
</tr>
<tr>
<td>SD</td>
<td>14.11</td>
</tr>
<tr>
<td><strong>Gender</strong></td>
<td></td>
</tr>
<tr>
<td>Male</td>
<td>48.5%</td>
</tr>
<tr>
<td>Female</td>
<td>51.5%</td>
</tr>
<tr>
<td><strong>Degree</strong></td>
<td></td>
</tr>
<tr>
<td>High School</td>
<td>2.0%</td>
</tr>
<tr>
<td>Associates</td>
<td>0.0%</td>
</tr>
<tr>
<td>Undergraduate</td>
<td>54.5%</td>
</tr>
<tr>
<td>Masters</td>
<td>40.4%</td>
</tr>
<tr>
<td>Doctorate</td>
<td>3.0%</td>
</tr>
<tr>
<td><strong>Academic Major</strong></td>
<td></td>
</tr>
<tr>
<td>Accounting</td>
<td>87.9%</td>
</tr>
<tr>
<td>Finance</td>
<td>4.0%</td>
</tr>
<tr>
<td>Business</td>
<td>7.1%</td>
</tr>
<tr>
<td>Other</td>
<td>1.0%</td>
</tr>
<tr>
<td><strong>Full-time work experience</strong></td>
<td></td>
</tr>
<tr>
<td>0-2 years</td>
<td>15.2%</td>
</tr>
<tr>
<td>3-4 years</td>
<td>8.1%</td>
</tr>
<tr>
<td>5-10 years</td>
<td>26.3%</td>
</tr>
<tr>
<td>11-15 years</td>
<td>11.1%</td>
</tr>
<tr>
<td>16-20 years</td>
<td>7.1%</td>
</tr>
<tr>
<td>20+ years</td>
<td>32.3%</td>
</tr>
<tr>
<td>All participants = 99</td>
<td></td>
</tr>
<tr>
<td><strong>Type of accounting position</strong></td>
<td></td>
</tr>
<tr>
<td>Staff Accountant</td>
<td>16.2%</td>
</tr>
<tr>
<td>Corporate Accountant</td>
<td>7.1%</td>
</tr>
<tr>
<td>Analyst</td>
<td>10.1%</td>
</tr>
<tr>
<td>Tax Accountant</td>
<td>9.1%</td>
</tr>
<tr>
<td>Auditor</td>
<td>18.2%</td>
</tr>
<tr>
<td>A/P or A/R</td>
<td>2.0%</td>
</tr>
<tr>
<td>Accounting Controller/Manager</td>
<td>27.3%</td>
</tr>
<tr>
<td>Consultant</td>
<td>2.0%</td>
</tr>
<tr>
<td>Other</td>
<td>8.1%</td>
</tr>
<tr>
<td><strong>Sector</strong></td>
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</tr>
<tr>
<td>Public Company</td>
<td>39.4%</td>
</tr>
<tr>
<td>Private Company</td>
<td>38.4%</td>
</tr>
<tr>
<td>Non-Profit Organization</td>
<td>4.0%</td>
</tr>
<tr>
<td>Government</td>
<td>9.1%</td>
</tr>
<tr>
<td>Self-Employed</td>
<td>3.0%</td>
</tr>
<tr>
<td>Other</td>
<td>6.1%</td>
</tr>
<tr>
<td>CPA</td>
<td>41.4%</td>
</tr>
<tr>
<td>Yes</td>
<td>58.6%</td>
</tr>
<tr>
<td>No</td>
<td></td>
</tr>
</tbody>
</table>

*Table I. Demographic information*
H2 concerns the likelihood of reporting fraud under differing historical response to fraud by management conditions. The main effect of outcome of previous reports is significant for likelihood of reporting to the supervisor (F(1,94)=19.112, p < 0.001, one-tail). Participants in the positive previous outcome condition indicated a higher intention to report with a mean of 87.81 (SE = 4.62). Therefore, the results are consistent with the hypothesis.

