

The Difficulty of Being Good: The Efficacy of Integrity Hotlines

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In an effort to motivate firms to more rapidly detect potential misconduct, legislators, regulators, and prosecutors incentivize firms to have integrity or “whistleblowing” hotlines. These hotlines provide individuals an opportunity to report alleged misconduct and seek guidance about how to appropriately respond. Beyond some isolated examples, little is known about the responsiveness of hotlines to actual claims of alleged misconduct. I undertake a field study to investigate the efficacy of hotlines by making four different inquiries of alleged misconduct to nearly 250 firms. I find that firms predicted to have internal control weaknesses and who have recently been sanctioned by regulators are more likely to discourage anonymity. One-fifth of firms have impediments (e.g. phone line disconnected, e-mail bounce back, direct to incorrect website) that hinder reporting. Once a report is made, however, most firms respond in a timely manner suggesting arguments that firms routinely disregard allegations of misconduct are overstated. Overall, my investigation illuminates the differences between integrity hotlines “on paper” and how they actually function in practice.

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1. Introduction

Misconduct imposes considerable costs on both firms and society (Dechow, Sloan, and Sweeney 1996; Karpoff, Lee, and Martin 2008; Kedia and Philippon 2009; Dyck, Morse, and Zingales 2017). In an effort to more effectively prevent and detect misconduct, firms create compliance programs that include training programs, codes of conduct, analytic detection software, and integrity (i.e. “whistleblowing”) hotlines.¹ Among these different compliance initiatives, hotlines have garnered especially significant attention from legislators, regulators, courts, and prosecutors. The Sarbanes-Oxley Act (SOX) requires firms to provide a means for employees to anonymously report alleged accounting misconduct, prosecutors at the Department of Justice (DOJ) consider the existence of a reporting hotline— among other factors— when deciding whether and how to charge a firm, and the United States Sentencing Commission (USSC) guides courts to consider more lenient sentencing for firms who have an effective hotline as part of their compliance program.

Integrity hotlines offer individuals an opportunity to report claims of alleged misconduct and to seek guidance about how to appropriately respond to potential misconduct. Prior evidence supports that hotlines can be effective in helping more rapidly identify and address misconduct. Dyck, Morse, and Zingales (2010), for instance, show that employees – as compared with auditors, analysts, or the media— more frequently detect and report misconduct. Similarly, the Association of Certified Fraud Examiners finds that nearly 40% of all cases of misconduct are detected through tips provided to organizations (ACFE 2016). By more swiftly detecting violations, internal tips also reduce the duration of misconduct. The median duration of fraud detected by a tip is 17 months as compared to frauds detected by external auditors or law enforcement which last 24 and 36 months respectively (ACFE 2016). By relying on insider knowledge of firm activity, hotline inquiries can provide valuable information to mitigate the adverse consequences associated with misconduct (Bowen, Call, and Rajgopal 2010).

While examples of misconduct being more rapidly detected and addressed because of hotline tips are plentiful, there is also considerable skepticism that hotlines are, on average, responsive to allegations of misconduct. For example, even after receiving numerous hotline inquiries describing the fraudulent

¹ Firms utilize different names to describe their hotlines with “ethics,” “integrity,” “whistleblowing,” and “reporting” used interchangeably. Weaver, Treviño, and Cochran (1999) examined the names of compliance/ethics related telephone lines and found a variety of different names including “compliance” hotline and “helpline” rather than “hotline.” For simplicity, I utilize “integrity hotline” in subsequent discussion although specific firms may utilize a different descriptor for their reporting mechanism.

creation of customer accounts, officers at Wells Fargo took no steps to follow-up or mitigate the misconduct (Wells Fargo 2017). One prominent attorney more bluntly described the skepticism about integrity hotlines by noting that “many employers create hotlines merely to help insulate themselves from legal liability without ever following up on complaints.” (Schieber 2017) Numerous regulatory bodies including the Securities and Exchange Commission (SEC), Internal Revenue Service (IRS), and Equal Employment Opportunity Commission (EEOC) have created their own hotlines to encourage reporting out of concern that firms own reporting systems may fail to detect misconduct or respond to inquiries. More recently, in tacit acknowledgment that some firms create “paper” compliance programs where initiatives like hotlines fail to actually function in practice, the Department of Justice hired a dedicated compliance counsel to help evaluate the effectiveness of compliance programs (Soltes 2018).

Yet, beyond anecdotal instances of hotlines publicly faltering or functioning, little is broadly known about the efficacy of integrity hotlines. In this paper, I conduct a field study to understand the availability and responsiveness of integrity hotlines by reporting four cases of alleged misconduct to nearly 250 firms. Two of these inquiries relate to financial reporting matters (financial statement manipulation and bribery) and two inquiries relate to workplace matters (harassment and discrimination). In each instance, my inquiry described a concern about potential misconduct and sought firm guidance about how to respond.

I examine the efficacy of hotlines by examining their accessibility and responsiveness. While firms can describe the availability of an anonymous hotline “on paper,” simply listing its availability does not mean that the hotline is necessarily functioning. Specifically, if an individual cannot readily report on the hotline, the hotline cannot be viewed as an effective anonymous reporting channel. Across sample firms, I find twelve different obstacles impeding the reporting of misconduct including redirects to incorrect pages, e-mail bounce backs, and disconnected phone lines. Notably, many of these impediments cannot be seen as mere nuisances or minor delays in the reporting process. In many instance, the reporting channel itself is non-functional and would thwart reporting. I find that 20% of firms within my sample have at least one obstacle on their phone, web, or e-mail hotline. Although firms may project “on paper” as having an accessible hotline, in practice those seeking to report on those hotlines often face considerable obstacles.

The inquiries reported to firms were framed as seeking the firm’s guidance about an appropriate response. In doing so, I could evaluate whether firms were responsive to the inquiry or merely recording reports without seeking a resolution. In contrast to some arguments that firms simply use hotlines as window-dressing (i.e. “many employers create hotlines merely to help insulate themselves from legal

liability without ever following up on complaints.”), I find that the vast majority of firms – more than 90% – respond in a timely manner to inquiries.

Most firms seek additional detailed information about each inquiry before they are willing to provide a response to proceed or halt activity. However, for the bribery related inquiry, I do find that firms who are predicated to have internal control weaknesses assert that it is acceptable to proceed without seeking any additional information. Given the potential ramifications of the inquiry, their haste in responding is potentially indicative of their weaker internal control systems. For the financial manipulation inquiry, I also find the allegation is viewed as far more serious when a named individual personally responds to the inquiry. Ultimately, I find that firm characteristics provide relatively limited explanatory power as to understand how a firm responds to a particular inquiry.

While some regulation – like SOX – focuses on offering hotlines to report potential accounting and auditing deficiencies, industry surveys suggest that integrity hotlines receive a far more diverse set of inquiries and allegations related to corporate misconduct (NAVEX 2016). To investigate how firms potentially respond differently to issues relating to employee abuse, I report two inquiries related to harassment and discrimination to each sample firm. As compared with the allegations of financial misconduct and bribery, I find that firms are just as inclined to respond to human resource concerns. Firms respond to financial manipulation and harassment inquiries marginally more rapidly than to the inquiries about bribery and discrimination. I also find that the length of the response to the financial misconduct allegation is the most extensive, but the average response to the harassment and discrimination inquiries are longer than that for the bribery inquiry. Together, this suggests that firms do not see their hotlines as merely fulfilling their obligations under SOX, but instead as reporting channels for a potential firm misconduct more broadly including those related to human resources. Moreover, the characteristics of the responses in terms of timeliness and length seem to be more heavily a function of the type of inquiry than the firm itself.

