THE ROAD TO WHISTLEBLOWING: A REVIEW THROUGH CASES

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Table of Contents

Abstract 2
Introduction 3
Literature Review 6
Methodology 8
Analysis 9
William Mark Felt (Deep Throat): The Most Famous Whistleblower 9
Douglass Durand 10
Sherron Watkins: A Whistleblowing Celebrity 11
Sarbanes-Oxley Act of 2002: A Fair Attempt to End Scandals 13
Jeffrey Wigand: The Tobacco Industry Whistleblower 15
Richard M. Bowen III 16
The Need for Additional Reform: Dodd-Frank Act of 2010 18
Whistleblowing: A Violation of Confidentiality 19
Conclusions: Negative Repercussions of Blowing the Whistle 20
Acknowledgements 23
References 24

Abstract

Numerous corporate scandals in the recent years have left the public wondering as to why situations such as cooking the books and other fraudulent activity go unreported for so long. Many times employees are aware of such frauds developing in their companies, but they fail to speak out because of fear. Yet fear is only one of the major reasons why potential whistleblowers hesitate immensely when considering blowing the whistle. Laws prior to these scandals did little to protect whistleblowers from negative results such as retaliation from employers. As a result, the public did not know frauds in companies until they became extremely out of hand and were as a result, highly publicized. The problem with not reporting frauds until they are massive is the fact that they become extremely costly and often cost taxpayers millions of dollars.

This research will be based on the analysis of several whistleblowing cases in order to evaluate the effectiveness of whistleblowing laws in providing appropriate protection to whistleblowers. It will not only provide information on each case, but also will go into the several negative repercussions that each whistleblower faced after blowing the whistle. The purpose of this research is to provide business students as well as the public with more information regarding the concerns of whistleblowers when attempting to blow the whistle, as well as with current laws that are in place for the protection of whistleblowers such as the Sarbanes-Oxley Act of 2002 and Dodd-Frank Act of 2010.

Introduction

Over the past decades, numerous corporate fraud scandals have occurred in the business world. Enron, Tyco, and WorldCom are just some of the companies that are triggered when the public hears the word fraud. It seems that despite these companies' fraud publicity, which should act as a deterrent to the rest of the country, news reports of some type of fraud activity among various corporations continues to occur. Regulations such as the Sarbanes-Oxley Act of 2002, which was passed after the Enron scandal, attempted to reduce the amount of fraudulent activity by keeping executives more in check and holding them accountable for their actions. Despite the Sarbanes-Oxley Act's attempt to deter fraud, fraudulent activity still did and does continue to occur.

In addition, many more frauds continue to go on unreported. Why is it that the public does not learn about this for years after it has occurred? Why is it that employees could not speak up even if they knew something was wrong before it went out of control? Many frauds are not reported to the public for several reasons; one of those being that the company would rather keep quiet about the incident in order to avoid any negative publicity. The other reason may be that potential whistle blowers are afraid of speaking up because of the potential negative repercussions of their actions. Even though it may not seem like so, whistleblowing can be a difficult action for employees for reasons such as contempt from coworkers, and the possibility of being laid off, to name a few. Therefore, in order to ease some of the tension, ever since the Sarbanes-Oxley Act in 2002, additional laws and rewards have been put in place in order to not only protect

whistleblowers, but also to encourage blowing the whistle and exposing whatever unethical activities a person or the executives of an organization may be involved in.

This thesis is based on careful analysis of several whistleblowing case studies. The whistleblowers that will be analyzed in this paper are William Mark Felt (Deep throat), Sherron Watkins, Jeffrey Wigand, Douglas Durant, and Richard M. Bowen III. William Mark Felt and Sherron Watkins will be analyzed because these whistle-blowings occurred prior to the passing of the Sarbanes-Oxley Act of 2002. The cases of Wigand, Durant, and Bowen III will be analyzed because they happened after the Sarbanes-Oxley Act of 2002 and thus will provide additional evidence as to how the Sarbanes-Oxley Act proved to be ineffective. This research will attempt to provide a better understanding of the whistleblowing process.