Note: Cell means represent participant responses to the following question: “How likely is it that you would report this instance of questionable behavior to your supervisor?” Participants indicated their response on a sliding scale from 0 to 100, anchored with not at all likely and very likely. Ethical environment is whether the participant received the paragraph which indicated a positive environment or a negative environment. Outcome of previous reports is whether the participant received the paragraph which indicated management had previously responded strongly or weakly to reports of unethical conduct.
93.10 (SE = 4.60), than participants in the negative previous outcome condition who had a mean of 73.00 (SE = 4.53). Therefore, the results are consistent with the second hypothesis.

H3 specified an interaction effect by expecting that individuals will be less likely to report fraud when management has responded less diligently and forcefully in the past in the incongruous situation that the organization has signaled the existence of a positive ethical environment. The interaction is significant for likelihood of reporting to the supervisor (F(1,94)=3.894, p < 0.05, one tail). The cell with the highest likelihood of reporting is positive ethical environment/positive outcome for previous reports with a mean of 93.36 (SE = 4.71), and the cell with the lowest likelihood of reporting is negative ethical environment/negative outcome for previous reports with a mean of 63.74 (SE = 4.53). Figure 1 depicts the consistency with expectations as the gap between negative and positive previous outcome is largest for a negative ethical environment.

5.3 Mediation analysis
The previously discussed hypotheses and results are explained using psychological contract violation theory. The significant results indicate that the occurrence of a violation should explain the findings. In other words, PCV should act as a rationale that connects both the manipulations of organizational ethical climate and outcome of previous reports, and the observed whistleblowing behavior. Whereas this is a quite plausible interpretation of the motives that the experiment has induced for participants, we cannot be sure that this is their only way of seeing the situation. More analysis is necessary to explore whether PCV constitutes the primary mental pathway between ethical environment/outcome of previous reports and intention to report to the supervisor. To gain this insight, participants were asked questions in the experimental instrument to determine if they thought a psychological contract was present and if the events described constituted a contract violation.

Participants were asked three questions to ascertain whether a psychological contract existed surrounding company ethics and how management is witnessed to behave. Every participant responded “yes” when asked, “When working for a company, is it important to

![Figure 1](image-url)

**Notes:** Figure 1 reports the participants’ likelihood of reporting the fraud to a supervisor by experimental condition. The experiment varies the observed outcome of previous reports of unethical activity (weak or strong) and the ethical environment of the organization (negative or positive).
you that the company to have a strong ethical culture?” Additionally, when asked, “When working for a company, do you expect management to lead by example?” all participants again responded “yes.” Participants then responded on a scale of 0 to 100, anchored with “low importance” and “high importance,” to the question: “How important is it to you that your company behave consistently with their stated intentions?” The mean score of 94.29 (median = 96, SD = 6.61) indicates high importance. From these results, it appears that respondents at least initially expect organizations to have strong positive ethical cultures. Employees may expect management to lead by example, and act in alignment with stated policies, training and cultural norms. Based on these results, a psychological contract appears to exist between the employee and the organization surrounding culture and how management acts to enforce it.

After completing the experimental task, participants answered questions to determine if their psychological contract was violated in their reading of the scenario they were given. The participants were asked to respond to on a scale from 0 to 100, “In the situation I just read about, I would feel: 0 = frustrated with IBC, 100 = happy with IBC”, “In the situation I just read about, I would feel: 0 = disappointed with IBC, 100 = pleased with IBC”, and, “Please indicate how well, in the situation previously described, IBC has fulfilled its obligations to you: 0 = very poorly fulfilled, 100 = very well fulfilled.” An average response score was created for each individual and used to test mediation in the model.

The juxtaposition of these explicit answers essentially creates an opportunity to conduct the mediation analysis recommended by Baron and Kenny (1986) that uses a correlation analysis that is confirmed using confirmatory factor analysis. Here we seek to determine through the correspondence between the experimental decision and the explicit acknowledgements whether a psychological contract violation plays the primary role in the paths of the model.