While regulation, like SOX, effectively mandates that firms have anonymous hotlines, firms need not encourage anonymity. While identification of callers can facilitate more rapid resolution of claims and limit frivolous allegations, psychological research also suggests that anonymity encourages reporting by increasing individuals’ comfort and willingness to report allegations. Among sample firms, I find that 13% explicitly discourage anonymity (e.g. “You may remain anonymous subject to any local laws, although you are encouraged to identify yourself.”) Moreover, I find that firms that discourage anonymity are more likely to be those predicated to have internal control weaknesses. In addition, firms with more numerous recent regulatory violations are also more inclined to discourage anonymity. Together, this evidence

suggests that firms facing potentially greater risks of misconduct and compliance failures are those also taking steps to discourage its anonymous reporting on their hotlines.

Overall, the investigation illuminates the efficacy of hotlines by better understanding their accessibility and responsiveness. The frequency in which firms discourage anonymity and create obstacles to reporting is disquieting. At the same time, the overwhelming majority of firms responded to inquires in a timely and responsive manner suggesting that arguments that firms tend to disregard allegations of misconduct, on average, are overstated.

This investigation has both scholarly and regulatory implications. The investigation contributes to the growing academic literature on hotlines and how misconduct is detected (Dyck, Morse, and Zingales 2010, Bowen, Call, and Rajgopal 2010, Miller 2006). Bowen, Call, and Rajgopal 2010, for example, describe how whistle-blowing can reduce agency conflicts within firms and expose potential misconduct. By examining regulatory whistleblowing hotlines, Lee 2017 and Wilde 2017 examine how reporting lines can deter misconduct.² My paper builds on this work by providing an understanding of how misconduct is revealed by investigating the actual mechanism— hotlines— that supports detection within firms. By exploring the impediments that different firms place upon whistleblowers who seek to use their hotlines and the variation in firm responses, this investigation shows that hotlines are not homogenously effective reporting mechanisms since some firm hotlines have greater efficacy than others.

This study also illustrates the disconnect that arises between regulatory policy and actual enforcement of that policy. As has been noted by Ball (2009) among others, jurisdictions can design policy, but if enforcement of that policy is weak, the regulation is unlikely to be implemented by firms. While SOX effectively mandates that firms have an anonymous hotline to report alleged misconduct, verifying that this hotline works falls outside auditors' traditional responsibility of assessing a firm's "internal controls." Moreover, regulators historically have not checked company hotlines for effectiveness. Consequently, many firms have hotlines that do not serve as easy and effective reporting channels as sought by SOX. In this way, regulation that leaves implementation and enforcement to firms creates potential gaps between the goals of the policy and how that policy gets executed in practice.³

² Relatedly, Call et al. (2017) examine how whistleblower involvement impacts enforcement actions.

³ In comparison to accounting and finance scholars, psychologists and business ethicists have written considerably more about whistleblowing and the principles that encourage reporting alleged violations. The empirical findings from this field study suggest that much of this research has either been disregarded or that firms have advanced practices beyond the inferences understood from this research. As an example, Treviño et al. 1999 describe the potential adverse consequences associated with outsourcing hotline to third-party consultancies and security firms (i.e. "the findings of this study suggest that it is better for the company to keep responsibility for reporting and investigation in-house." page 148). In spite of this, I find that more than 90% of firms choose to outsource their hotlines to a third-party (see Section 5). While there may be additional considerations motivating these choices,

The results of this study indicate that regulators and prosecutors ought to view hotlines with greater suspicion. Prosecutors can provide credit to firms with effective compliance programs. However, prosecutors have typically relied on firms to produce evidence of their programs' effectiveness (including on their hotline) after the firm is charged with wrongdoing. Credit (according to the sentencing guidelines) should be offered to firms that have an effective compliance system at the time of the misconduct, rather than for changes made only after the misconduct has occurred (see Soltes 2018). The weakness in hotlines suggests that prosecutors ought to investigate the hotline prior to charging to ascertain whether it is effective and to further verify firms' own assessment of their hotlines efficacy. Practically, this can be implemented by the FBI who can conduct a similar test as done in the study by calling the hotline. The numerous obstacles described from this field study illustrate some of the common impediments to reporting that may be considered during this evaluation. Ultimately, by conducting a test similar to that described in the paper, regulator and enforcement agencies can help verify that a hotline fulfills its purpose in allowing individuals to anonymously report alleged misconduct.

2. Assessing the Goals of Integrity Hotlines

Firms have both legal and reputational incentives to maintain compliance with laws, rules, and regulations (for an overview, see Soltes 2018). To help assure compliance, firms deploy a variety of internal controls and compliance processes to help guide appropriate behavior (Simons 1991, Simons 1995). These controls influence managers and employees by helping align their incentives and conduct to those of the firm. However, achieving perfect control is untenable due to both costs and individual objectives (Merchant 1985). Psychologists have further documented a number of behavioral biases that undermine control and compliance processes (e.g. Gino 2013, Bazerman and Tenbrunsel 2011).

As part of their control and compliance systems, firms employ audit and analytic systems which seek to monitor behavior and detect misconduct. Firms can also rely directly on employees, suppliers, clients, and other agents connected to the firm who are positioned to observe and report misconduct (Treviño et al. 1999, Near and Miceli 1985). By acting on these reports, managers can respond to the allegations and seek to prevent the behavior from continuing or escalating.

An integrity hotline is a telephone, web page, or e-mail based system for centrally collecting reports and inquiries. When an individual provides information to the hotline, his or her report is directed to the part of the organization that is most capable of handling and responding to that allegation (e.g.

the data of how firms actually design programs contrasts starkly with the psychology and business ethics literature on how to encourage reporting and mitigate misconduct.

general counsel, internal audit, occupational safety, human resources, etc.) Several studies have provided evidence that such reporting systems can help detect potential fraud and misconduct (Johansson and Carey 2016, Lee and Fargher 2013, Calderon-Cuadrado et al. 2009).

A number of different regulations, courts, and institutions create benefits for firms to create hotlines. For example, if a firm later found itself in the position of potentially being prosecuted, the firm could face considerably fewer sanctions if the firm had an anonymous reporting hotline— along with other components of an effective compliance system— at the time of the misconduct.⁴ Fines, for example, could be reduced by as much as ninety-five percent if the system was in place at the time of the alleged misconduct (Soltes 2018). Even more directly, the Sarbanes Oxley Act (SOX) in 2002 effectively mandated hotlines for publicly traded firms by stating that firms were required to have a process to receive “confidential, anonymous submissions by employees of the issuer of concerns regarding questionable accounting or auditing matters.” (Sarbanes-Oxley Act §301) Appendix 1 provides more detail on the specific development and requirements for firms around the design and creation of hotlines.

Although legislative and regulatory bodies provide both incentives and requirements to encourage reporting misconduct, regulators, courts, and prosecutors have provided little prescriptive guidance about how firms should create an anonymous hotline. As a result, the design and implementation has effectively fallen upon firms leading to heterogeneity in practices.