In addition, this thesis will also attempt to carefully examine each whistleblower and the ethical concerns that they may have faced when attempting to blow the whistle. Another purpose of this inquiry is to examine the current whistleblowing protection laws and discuss whether they are effective and if they are not how should they be modified? Lastly, this research intends to analyze whether the various whistleblowing activities were performed with the intention of protecting an organization's environment from fraud through evaluating the cases selected in this inquiry. In other words, whether or not the whistleblowing activities were done for the right reasons?

This research is relevant because unethical behavior is very prevalent in our society today. Unethical behavior can lead to costly consequences not only to the organization where it is happening, but also the employees and other stakeholders that are part of the organizational environment. When the individuals of an organization behave

ethically, there are fewer possibilities for any unethical behavior that may lead to a series of grave consequences to occur.

The following sections follow this thesis introduction: a literature review of the five-whistleblowing cases mentioned above, methodology for this research, research results and conclusions.

Literature Review

Who is a whistleblower?

According to Black's Law Dictionary (Garner, 2004), a whistleblower is "an employee who reports employer wrongdoing to a governmental or law-enforcement agency." As the authors of the *Whistleblower Protection: Fact or Fiction?* (Goodof et al, 2013) mention, Sherron Watkins would not be considered a whistleblower because she reported to neither a government nor a law-enforcement agency. Social scientists, on the other hand, define whistleblowers as employees who report company wrongdoing either internally or externally. The author of *A Word to the Whistle-Blower* (2002), states that a classic whistle blower is one who calls attention to practices that he or she believes are illegal or immoral. This person discloses such information to an outside authority, whether it is the press, regulatory agencies, public-interest groups or the Department of Justice. The article also mentions that what the whistle blower discloses must also be of importance. Thus, it cannot be gossip or speculation.

In addition, not only do separate entities define whistleblowers differently, but also whistleblower protection laws differ from state to state. For example, Massachusetts has specific citations that protect any employee from employer retaliation against these whistleblowers who may report violations of law such as risks to public health, safety, or the environment (whistle laws). On the other hand, states such as Maryland, Missouri, and New Mexico do not have any specific laws that protect whistle blowers.

Whistleblowing statutes differ in every state. Some have a wide range of coverage while others are applicable to specific industries (Goodof, 2010). The differing interpretations of whistleblowing laws in diverse states is what Goodof (2010) states makes whistleblowing cases to be inconsistent.

Methodology

This paper will review the evolution of whistleblower protection laws, not by studying whistleblowing laws but by reviewing cases to evaluate the Sarbanes-Oxley Act of 2002 and Dodd-Frank Act of 2010. The whistleblowing cases concerning William Mark Felt, Douglass Durand, and Sherron Watkins were whistleblowing cases that occurred prior to the passing of the Sarbanes-Oxley Act of 2002. The scandal at Enron is actually a major cause for the passing of Sarbanes-Oxley. Therefore, the aforementioned cases will be analyzed in order to determine the necessity of additional whistleblowing protection laws. After analyzing the Sarbanes-Oxley Act, the cases of Jeffrey Wigand and Richard M. Bowen III will be examined. Lastly, information concerning Dodd-Frank Act of 2010 will be provided in order to contrast this new law with the Sarbanes-Oxley Act of 2002.

*William Mark Felt (Deep Throat): The Most Famous Whistleblower (*Weiner, 2008*)*

William Mark Felt, who is most commonly known as Deep Throat, was at the time of his whistleblowing, an FBI Agent. He is known for revealing secret information about Watergate in the 1970s that would eventually bring former President Richard Nixon's time in office to its demise. What many may not know is that Felt anonymously kept the public informed about Watergate and it was not years after Nixon resigned that the true identity of the Watergate whistleblower came to light.

What distinguishes Felt from many of the whistleblowers in our time is the fact that he went directly to the public instead of reporting to an internal or a law enforcement entity. Felt anonymously provided Bob Woodward of the Washington Post with crucial details of the unethical behavior that Nixon was hiding. Felt played a crucial role in which he not only made sure to keep the story alive in the press, but also that the FBI's investigation of Watergate would continue despite President Nixon's attempts to impede it. It is believed that without Felt's action of blowing the whistle, President Nixon's unethical behavior would have gone undiscovered. Felt revealed many abuses of President Nixon including illegal wiretapping, money laundering, and burglaries.