The results indicate that the experimental outcome of previous reports is significantly correlated with the PCV mediator variable. The standardized beta of the outcome of previous reports to intention to report to the supervisor path is 0.46 (standardized total effects and direct effects are 0.46). This suggests that people identify the inconsistent action of the company as a contract violation. However, there is less connection between the experimental ethical environment and the PCV mediator variable. That this portion of the mediation is not significant, indicates that participants’ conscious ability to label psychological contracts as such is incomplete and therefore is not the full explanation of their thinking about the ethical environment.

When the psychological contract violation mediator is added to the model the standardized beta of this path is 0.36 (standardized total effects are 0.47, direct effects are 0.36, and indirect effects are 0.11). These results indicate partial mediation through explicitly identified PCV. Standardized betas and \( p \)-values are displayed in the model shown in Figure 2.

6. Conclusion
Most of our knowledge about psychological contracts, and reactions to their violation, has been assembled through surveys. Many of these are impressively large data collections that have allowed us an informed picture of what employees actually think about frustrated expectations (Coyle-Shapiro and Kessler, 2000). Sometimes surveys allow us to see if our basic ideas are sufficiently robust to describe neglected sectors, such as public sector employment (Coyle-Shapiro, 2002). However, survey data is always more problematic than we like to admit, and the psychological contract literature is no exception (Freese and Schalk, 2008). In more recent years, researchers have turned to experiments to attempt to get
Notes: Figure includes standardized regression weights and p-values where *, **, and *** indicate $p < 0.05, p < 0.01, p < 0.001$, respectively, one-tailed. Psychological Contract Violation is the factor created using participant responses to the questions “In the situation I just read about, I would feel: 0 = frustrated with IBC, 100 = happy with IBC”, “In the situation I just read about, I would feel: 0 = disappointed with IBC, 100 = pleased with IBC”, and “Please indicate how well, in the situation previously described, IBC has fulfilled its obligations to you; 0 = very poorly fulfilled, 100 = very well fulfilled”. Ethical Environment is whether the participant received the paragraph which indicated a positive environment or a negative environment. Outcome of Previous Reports is whether the participant received the paragraph which indicated management had previously responded strongly (a positive response) or weakly (a negative response) to reports of unethical conduct. Participants responded to “How likely is it that you would report this instance of questionable behavior to your supervisor?” on a sliding scale from 0 to 100, anchored with not at all likely and very likely to assess intention to report fraud to the supervisor.

greater control and lower “noise.” Only through purposefully controlled variables can we discover what really matters in a situation.

This paper could be seen as a juxtaposition of literatures. The study of those who report wrongdoers (i.e., whistleblowers) is vast and undisciplined. By seeing the phenomena as a socially generalized type of psychological contract, a needed theoretical basis (Miceli and Near, 1985) is constructed. In the other direction, normative power is added to the psychological contract literature. When fraud is afoot, individuals are called upon to do selfless acts that depart widely from the standard whining over unmet entitlements to attain personal rewards that unfortunately marks the area. The paper also brings the study of
fraud closer to the orbit of subjective ethics. As Gundlach et al. (2003) assert, every whistleblowing case is a personalized attribution scenario. This research downplays conventional whistleblowing parameters that have focused upon the fraudulent act and the psychological characteristics of its observer (Taylor and Curtis, 2013; Curtis and Taylor, 2009) to prioritize the intensity of the perceived ethical climate that surrounds the events.

In many ways, the psychological contract is an overly rationalized account of human behavior. To believe that people are constantly keeping score of what they are owed and aligning its delivery with the quality and quantity of their efforts, may be a reflection of an accountants’ worldview. Even if the contract is grounded in subjectivities, that which is truly believed is real in its consequences (Thomas and Thomas, 1928). Whistleblowing offers individuals a chance to do something that involves higher-order conceptions of distributive justice, and therefore is inherently emotional in texture (Gundlach et al., 2003).