To assess hotlines in practice, I seek to address several questions. The first set of questions I seek to investigate is whether the firm has an anonymous reporting line and whether it is accessible. To the extent that firms follow legislation (i.e. SOX), exchange rules (e.g. on NYSE, NASDAQ), and incentives by prosecutors/regulators (e.g. DOJ Evaluation of Corporate Compliance Programs), all publicly traded firms should have hotlines that facilitate anonymous inquiries. Some legal scholars suggest that many compliance systems are mere “paper” programs that do not actually work in practice (e.g. Laufer 2017, Krawiec 2003). Anecdotal examples also suggest that firms sometimes list hotlines that are effectively inaccessible to potential callers.⁵ Moreover, to the extent that hotlines are not commonly reexamined, it

⁴ Even if a firm was prosecuted, the Sentencing Commission acknowledged that the firm could still have an overall effective compliance program. Specifically, “Such compliance and ethics program shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting criminal conduct. The failure to prevent or detect the instant offense does not necessarily mean that the program is not generally effective in preventing and detecting criminal conduct” (Chapter 8 Sentencing of Organization, §8B2.1).

⁵ As an example, in response to allegations that the 21st Century Fox knew of inappropriate conduct of one of its television hosts, but chose to ignore it, 21st Century responded that no employee had ever reported allegations of misconduct on its anonymous hotline. However, according to several people familiar with the firm’s practices, there was no discussion of the firm having a hotline. In response, 21st Century said it had a hotline for more than a

is feasible for firms to either design non-responsive hotlines or hotlines that fall out of compliance (i.e. were once functional, but now are no longer). Thus, in practice, it is not clear how many firms actually have accessible functional anonymous hotlines and what those barriers may be.

The second series of questions seeks to understand firm responsiveness. To the extent a firm responds to an inquiry, I can examine how long they take to respond, whether the response is personalized, and whether the firm potentially approves of the conduct. It should be noted that the investigative process is separate and distinct from the hotline itself. That is, a firm can have a functioning hotline and a broken investigative function. As an example, the forensic audit manager from ADT, a large security systems company, wrote in *Fraud Magazine* how his firm failed to investigate allegations that it received on its hotline:

The ethics hotline of the company I work for, which provides home automation and security systems, annually received more than 100 allegations of fraud. However, prior to 2014, no one adequately investigated actionable information, and no one investigating the allegations communicated with other departments. The lack of communication became obvious during an investigation in which we identified more than seven hotline calls going back two years that, if we'd investigated, could've led to the early discovery of an asset misappropriation scheme. The inaction cost our company more than \$100,000. Had we properly investigated the first allegation the loss to the scheme might have been only \$7,000 (Wahlstrom 2017).

Moreover, how a firm responds may be a function of the type of inquiry. By making several inquiries to each firm, I can evaluate whether the response is a function of firm characteristics or more heavily related to the type of inquiry made. In many instances, it is difficult to assess whether a firm effectively responds to a report alleging misconduct (i.e. "I observed specific misconduct X") since the resolution occurs internally.⁶ To overcome this limitation and observe a portion of the resolution process, I made inquiries about potential misconduct that may occur or continue to occur pending guidance about how the firm responds. In doing so, I can assess the efficacy of the hotline by seeing if and how a firm responds.

decade, but only recently started to "highlight" its existence to employees. See "Anonymous Harassment Hotlines Are Hard to Find and Harder to Trust," *The New York Times*, April 21, 2017, Noam Scheiber.

⁶ Due to concerns about litigation and privacy, even when firms take action (e.g. fires an employee), the individual who made the report is typically not made aware of the outcome. Even when an employee makes a report of misconduct and the firm takes action, firms often do not reveal what action was taken. Several companies explicitly noted that they would not share the outcome after investigating. As an example, one firm noted: "the Company would not be able to share disciplinary action steps regarding another employee. Any information you would like to provide would be investigated and appropriate action taken." To the extent that the individual making the report would learn of the outcome, it would likely occur through secondhand information.

3. Assessing Hotlines: Field Study Design

In Section 3, I describe the methodology underlying the design of the study. Additional information related to study design is also described in additional appendices as referenced in this Section. In 3.1, I describe the sample selection of firms selected for the study. In Section 3.2, I explain the process of designing the inquiries. In this sub-section, I also describe a number of the moral and legal issues considered while designing the study. In section 3.3 and 3.4, I explain the process of reporting the inquiries on hotlines and collecting firm responses.

3.1 Firm Sample

In order to make the field study manageable given the costs of placing the inquiries, I sought to restrict the ultimate number of firms that inquiries would be sent to while not overly hampering the generalizability of the study. I began with all firms listed on CRSP as of December 31, 2016. The allegations described in the vignettes were devised to be applicable to operating entities so I removed real estate investment trusts (SIC= 6798). Furthermore, to assure that firms were aware of the regulatory environment of integrity hotlines in the United States, I excluded firms that were not incorporated in the United States, leaving 3,643 firms.

Small publicly traded firms created potential barriers to conducting a field study for two reasons. First, to the extent that I sought to submit more than one inquiry to a firm, smaller firms are more likely to find multiple inquiries unusual which could impact their responses. Second, I sought to place requests on web or e-mail based hotlines to remove the variability created by oral reporting on phone hotlines (I describe this criteria more in the subsequent section). Smaller firms are less likely to have a non-phone hotline for reporting available. Consequently, I further restricted my potential population to firms within the S&P 500 or S&P 400 midcap index. Although this restriction reduces generalizability of the field study, the direction of this bias is likely to make hotlines appear to have greater efficacy since larger firms are, on average, more likely to have dedicated compliance departments (instead of a partial role fulfilled by the general counsel). With this additional consideration taken into account, I have 685 potential firms.

Making each hotline report is time intensive and I also sought to make multiple reports to each sample firm. Thus, I determined that to feasibly conduct the field study, I would need to sample from this potential population of firms. I sought a sufficiently large number of firms to appropriately capture the range and heterogeneity of firm practices, but balance this against a reasonable amount of resources that could be applied to the project. In the end, I drew a random sample (i.e. SRS) of 250 firms.

The sampling process produced a final sample of firms that is larger, as expected, than the population of listed firms overall. Specifically, the mean market capitalization of my sample firm (n=250) is \$32,430 million at the end of 2016 as compared with the overall CRSP population (n=4,669) of \$6,620 million. Notably, however, the SRS draw of 250 firms produces a sample that is not statistically different in market capitalization than that produced by the sampling procedure (n=685). In particular, the market capitalization for the potential firm sample (n=685) is \$26,454 million with a t-statistic for the difference in means between potential and final sample of 1.3. Table 1 provides descriptive statistics of the final sample. Revenue, age, excess returns, and sales growth were computed from CRSP/Compustat as described in the variation definition in Appendix 2.

For each firm in the sample, Table 1 also shows the number of publicly disclosure regulatory violations that firms have incurred over the prior three years. Violation is a binary variable if the firm engaged in a civil (e.g. Securities and Exchange Commission) or criminal (e.g. Department of Justice) violation. Notably, 27% of all firms in the sample have at least one violation during this time. When this is restricted to only serious criminal violations, I find that 4% of the sample has at least one criminal violation. In addition, more than 10% of the sample is a recidivist with multiple violations in the prior three years. The frequency of firm violations in the sample suggests that Sutherland (1949)'s conclusions about the perceived ubiquity of corporate misconduct in the early 20th century continues to be true even to this day.