Why did Felt blow the whistle on Watergate? According to Tim Weiner of the New York Times (Weiner, 2008), neither Felt nor anyone else ever answered what Felt's motives for blowing the whistle were. However, Felt did say that the attempts to shut down the Watergate investigation were unjust and that was perhaps why he felt that he needed to come forward with this crucial information to the public.

Eventually, Felt was tried for authorizing illegal break-ins at the homes of people who he believed had committed crimes. However, these people whose homes were searched turned out to be innocent, and resulted in Felt's criminal trial and then conviction for violating the Constitutional rights of citizens. Felt's conviction, however, did not last long since seven months later President Ronald Reagan granted him a pardon. After this, Felt disappeared from the public eye, and denied time and time again that he had been Deep Throat. The mystery would soon come to end in 2005 when he confessed that it had been him who had supplied the Watergate Scandal information to Bob Woodward of the Washington Post. This particular element of remaining anonymous for a long time, as well as not receiving any monetary compensation distinguishes Felt from many whistleblowers in the past years.

***Douglass Durand (*Weinberg, 2005)**

Douglass Durand, although not as well known, is another key whistleblower. In early 1995, Durand joined TAP Pharmaceutical Products' workforce as the vice president of sales. It was shorty after that Durand began having suspicions about the company conspiring with doctors to overcharge the government's Medicare program by millions of dollars. Instead of quickly acting on his suspicions, Durand spent months gathering evidence to back up his beliefs. In 1996, Durand quit and filed a lawsuit against TAP. Durand hoped that if his suspicions were correct, then he would get a share of money from TAP.

Durand spent eight years helping the government build a case against TAP. Durand played a major role by compiling a list of suspected conspirators and then called

them while the FBI listened in the conversations. TAP eventually had to pay $885 million to settle the case. One of the major winners was of course, Durand, who received approximately $126 million from the U.S. government for all the help in the case against TAP. However, Durand's victory did not last very long. As the trial of the twelve TAP employees unfolded, Durand's claims possessed many holes. Durand's claim that the doctors had received kickbacks from TAP had never happened. Also, those price increases he had accused the firm of imposing had not taken place (Weinberg, 2005).

Durand's whistleblowing is often criticized because of the fact he received millions of dollars in return for exposing TAP. This also plays into the idea that sometimes whistleblowers do not blow the whistle for the right reasons. The idea of whistleblowing is to expose wrongdoing in a company in hopes of correcting the wrongdoing and being a more ethical company. However, many times whistleblowers are not so concerned with correcting the wrongdoing, rather with cashing in on the rewards that result from blowing the whistle. In addition, the fact that Durand's claims were later proved wrong after he had received millions from the lawsuit is often criticized. Certainly, this case proves that there was a necessity for a clearer definition of the act of a proper whistleblowing.

Sherron Watkins: A Whistleblowing Celebrity (Watkins, 2003)

Probably one of the most recognized whistleblowers in our society is Sherron Watkins. Sherron Watkins, a former employee of the infamous Enron, is responsible for coming forward with all the unethical behavior of the Enron executives back in 2002.

Prior to the collapse of Enron, Watkins wrote a letter anonymously to Ken Lay, CEO of Enron, expressing her concerns of a potential meltdown of Enron because of the unethical accounting practices. Enron was essentially cooking the books and Arthur Anderson was not only aware of this, but also was aiding the corrupt executives of Enron with these fraudulent practices. Enron was a major portion of Arthur Anderson's revenue and thus, Arthur Anderson could not afford to lose Enron as a client. It was a result of this massive corporate scandal that the Sarbanes-Oxley Act of 2002 was passed.

Prior to blowing the whistle, Watkins' job at Enron was to prioritize assets that were for sale. Watkins evaluated book and market values to determine which assets would bring more cash to Enron, which would in turn be used to pay off some of Enron's debt. It was then that Watkins confesses she discovered the worst accounting fraud she had ever witnessed. Watkins explains that Enron was ultimately hedging with itself. She wanted to confront Enron CEO Jeff Skilling, but he quickly resigned due to personal reasons before she could do so. Watkins believed that this reason was Skilling's inability to sleep at night because Enron's stock price had declined significantly from $80 to $45 in a short amount of time.