Rather than straining to ground behavior in far-fetched theories of reasoned action (Izraeli and Jaffe, 1998), we go beyond instrumental values (Murphy et al., 2012) to broader ideas of who will be hurt and their relative culpability (Miceli andNear, 1992).

Although the research does not explicitly consider the changing nature of employment in today’s economy (Chaudhry and Song, 2014), this dynamic condition merits observation. If employment becomes more flexible and more fluid in the future, employees may become less attentive to ethical signaling by organizations. The psychological contract may have to be made more explicit, essentially more similar to a legally enforceable contract. Gratuitous whistleblowing facilitated by unrecognized feelings of reciprocity might be more endangered.

This paper did not explicitly consider whether a “new” employment relationship has or is emerging. We can all agree that what employment means is not constant (Chaudhry and Song, 2014). Here, some writers touch on the increased use of teams (Sverdrup and Schei, 2015), external job market conditions for employees (Morrison and Robinson, 1997) and strain on organizational resources (Guest, 1998) as predicates for new contract flexibilities.

One might also expect that basic exchanges in employment will become more complex over time (Alcover et al., 2017). Such may be the reason that organizations that offer whistleblowing rewards often get counter-intuitive and undesired results (Brink et al., 2013).

The very nature of the psychological contract weighs against simple solutions to the problems of insufficient whistleblowing in organizations. The basic idea is that everything matters to employees and perceived shortcomings may dissuade performances in unrelated domains. This research takes this holistic problem even further, suggesting that organizational failures might have nothing to do with employee benefits, but instead pertain to inadequacies of its ethical leadership. A failure to aspire to say the right things about righteousness and to follow up with actual behaviors consistent with that aspiration leads to more unreported fraud. A clear suggestion would be for organizations to seek to do better in this realm, or to at least appreciate that the failure to model correct norms and behaviors will create collateral problems in the denial of extra-role fidelity by employees.

Two other dimensions often seen in the whistleblowing literature were not modeled even though a case could be made about their relevance. In the real world, the quality of the evidence that wrongdoing has occurred matters to an observer’s reaction. Nobody benefits from a false accusation, and weak evidence muddies conclusions about the ethical climate. Unfortunately, evidence strength intertwines with type of fraud (Near et al., 2004), making it unclear if participants were making evidentiary distinctions. Whistleblowers also face possible retaliation. Although such events are much more likely for external whistleblowers, some degree of interpersonal “blowback” is likely for internal reporting. Payard et al. (2014)
for example show reporting is more likely when such retributive consequences are not high (see also Wainberg and Perreault, 2016).

This paper has several limitations. To focus on organizational elements believed involved in psychological contracts, individual differences are not emphasized. This does not suggest that future research should also ignore them. One difference that might merit more attention is national culture. For example, individuals from high power distance cultures tend to react less to psychological contract violations (Zagenczyk et al., 2015). Some groups apparently do not as readily subscribe to what could be called organized dissent (Zhuang et al., 2005). Ethical cultures also have to be more integrated with ideas about where power exists in the organization (Kaplan et al., 2010) but at the same time decomposed into more specific elements about its operation (Kaptein, 2011).

The experimental method used in this research offers the advantage of rigorous control over the ideas that surveys allow to vary when processed by the minds of respondents. However, that method cannot offer the richness of some qualitative methods such as interviews with knowledgeable subjects. Unfortunately, that approach would not work well here due to the social desirability dimension of the fraud reporting phenomenon as well as the exceptional circumstances that would have to be isolated in the real world by researchers.

The hypotheses were grounded in the framework of exchange theory, from which the logic of psychological contracts originates. The results suggest that ethical organizations provide most people with socioeconomic resources that serve as an element of exchange to which most feel obligated to reciprocate with appropriate prosocial acts. While other currencies may be available to employees in their actual employments, reporting fraud seems to be within the set of valuable performances employees can offer to balance their workplace relationships.

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