3.2 Designing the hotline report scenarios

I sought to design hotline inquiries with several different competing criteria in mind. Specifically, the four considerations taken into account were making the inquiries realistic, having inquiries that would be broadly applicable to a typical operating firm, framing the inquiry in a manner that would prompt a firm response, and minimizing liability concerns.

To begin creating a set of hypothetical inquiries, I started by reading numerous practitioner publications (e.g. *Fraud Magazine*, *HR Magazine*) and media reports (e.g. *The New York Times*) that describe situations that firms receive as reports on their integrity hotline. NAVEX, one of the leading third-party operators of compliance hotlines, also produces an annual report (i.e. *Ethics & Compliance Hotline & Incident Management Benchmark Report*) describing the frequency of different kinds of reports on hotlines. Based on reading these articles, I devised an initial set of plausible situations which I expanded into plain-language reports. I circulated this set of possible scenarios to several experienced compliance

officers who provided feedback both on the realism of the request and the construction of the language.⁷ Based on their feedback, I chose the four scenarios that received common agreement as being both realistic and highly plausible based on their experience. I also heavily revised the language and formatting of the requests to make it resemble, based on their experience, a typical report.⁸

The final scenarios covered four different sources of potential corporate misconduct: financial misconduct, bribe/kickback, harassment, and discrimination (See Appendix 3). The two non-financial scenarios were included to examine whether a firm's hotline was potentially better suited to address human resource related inquiries rather than financial related inquiries (see Section 7 for discussion). I also sought to send multiple scenarios to each sample firm to ascertain the overall responsiveness of their hotline rather than to a specific inquiry at a specific time. For example, if I happened to send a particular scenario at a time in which other events at the firm potentially caused a hotline inquiry to be overlooked, I did not want that to be the sole data point on the firm. At the same time, it was untenable to send multiple different financial reporting inquiries to a firm over a short period of time. NAVEX (2016) reports that less than 2% of all hotline reports are around accounting, auditing, and financial reporting matters. Thus, diversifying inquiries to include other business integrity and workplace conduct issues facilitated my ability to report multiple inquiries to sample firms.

One additional, but important, consideration also influenced the design of the scenarios. The project was deemed as not human subject research by my university's institutional review board.⁹ However, given the unusual nature of the project, I faced a subsequent review by the university's general counsel that raised concerns regarding legal liability associated with the project. One of the most salient

⁷ Compliance officers who provided feedback were not employed by any sample firms in the study. While I did state that I was doing a study broadly related to hotlines which is why I was creating these scenarios, I did not provide any details of the study. I did not engage in a more formal feedback process to evaluate these scenarios to a larger group of compliance officers out of concern that my study could leak to members in the compliance community more generally and impact the responses I would receive from their firms in the study. Thus, my requests were made informally to compliance officers who I knew from prior research and I could depend on to not share the sample scenarios with others in the compliance community as I requested.

⁸ The first versions of my scenarios were viewed as too precise and "well-formatted." From a research perspective, the careful and detailed articulation of the concern is appealing so there is little ambiguity as to what is being reported. At the same time, this kind of request is less representative of what actual reports tend to look like. Thus, after iteration and rewriting, the final scenarios represent an effort to make the report more "casual" in line with what employee hotline reports more often look like. Although this potentially risks having one firm interpret a scenario in a different way than another, I felt that the final scenarios' descriptions were sufficiently specific, but more critically realistic in format and design.

⁹ A considerable amount of thought went into this determination. It was concluded that reporting scenarios to corporate hotlines is not submitting to "people," but rather "firms." Under DHHS and FDA regulation that guide Institutional Review Boards, this would not be human subject research. For a similar exemption from IRB since the unit of observation was "firms" rather than "humans" see Nunley et al (2016).

was around fraudulent misrepresentation (i.e. a false representation of material fact with knowledge of its falsity, made for the purpose of inducing the plaintiff to act on it, which the plaintiff relied upon to its damage). To mitigate the potential for damages, the scenarios were designed in a way to make it unlikely that a firm could engage in a substantive or costly investigation without additional information. Specifically, the inquiries were framed around pending behavior that could become misconduct depending on subsequent decisions. I also included additional language in the inquiries, like “suppose,” to help reinforce the scenario as an inquiry, rather than report.

I also sought to mitigate fraudulent representation by caveating and supplanting additional information to avoid misrepresentation. For example, firms would sometimes ask if the report was being made by an employee. If I were to state the inquiry was not being made by an employee, the inquiry was unlikely to be viewed with the firm’s typical degree of responsiveness, thus undermining the investigation. At the same time, expressing that I am an employee would be unambiguous misrepresentation. To address this, I would select the default employee designation if required, but then I would additionally state that I sought to inquire about my concern anonymously without providing my actual position. In this way, to the extent that a firm inferred that the inquiry was made by an employee of its firm, this would simply be an assumption since the desire to not report the individual’s actual position was explicitly noted.

As an additional consideration to manage potential liability associated with the project, I agreed to not publish the names of firms who were contacted. This addressed the concern that some firms, depending on their response, could view such publication as causing damage to their firm reputation. Specifically, while the direct costs for a firm to respond to a particular inquiry might be inconsequential, the reputational costs could conceivably be much larger if a particular firm response was viewed negatively by external observers. As there was limited research benefit to publishing firm names, but a substantive legal concern, I agreed to keep these names confidential for the purposes of the project.¹⁰

3.3 Reporting Process

For each sample firm, I began by finding the location of their hotline(s). As a typical practice, firms provide the contact information for their hotline in their code of conduct. The NYSE and NASDAQ require

¹⁰ The ethical and legal considerations of submitting what some could argue are false claims to an integrity hotline was not lost on the author. The final design of both the reporting scenarios and how they were processed reflect a desire both to submit realistic reports, but also lessen the potential for perceived misrepresentation in a moral and legal sense. For a discussion of how the author viewed the morality of engaging in this and related work on corporate misconduct, see Soltes (2017b).

firms to publicly post their code of conduct making this a readily available means to locate hotlines.¹¹ In some instances, the codes of conduct did not have the hotline information provided. In these cases, I would manually search the two dominant third party hotline providers (NAVEX and Convercent) for their client's reporting page. If I could not find this information online, I would call the firm (e.g. telephone hotline, general counsel's office, etc.) and ask for contact information for the anonymous hotline.

Firms offer hotlines in a variety of mediums including telephone, web-based, e-mail, and letter with telephone and web-based being the most common. Initially, I planned to report both on phone and web-based hotlines. However, in initial piloting of the project, relying on phone reporting to produce a homogenous report of each inquiry proved exceedingly difficult. The quality and proficiency of the individual taking down the report would significantly influence what the firm would receive.¹² Given my desire that all firms would receive the same information about each scenario, rather than variation based on the individual who took down the report, I decided to report exclusively on online reporting systems. Specifically, I would use a web-based reporting hotline if available. If this was not available, but the firm provided an e-mail address for hotline requests, I would use that as an alternative. Although this further reduced the number of sample firms (as per the sample selection in Section 3.1), this significantly improved both the precision and consistency of reporting inquiries to different organizations. To send out the reports, I created a randomization protocol where each scenario was assigned a number. I spread the inquiry reports to sample firms over a two month period and randomized the order in which firms received different scenarios to avoid making several reports to the same firm within a short period of time (i.e. same day or within several days).