It was after this that Watkins sent an anonymous letter to Ken Lay regarding Enron's dishonest accounting practices. Watkins eventually met with Lay, and expected an Enron recovery team to be established, but much to Watkins' dismay, it did not happen. Lay, along with investigative attorneys, had concluded that there was nothing wrong with Enron's accounting practices. However, they recommended that Enron should undo those transactions Watkins had discovered because they were not good. The

undoing of those transactions eliminated about 1.2 billion dollars from Enron's equity and would lead to Enron's declaration of bankruptcy just six weeks after.

Collapses like that of Enron in 2002 in addition to the others around that time such as WorldCom and Tyco, which are not analyzed in this thesis, as well as the Felt and Durand cases are major reasons why there was a need for reform. Sarbanes-Oxley was a good attempt to establish some ground rules when it came to trying to deter fraud, however it was ineffective.

Sarbanes-Oxley Act of 2002: A Fair Attempt to End Scandals

After the major Enron scandal, the Sarbanes-Oxley Act of 2002 was put in place as a way to establish some ground rules, which would in hopes bring corporate financial scandals to their culmination. The Act had several goals, the main one being the holding of corporate executives more accountable for the validity of the financial statements. The Act made it a requirement that every year the CEO of each publically traded company sign off on the annual report as a manner of declaring themselves responsible for having reviewed the financial statements and making sure that the numbers presented there represent factual numbers. Another element that the Sarbanes-Oxley Act touches upon is auditor independence. After all of the collusion that occurred between Arthur Anderson and Enron executives, SOX mandates the importance of auditor independence to the extent that it makes it obligatory of firms to switch auditors every five years (Johnstone et al, 2014).

Another element that SOX includes is the strengthening of internal controls. The SOX has two requirements regarding internal controls. One of them states the responsibility of management for maintaining adequate internal control procedures for reporting purposes. The second contains a requirement of assessing the effectiveness of those internal control procedures when it comes to financial reporting (Sarbanes Oxley Act of 2002, 45-48). In addition to the strengthening of internal controls, the SOX Act also required companies to establish a whistleblower complaint system through which unethical activity in companies could be reported. This led to the establishment of various anonymous whistleblower hotlines within companies.

Yet another crucial part of the Act was the requirement for a code of ethics to be established. Companies across the U.S. scripted out their own versions of this code. The main goal of such a code was to stress to the employees of companies the importance of behaving ethically within their organizations. Even though this might have seemed to be effective, it was not enough. Many companies who have lengthy, appealing codes of ethics still failed to behave ethically. Most of the time these codes of ethics were scripted out merely to comply with the Act and not as a method to deter fraud.

After the subsequent scandals from Enron, Tyco, and WorldCom, the SOX of 2002 was a good attempt at regaining the trust of investors in the financial statements of publically traded companies. However, it failed to grant whistleblowers with the needed protection from retaliation. Sarbanes-Oxley does have a section, which mentions that protections from retaliation would be granted for persons who report internally to "a person with supervisory authority over the employee" (Sarbanes Oxley, 2002). However, the act failed to provide these promised protections to whistleblowers. According to

CFO.com, about one thousand whistleblowing cases were filed under Sarbanes-Oxley up to the year 2007 and many of them were dismissed as the court thought they had no merit (Whistle-blowers Never Win, 2007). According to the site, not one single whistleblower made it past company appeals or won the case. Despite the crucial role whistle blowers play in reporting fraud, the Sarbanes-Oxley Act failed to provide such individuals with potential protection from being fired from the negative repercussions of their actions and failed to provide incentives for individuals to report unethical activity. Thus, even though Sarbanes-Oxley promised protections, it failed to provide them.

*Jeffrey Wigand: The Tobacco Industry Whistleblower (***Enrich, 2001***).*

Jeffrey Wigand, prior to blowing the whistle, had established himself as the chief scientist at the Kentucky-based Brown & Williamson Tobacco Corporation. His main goal was to develop a cigarette that was not only less addictive but also less harmless. However, Wigand soon realized that the company had an interest in keeping people addicted. Wigand had agreed to keep quiet on the companies' secrets, but he his undying remorse led him to talk even though he knew it would be a risky decision. In secret interviews with government investigators, journalists, and lawyers, Wigand disclosed details about what he had witnessed at Brown & Williamson. As expected, industry executives were furious and scared at the same time about what might unfold as a result of Wigand's whistleblowing.