¹¹ In some instances, a firm would have multiple codes of conduct available online. In this case, I would utilize the most recent code of conduct to locate contact information.

¹² The individual taking the report would reread the report in its entirety to make sure the reporter is satisfied with how it was taken down. There was considerable heterogeneity in how well reports were initially captured. I initially considered correcting each report while on the phone so they were the same (thereby assuring homogeneity in reports), but such a process would not be representative of the actual process of reporting to that firm (given that most people would not seek that level of precision) and this would also be extremely time intensive (in some instances, expected to take more than 30 minutes per inquiry per firm). Understanding how the recording of hotline inquiries influence a firm's response could be an interesting study in its own right, but was not the primary focus here. An additional obstacle to phone reporting was an unusual degree of "hang-ups." For example, for one firm I was unexpectedly disconnected first after 11 minutes and then again after 13 minutes on the call when the firm representative answering the call said he was finding a pin to provide for follow-up. It is unclear whether this was simply a coincidence (i.e. at the exact same portion of the call when the firm representative was verifying the report and finding a pin) or some more deliberate attempt to hinder reporting. Ultimately, such time-consuming impediments made it impractical to conduct a large sample field study using telephone hotlines.

For web-based reports, firms often required additional information beyond the actual complaint or concern. This included information about location, the nature and timing of the incident, who knew about its occurrence, assessment of magnitude, and the number of times it occurred. In an effort to homogenize the information provided, additional information about each inquiry was created (e.g. the impact was expected to be material). If required, firms were provided with this additional information for each inquiry. Appendix 4 describes this supplemental information.

When a web-reporting channel was not available, I submitted the inquiry to the e-mail channel (if available). To do this, four different e-mail accounts were created and each account was used for the submission of one inquiry type. The same description of the inquiry as web-based reports was provided to the firm as described in Appendix 2. As with the web-based reports, the ordering and timing with which e-mail inquiries were submitted to firms was randomized.

3.4 Recording Firm Responses

After making each initial report, I returned to the hotline to access the firm's response approximately two weeks later. The date of the firm's response and response itself were recorded. In some instances, the firm sent multiple responses each of which was recorded. In order to focus on how the firm resolved the inquiry, "automated" responses (i.e. "Thank you for your submission. We are now investigating your report and will return...") to the initial inquiry were discarded.

In some instances, firms closed an inquiry without responding. As the firm had received the inquiry, but chose not to respond, these responses were coded as the firm closing the inquiry without a response. In addition, if the firm did not respond to our inquiry within fourteen days of the original inquiry, I also deemed the investigation closed. Given the desire for a resolution in each inquiry, two weeks was viewed as an adequate amount of the time for the firm if they were going to respond.¹³

Beyond the original inquiry, no additional follow-up was provided to the firm. After some initial piloting, it was deemed that providing additional information or consuming more firm time would increase the risks associated with making inquiries on the hotline. Thus, the final coding reflects the firms' response to only the information initially provided in the initial inquiry on the hotline. While this limited the ability

¹³ In some instances, firms were found to respond to inquiries after two weeks. However, some of the inquiries— one (bribery) and two (financial manipulation) in particular – were time sensitive. For instance, one firm responded to the bribery inquiry three weeks later with "I apologize for the delay, something happened with the mailbox. This is definitely a conflict of interest issue and since it is a government official, it is ever more problematic." However, a firm responding nearly three or more weeks after the initial inquiry is not particularly helpful for an individual seeking guidance about how to appropriately respond to a dilemma. Consequently, the shorter two-week period reflected the need for a reasonably timely response.

to always see how a firm would resolve the inquiry as some firms sought additional information before offering specific guidance, it also made the information provided to each firm homogenous and avoided significantly increasing the potential liability associated with the project.

4. Hotline Analysis

While anonymous hotlines can appear to function effectively “on paper”, how they actually function in practice could differ and is the focus of the field investigation. In this section, I begin by examining how firms present their hotline to prospective callers by encouraging or discouraging anonymity. I then examine, in 4.2 and 4.3, the obstacles encountered when reporting alleged violations and how firms responds. Finally, in 4.4 I examine how responses vary across the financial and HR vignettes.

4.1. Discouraging Anonymity when Hotline Reporting

Research by psychologists finds that offering individuals the opportunity to anonymously report alleged misconduct encourages reporting (Miceli, Near, and Dworkin 2009, Treviño et al. 1999, McDonald 1999). Following this line of research, SOX required firms to have an anonymous process for submitting allegations of misconduct (i.e. SOX §301). Nevertheless, while the legislation required firms to make an anonymous reporting process available, firms were not required to actually encourage anonymous submission.

Given this flexibility, some firms chose to discourage anonymous reporting. Several possible explanations can account for this decisions. First, hotlines may be used to make frivolous complaints and allegations. By requiring the individual to identify him or herself, the potential cost of making false or exaggerated complaints rises thereby reducing their frequency (Near and Miceli 1996). Second, anonymous reports can be more time-consuming and expensive to investigate and thus having the identity of the employee, supplier, or client making the report helps expedite the investigation (NAVEX 2016). Finally, it is not clear whether firms that have potential violations actually desire to detect them. By discouraging anonymous reporting, it discourages whistleblowing which can facilitate managerial efforts to conceal misconduct.

To examine the characteristics of firms that encourage or discourage anonymity, I find the language pertaining to the hotline within each code of conduct. I classify the language referring to

anonymity as either encouraging (or agnostic) or discouraging.¹⁴ Examples of language that encourages or is agnostic about anonymous reporting include:

Your call is confidential and you may remain anonymous.

You may, of course, make your report without revealing your identity. Anonymous reports will be investigated as thoroughly as reports for which the caller is identified.

In contrast, example statements by firms that discourage anonymous reporting on hotlines include:

It may be difficult or impossible [for firm name] to thoroughly investigate reports that are made anonymously. [Firm name] therefore encourages employees to share their identity when reporting.

You may remain anonymous subject to any local laws, although you are encouraged to identify yourself.

In Table 2 Panel A, I find that 13% or 33 companies in my sample explicitly discourage individuals from reporting anonymously. While it is a relatively small portion of firms, such discouragement is potentially significant in that it is implicitly undermining the spirit of having an “anonymous” hotline.

To better understand the types of firms that discourage anonymity in reporting, I regress whether the firm discourages anonymity on firm characteristics in Panel B of Table 2. Notably, I find that firms that are predicted as more likely to have internal control weaknesses are significantly more likely to discourage anonymity. ‘ICW rank’ is the scaled rank of fitted values of the determinants as described in Doyle et al (2007) and also used in the examination of whistleblowing target characteristics in Bowen, Call, and Rajgopal (2010). The association between potential internal control weaknesses (i.e. “a significant likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected,” PCAOB 2004) and firms that explicitly discourage anonymous whistleblowing is significant since the firms that are most likely to have deficiencies are more likely to be the same firms that are

¹⁴ Given the relatively small sample, codes were manually rather than algorithmically coded. This permitted us to capture the more nuanced language and differences across codes that could discourage anonymity. However, a number of common language elements helped delineate whether to classify a code as discouraging anonymity. These include: “encourage[s/ed] [to identify oneself]”, “does not allow complete anonymity,” “limit or ability [to investigate if anonymous,” “anonymity cannot be guaranteed,” “prefer that you identify,” “to the extent possible [protect anonymity].” If a hotline is not explicitly referenced in the code of conduct, but the firm does have a fully anonymous hotline, I record the hotline as being agnostic toward anonymity.

undermining a reporting channel to identify these weaknesses (i.e. by discouraging the anonymous use of their hotline).

I further investigate the recent history of firms that encourage or discourage anonymity. Although firms that simply have a recent violation are statistically no less inclined to discourage anonymity (in Model 1), I find that firms with more violations are more inclined to discourage anonymity in Model 2. An approximately one-standard deviation in the number of violations (from one violation to three violations) increases the likelihood of discouraging anonymity by 7% (from 10% to 17%). In Model 3, I examine whether financial or employment violations are associated with firms that discourage anonymity and find an association only with recent financial violations. In summary, while SOX required firms to have a means to anonymously report potential misconduct, firms that have recent financial misconduct are also the ones that discourage anonymity.¹⁵

One interpretation of the results from Table 2 is that firms that are most likely to have violations (as measured by modeling the firm's likelihood of having an internal control weakness) desire to more expeditiously and efficiently resolve potential issues which is why they discourage anonymity on hotlines. Yet, their ability to more expeditiously resolve allegations is predicated on individuals feeling comfortable reporting. As prior research suggests that anonymity is an important feature in considering what improves reporting hotlines, by discouraging anonymity, firms that are already more inclined to have potential problems (e.g. internal control weakness) may be further undermining the ability to enhance their internal controls. In this regard, discouraging anonymity could potentially be viewed as yet another internal control weakness since such discouragement is likely to lessen the likelihood that these deficiencies will be reported and rectified.

4.2 Obstacles Associated with Hotline Reporting

A firm may encourage or discourage anonymity in referring to its hotline, but the hotline can still be viewed as functioning as an anonymous hotline. Yet, the functioning of the hotline may only be "in theory." In particular, the hotline may not actually work as easily as described by the firm in its documentation. Hotline impediments increase the difficulty of placing reports. In some instances, these obstacles explicitly undermined the anonymity of the hotline. As examples from the field study:

¹⁵ I also examined whether a number of additional governance related variables (i.e. dual class stock, classified board, percentage required to amend the charter, presence of a golden parachute, and poison pill) on whether a firm was more or less likely to discourage anonymity. I did not find a statistically significant relationship with any of these factors.

Firm utilizes caller ID to identify “anonymous” caller: When the integrity hotline listed in the code of conduct was called, an employee of the firm answered. The employee stated that they believed I had the wrong number since she did not believe it was her responsibility to record such allegations. After hanging up, the employee later— using the caller identification function from the firm’s phone— called back to note that she had been mistaken and the correct number had been called. If still desired, she could create an “anonymous” report.

“Anonymous” hotline only permits allegations from identified employees: When an e-mail was sent to the firm’s hotline, an automated response was sent back saying that the “anonymous” hotline only accepted e-mails sent from identifiable e-mail accounts owned by the firm.

The second example is especially surprising given the concern of retaliation that many employees have in reporting claims of misconduct. As Debra Katz, a prominent civil rights attorney, has noted “unsophisticated people [who] provide the company an e-mail will frequently become the subject of investigation themselves.” (Scheiber 2017) By requiring individuals to use their company issued e-mail account to make reports, this firm is effectively ensuring that anonymity is not preserved. Moreover, both of these instances represent firms failing in their obligation to create an anonymous reporting channel under SOX §301.

Beyond impediments that limit the anonymity of hotlines, a variety of other impediments also encumber the actual use and reporting on hotlines. As examples from the field study:

Incorrect routing of request: When one follows a link to the integrity hotline web-address provided in a firm’s code of conduct, the link re-routes to the company’s home page.

Wrong or complete phone number provided: A firm provided a link to a third-party hotline provider, but no information about how to access the actual hotline. If a reporter dialed numbers on the linked page, he would be connected to a customer specialist that would say that the caller had reached the wrong number and would need to talk to their firm to find the appropriate hotline location.

Broken reporting link: A firm provided a web address to anonymously report, but the address is incorrect leading to a “web page not found” error.

To systematically examine obstacles to anonymously reporting on hotlines, every phone and web hotline in the sample was investigated. Phone hotlines were tested by calling each firm. Once the call was answered, I stated that I would like to make an anonymous report of potential misconduct. Once the respondent to the call said it was possible to make the report, I noted that I would call back later thereby ending the call. For web hotlines, I followed the link for each website cited by the firm as their anonymous

reporting channel. As it was not possible to effectively test an e-mail hotline unless a legitimate inquiry was sent, e-mail hotlines were only tested if they were a sample firm where we planned to send an inquiry. In this regard, we were able to more comprehensively test phone and web hotlines as compared to e-mail hotlines.

Panel A in Table 3 describes a complete list of the obstacles that were encountered across the three mediums and the number of times each impediment occurred (see Appendix 5 for detailed descriptions of each obstacle type).¹⁶ Although some of the obstacles were infrequent (e.g. person answering the hotline was unaware that it was the anonymous reporting line), the detailed categorization sought to capture each limitation encountered when trying to place a report.

Web hotlines had the greatest number of obstacles. The two most common obstacles were generic third party links and non-functioning websites. The generic links make it difficult to locate the correct place to report since using the link would direct the reporter to a page of a hotline service who, if called, will tell you to contact the firm for whom one wants to make a report to acquire the correct location. In this regard, the impediment is from the firm not providing the correct reporting information. In contrast, non-functioning websites are an impediment created by the website host. As will be further described in Section 5, nearly all online hotlines are supported by third-party providers suggesting that some deficiencies in their services have not caught the attention of their clients (i.e. the firm who hires a third-party provider to create a functioning reporting hotline). Some of the impediments entirely impair the functioning of a particular reporting medium. For example, four e-mail hotlines had e-mail bounce back (i.e. “server not configured” error from the recipients server).¹⁷

¹⁶ The obstacles analyzed in this section are those observed externally when a reporter seeks to contact a firm. In this regard, it is an underestimate of all the obstacles arising in the reporting process since some may only be observable on the firm side. For example, one firm started their response by saying “I apologize for the delay, *something happened with the mailbox.*” Thus, the firm admitted that there was some problem associated with their reporting line, however this was only observable from the firm’s perspective.

¹⁷ One concern is whether the information provided on a firm’s website was “outdated” thereby causing these impediments. In this way, some firms might argue that the obstacles are not genuinely present since the code of conduct document or the web-site code of conduct was no longer the one being currently distributed to employees (i.e. the firm has not updated information for employees on its webpage and has internally provided some newer document). Even if this was the case, such an explanation does not address many of the impediments found (e.g. firm representative does not know that they are the designated hotline representative, etc.) Moreover, given that the contact information used in the field study is still widely presented by the firm and readily accessible, it is not improbable that individuals seeking to use the hotline would also attempt to use the same contact information. It is likely that many of these hotlines were fully functional at one point, but to the extent that the firm does not communicate up-to-date information about utilizing the reporting channel as changes are made (i.e. e-mail address of hotline changes), it creates the types of impediments described here.