Many whistleblowers are hesitant to blow the whistle because of fear of being threatened or being fired. This is especially true in Wigand's case. Wigand was often

followed home, received threatening calls, and even found a bullet in his mailbox. This was not only the negative repercussions of blowing the whistle, but also Wigand found himself being sued by Brown & Williamson. Brown & Williamson was suing Wigand because they claimed he had violated a confidentiality agreement. The company went as far as publicizing a shoplifting and domestic abuse that had been a thing of the past for Wigand. Wigand and his family were facing much pressure, which became intolerable for his wife, whom as a result filed for divorce and took their children to Texas.

***Richard M. Bowen III (*Cohan, 2013)**

Richard M. Bowen III may not be a name that the public comes up with when talking about whistleblowers. Nonetheless, Bowen was a pivotal whistleblower during the financial crisis of 2008. Bowen is different from the common whistleblowers in that he was actually an executive of Citigroup when he blew the whistle. Years prior to the crisis of 2008, Bowen had discovered that Citigroup, like many other firms, had been purchasing billions of dollars in risky home mortgages and then reselling them as investments.

According to Bowen, on November 3, 2007, he sent an e-mail to a group of executives at Citigroup informing them about the breaks in internal controls at Citigroup. However, Bowen got a response that was quite unexpected. Apparently, the Tuesday following his revealing e-mail, a Citigroup lawyer informed Bowen that they were taking this matter seriously and that they would contact him. Bowen sent more e-mails to the lawyer, but received no response.

In April 2008, after having his responsibilities at Citigroup reduced, Bowen filed a complaint under the Sarbanes-Oxley Act expressing that he had been retaliated against after writing the e-mail to the executives at Citigroup. According to Bowen, he provided the SEC with his testimony along with more than a thousand pages of documents to support his claim, but the SEC did not pursue the claim.

Eventually, in January 2009, Bowen was fired from Citigroup. He signed a separation and confidentiality agreement and received a severance package amounting to just less than one million dollars (Cohan, 2013). Citigroup would eventually receive about forty-five billion dollars as a bailout from U.S. taxpayers in addition to guarantees on almost three hundred billion dollars worth of securities that were mainly the faulty mortgages Bowen had warned Citigroup about. Now, Bowen has moved on and is teaching accounting at the University of Texas.

The fact that their employment can be terminated after blowing the whistle is another major concern of whistleblowers. As in Bowen's case, many times whistleblowers have their duties at work be reduced or are often terminated from employment. According to the Sarbanes-Oxley Act of 2002, these would be retaliations from the employer that whistleblowers would be protected from, however, as mentioned earlier many cases, such as that of Bowen and many other whistleblowers, were dismissed because they did not possess significant worth to the court. After losing their jobs, whistleblowers also have a hard time finding another job because of the fact that they blew the whistle on another company.

The Need for Additional Reform: Dodd-Frank Act of 2010 (Taylor and Thomas, 2013)

After all of the corporate scandals over the past decades and the failed attempt of the Sarbanes-Oxley Act of 2002 to eliminate the amount of frauds that occur, the Dodd-Frank Act was enacted. Our current President Barack Obama passed the Dodd-Frank Act on July 21, 2010. Perhaps one of the most crucial parts of the Act is the part that concerns the establishment of a whistleblower protection program. This program was crucial seeing as the Sarbanes-Oxley Act simply was not enough ammunition in the prevention of corporate scandals, and more importantly: fraud.

The whistleblower protection program within the Dodd-Frank Act required the SEC to establish not only protections for whistleblowers, but also monetary awards to those individuals who report violations of the law. Violations of such laws would include misrepresentations or omissions of important information in regards to the financial statements, manipulation of the price of securities, engaging in insider trading, and bribing to name a few (Taylor and Thomas, 2013).

Prior to Dodd-Frank, when auditors suspected there was a fraud going on they had to report the wrongdoing to the audit committee or to the board of directors. Thus, externally reporting the fraud was not entirely the auditor's responsibility, but that is not the case any longer under the Dodd-Frank Act. The Act specifies that a firm may not, "discharge, demote, suspend, threaten, harass, or in any way discriminate against whistleblowers who provide information to the SEC" (Taylor & Thomas, 2013).