Panel B of Table 3 shows the number of firms with no obstacles and at least one obstacle. Four firms had more than one impediment to readily reporting on their anonymous hotline. Because some firms “gated” their hotlines (e.g. required to log into their intranet to view contact information), we were not able to test hotlines for all firms in the sample which is why 19 firms were not tested. Thus, the finding that 20% of firms having some obstacle is likely to be a conservative estimate of the percentage of firms with some obstacle to reporting (Appendix 6 provides a Venn Diagram showing the number of firms with phone, web, and e-mail hotlines). It should also be noted that in the case a firm does not have an obstacle to reporting, this does not imply that firm representatives would respond to inquiries in a timely manner. Rather, a firm without an impediment simply suggested that an individual could make a report on any of the firm’s reporting channels without facing an impediment.

As non-functioning hotlines undermine their effectiveness by making it more difficult to report, Panel C of Table 3 examines the characteristics of firms that had obstacles associated with reporting. Firms that are smaller, less likely to have internal control weaknesses, and recent criminal convictions are more likely to have reporting obstacles. The negative association between internal control weaknesses and obstacles suggests that firms that seek to better maintain their internal controls actually seem to overlook potential obstacles to reporting. To the extent that a firm has stronger internal controls, they may be less inclined to have users of the hotline which is one potential explanation for this relationship.

The positive association, albeit weaker at the 10% level, between firms with recent criminal convictions and reporting obstacles is surprising given that as part of organization sentencing after a criminal conviction, firms normally have a review of their compliance program. Often times, such reviews are done with the guidance of court appointed monitors (Khanna and Dickinson 2007). However, to the extent the firm continues to have reporting obstacles, this suggests that the accountability placed on firms by corporate monitors and prosecutors is not always effective in ensuring a fully functioning compliance program in the future.

In Model 2 of Panel C, I limit the dependent variation to only equal one when a firm has such a serious obstacle that the hotline is broken (e.g. e-mail bounce back).¹⁸ In this case, there is no longer a statistically significant relationship between recent criminal conviction and having a broken reporting channel suggesting some amount of accountability post-conviction. However, I continue to find that firms less likely to have internal control weakness are more likely to have broken reporting channels.

¹⁸ Serious obstacles that effectively prevent reporting include (per Table 4) misconfigured e-mail accounts, must use internal e-mail address, incorrect phone number, phone line disconnected, firm contact unaware of hotline, redirect to incorrect webpage, and website errors.

In summary, Table 3 shows that despite many reports stating that they have anonymous reporting channels, a significant number of firms— 20% of the sample— have an impediment that hinders reporting. Some of these obstacles are serious and effectively impeded reporting on the reporting channel all together. In numerous instances, these obstacles sufficiently serve to undermine a firm’s ability to fulfill its obligation to provide an anonymous reporting channel under SOX §301. Taken together, it suggests that there is considerable heterogeneity in the ease of accessing different reporting lines. Some firms, despite stating that they have a reporting channel, do not actually support its functioning.

4.3. Firm Responses to Hotline Inquiries

By framing each report as a question, each hotline inquiry was designed to prompt a firm response. Firms could respond to the report by answering the question explicitly (i.e. conduct is appropriate and it is acceptable to proceed) or seeking additional information before proceeding. A firm could also close the investigation or choose not to respond. If a firm either closed the investigation (which was sometimes viewable on the system) or did not respond with two weeks, I viewed the investigation as closed.

In Table 4, Model 1, I look at the characteristics associated with closing investigations by looking at organizations that close inquiry 1 (bribery related) or inquiry 2 (financial manipulation related) without any response. I find that firms less prone to have weaknesses in their internal controls were more likely to close an inquiry. One reason for this relationship is that firms with stronger internal controls may have investigated the matter and found no need to continue asking additional information to resolve the matter. In addition, I also find that firms ranked more favorably by employees (as indicated by Glassdoor, a popular site for employees to review the quality of their firms) were less likely to close inquiries.

Inquiry 1 described how a city council member requested to utilize the firm’s parking lot for his child’s school. However, the inquiry noted a concern that such conduct could be viewed as inappropriate given that the council member could influence future zoning decisions related to the company. The majority of firms sought additional information (e.g. location of school, name of council member, etc.) before they were willing to reach a conclusion. However, 46 firms provided an explicit answer without requiring any further information than that described in the inquiry. 52% of the responses were ‘yes.’ Most ‘yes’ responses to Inquiry 1 were short and direct. As an example:

The Ethics Office sees no reason to object to the request of using our parking lot for school purposes as it is another way for [firm name] to be a good steward to the community and supporter of local functions

Several responses provided explicit detail into how the compliance and ethics office arrived at their 'yes' decision. One particularly detailed account stated:

Individual Council members may have influence but no single council person can act independently. Even the mayor, in this case, is mostly a titular role and he doesn't have the authority to act singularly. Let's say we wanted to rezone part [of firm building] for some different kind of use. We would present a proposal to the planning department who then reviews all of the information in accordance with the city master plan. They make their comments and we work back-and-forth with them until we have something that can then be presented to the Planning Commission. The Planning department is staffed with employees not elected officials. Once it moves through the planning department then it can go to the planning commission for a vote. There will be public comments at this meeting and then a vote by the commission. The issue may or may not go to the City Council. If it ever came up to the Council for a vote, we should ask that the Council person recuse himself/herself from the vote. So we, therefore, do not see a conflict of interest in this case.

In contrast to these 'yes' responses, slightly less than half (47%) of firms that responded said it would be inappropriate and not to proceed (i.e. 'no'). As examples of 'no' responses:

We have researched your question and strongly believe [firm name] should not take the action of allowing the use of the parking lot based upon a request from a local government official. This is specifically prohibited under both our FCPA and Lobbying policies. This could be construed as an improper payment and is not allowed.

The action you describe would not be appropriate.

Although the number of firms providing an explicit answer to inquiry one was small (n=46), understanding which firms answered affirmatively without additional information is of interest. In particular, as indicated by the sample 'no' response, proceeding is not a particularly conservative response especially without additional information about the nature of the relationship between the council member and firm.

In Model (2) of Table 4, the dependent variable is equal to one when the firm said granting the parking lot was acceptable and no if they stated it would not be appropriate. As shown, there are few firm characteristics that explain firm decisions which may be a result of the limited power of the model given the small sample size. However, firms predicated to have internal control weaknesses are more inclined to respond affirmatively at a marginally significant 10% level. Firms that respond without additional information may be viewed as having weaker compliance which is similarly echoed in their internal controls.

Inquiry 2 reported a potential concern about holding back invoices. The inquiry was deliberately vague about the specific nature of the incident and whether it was impacting accruals or simply cash flows (or both). With few exceptions, firms requested additional information to investigate. However, some firms saw the report as quite serious, while others viewed it as non-threatening and likely acceptable. Some of the language that firms used when they viewed the inquiry as serious included:

The situation you described may be a very serious one. If the invoices received are not entered into the AP system in the period they are received, our expenses are not properly recorded, which is a form of financial fraud

The described activity is a violation of company policy. It is absolutely not okay to delay payment on invoices and it is very important that we are made aware of the department and amounts involved as soon as possible so the matter can be addressed.