Another element that was amended in the Dodd-Frank Act is the monetary compensation of whistleblowers. The whistleblower protection program requires the SEC

to pay whistleblowers 10-30% of the excess of one million dollars that the SEC may collect as a result of the case. Just in 2011 alone, a reported one hundred million dollars were awarded to diverse whistleblowers. The monetary awards were imposed to entice whistleblowers to report any fraudulent activity. However, these awards are also criticized because, as in Durant's case, sometimes the intentions of whistleblowers can be questionable. Many times it is uncertain whether whistleblowers blew the whistle because they wanted to do what was ethical or because they wanted to cash in on the potential rewards.

Whistleblowing: A Violation of Confidentiality?

Confidentiality is a major concern when it comes to whistleblowing (Taylor & Thomas, 2013). Many companies require their employees to sign off on confidentiality agreements that state that the signer will not disclose any information to the public. But by blowing the whistle, employees are often troubled because they may find themselves violating such confidentiality agreements. Therefore, the question of whether the whistleblowing is ethical comes into play. Is it ethical for an employee to violate their confidentiality agreement and disclose the information to the public? Or are potential whistleblowers being unethical by failing to report such information?

As in Jeffrey Wigand's case, Brown & Williamson, the cigarette company he worked for sued Wigand for a violation of his confidentiality agreement by disclosing specific ingredients that were utilized in the addictive cigarettes. However, in this case,

what Wigand did might have been illegal, but not unethical. Violating a legal document such as the confidentiality agreement is illegal, but at the same time Wigand was doing what he believed to be ethical in reporting the addictive ingredients to the popular cigarettes. But, in other situations this confidentiality agreement may stop people from blowing the whistle because they may be afraid they will be sued for doing it. And so, the fraud continues to be unreported.

Conclusions: Negative Repercussions of Blowing the Whistle (Taylor and Thomas, 2013).

As stressed in the above cases, whistleblowers may face many negative repercussions after they blow the whistle. These negative results are the reasons why whistleblowers often hesitate to blow the whistle even though many times they know that reporting the wrongdoing is what is morally right. Whistleblowers can often lose their jobs, are retaliated against, and suffer emotional distress after they blow the whistle. These negative consequences are evident in the cases mentioned throughout this thesis. Whether it is receiving threats as in Wigand's case, or being fired from Citigroup like what happened to Bowen, whistleblowers have much to lose in many cases. Blowing the whistle can have many negative outcomes as mentioned in Wigand's case. His family simply could not endure all of the negative scrutiny and thus, had to move away. In addition to the harassment from employers, whistleblowers are often harassed from fellow workers. This harassment, as Goodof states in his article, makes their job intolerable (Goodof, 2010).

Another crucial whistleblower mentioned in this thesis was Richard Bowen III who blew the whistle on the faulty mortgages at Citigroup. What came about that was he being retaliated against by slowly losing his responsibilities at Citigroup, which eventually led to the termination of his job. Another major concern for whistleblowers is whether they will be able to obtain a new job. Individuals such as Sherron Watkins, Jeffrey Wigand, and Richard Bowen III were highly publicized whistleblowers. Many times the negative outcomes of such public individuals are the fact that companies may not want to hire a person who blew the whistle on another company. Prospective

employers may not be willing to hire someone who has been scrutinized in the public for being a whistleblower because of all the negative publicity that may follow. Thus, potential whistleblowers may remain quiet about potential frauds because they cannot afford to lose their job.

Laws prior to Dodd-Frank, such as Sarbanes-Oxley, did nothing to protect whistleblowers from the mentioned repercussions. The Dodd-Frank Act contains many provisions that specify certain whistleblower protections and incentives for whistleblowers to not hesitate so much when attempting to blow the whistle. Goodof (2010) mentions that the reward for blowing the whistle should be enough as to make sure that all these concerns of whistleblowers do not impede them from blowing the whistle. Whether or not Dodd-Frank was sufficiently effective in providing full protection to whistleblowers will be answered in time. The Act was passed in 2010 so as of now, it is too early to determine its success or failure.

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