You should not hold off or delay reviewing or paying any invoices--even if your supervisor asks you to. You should open all mail, review all invoices, and approve invoices for payment promptly without regard to budget.

In contrast, other firms inferred that this was likely acceptable cash-flow management and therefore not serious. As examples of firms that viewed the inquiry as less serious:

There is nothing wrong with this practice as long as invoices are accrued for. It is simply managing cash flow.

As long as all amounts are accrued properly, there is no violation of the law or our policies. Delaying payment does not affect our numbers.

In Model 3 Table 4, I examine the characteristics of firms whose response indicates that the allegation in Inquiry 2 is serious. As with Inquiry 1, firm characteristics provide limited explanatory power into understanding how a firm responds. One explanatory variable that does offer insight into the firm's response is whether the response is signed by an identified person. Specifically, some firms have personalized responses signed by a named person. I find that when the response is signed by a person, the response is much more likely to cite that Inquiry 2 is serious in nature. In particular, the likelihood that the response says it is serious rises nearly 14% (from 4% to 18%) when signed by an identified person.

Ultimately, firm level characteristics provide fairly little insight into how firms respond. One limitation of the field study design is that I could not reasonably continue dialogue to ascertain their

ultimate conclusion. Firms may have provided different responses by providing more information. However doing so would unnecessarily burden firms, raise risks for undertaking the project, and require more plausible information about a firm (e.g. specific names of accounts or parking lots) than would be feasible to provide. Nevertheless, the qualitative responses in instances where firms did respond offer some insight into the significant differences in how firms respond to such inquiries.

4.4. Financial Misconduct versus Human Resource Hotline Inquiries

In the wake of several financial scandals, a considerable amount of emphasis was placed on having a hotline available for submitting concerns around accounting and auditing matters. In particular, the passage of SOX mandated the creation of such an anonymous reporting system. However, firms face considerable liability concerns associated with non-financial matters that hotlines can also help manage. These non-financial matters include employment issues related to harassment and discrimination. By providing a reasonable care defense in negligence-based suits, hotlines can manage the firm's legal exposure to such incidents. Thus, firms may utilize anonymous hotlines to detect human resource (HR) related problems in addition to potential financial misconduct (Feldblum et al 2016, McHard and Mohr 2011). Given the potential competing roles of hotlines in resolving both financial reporting and HR related allegations of misconduct, one question is whether firms' responsiveness differs by the nature of the alleged misconduct.

Beyond the two inquiries related to bribery and financial manipulation, I submitted two additional HR related allegations of misconduct to understand how firms respond to such claims. Inquiry 3 related to seeing a photograph of a co-worker participating in a neo-Nazi rally and holding a swastika sign. The inquiry described the reporter's fear of working with such an individual and wanted to know if participation in the neo-Nazi rally violated company policy. Inquiry 4 described a situation where co-workers were merrily drinking with a client. To better satisfy the client, the firm's manager assigned co-workers who drank to the account. The reporter, who did not drink for religious reasons, saw a potential tradeoff between holding their religious convictions (and not drinking) and succeeding at the firm. The detailed description of both inquiries is described in Appendix 3.

To compare differences between financial and HR inquiries, I compare the likelihood of closure, response time, and length of the firm's response in Table 5. In Panel A, I provide the descriptive statistics across the four inquiries. I find that marginally fewer inquiries around financial manipulation were closed (7.5%) compared to either the harassment (11.6%) or discrimination (11.2%) inquiries. However, these

differences in closure rates are not statistically significant (chi-squared test) suggesting that firms' hotlines were equally adept at responding to claims of financial misconduct and HR concerns.

The response time was measured as the number of days between the original report and the first, non-automated, response from the firm.¹⁹ In this instance, firms more rapidly respond to inquiries of financial manipulation over claims of bribery and discrimination. Moreover, this difference is statistically significant with a one-sided p-value of .01 and .03 respectively. The faster response time underscores the perceived importance of more immediately resolving the potential allegation. I find that firms are just as rapid at responding to Inquiry 3 regarding the neo-nazi rally as Inquiry 2 of financial manipulation. One potential reason for this similar urgency in addressing Inquiry 3 was the considerable coverage of white-supremacy rallies during the time the period of the field study (Summer/Fall 2017) as well as discussion of whether external views ought to impact employment (e.g. firing James Damore at Google for writing an alleged anti-diversity memo).

The length of responses to allegations of financial misconduct were also considerably longer than others reflecting the relatively greater complexity of the inquiry. Word counts included all responses with the exception of automated responses which were excluded. The mean length, 175 words, for Inquiry 2 was longer than either of the three other inquiries and this difference was statistically significant (one-sided p-value of .00, .01, and .01 respectively for the differences in word count between Inquiry 2 and Inquiries 1, 3, and 4 respectively). The response to the bribery claim, by contrast is shorter on average than either the harassment or discrimination claim (statistically significant with a p-value of .04 and .00 respectively). Thus, response depth appears to be driven by the type of inquiry rather than a perceived importance of finance versus HR inquiries.

In Panel B of Table 5, I regress closure, response time, and response length on firm characteristics. As multiple responses for the same firm are included in the panel, regressions are clustered by firm. I find some evidence that more rapidly growing firms (as indicated by sales growth) are more likely to close inquiries and have slower response times. Further, in line with the univariate statistics, Inquiries 2 and 3, have more rapid response times than the excluded category (Inquiry 4). The relatively few firm level determinants that explain how a firm responds suggests that the nature of the inquiry itself, rather than the type of firm, more significantly explains how a firm's hotline responds.

¹⁹ The calculated amount of time in this analysis is total days between the submission of the inquiry and the response. If only work week days are included, the median response time falls by approximately one day across inquiries.

Overall, Table 5 indicates that integrity hotlines respond to allegations of financial misconduct and HR concerns in a broadly similar manner. Although the claim of financial manipulation has a marginally faster response time on average than the discrimination claim, this difference is not large economically (i.e. approximately one day on average). Moreover, the harassment claim has a similar response time as the financial manipulation claim. Ultimately, this suggests that while regulation (e.g. SOX) focuses on the financial and accounting role of integrity hotlines, firms are adept and seek to respond to other claims of misconduct in a similar manner in terms of timeliness and length of response. These results suggest that some claims like “many employers create hotlines merely to help insulate themselves from legal liability without ever following up on complaints” (Scheiber 2017) is somewhat exaggerated since the majority of firms responded in a timely manner to most inquiries.

In fact, the role that HR plays in resolving allegations of misconduct might even marginalize the role that internal audit, accounting, and finance may play in responding to inquiries. The largest third-party provider of hotlines shows that the vast majority— 72% in 2016— of all reports to integrity hotlines relate to HR issues suggesting that some firms may delegate or see their hotline primarily as a system for resolving HR concerns (NAVEX 2016). By focusing the emphasis of hotlines on swiftly resolving HR concerns, the hotline could mis-categorize non-HR inquiries. Responses from two firms about Inquiry 2 (financial manipulation) shows how firms can mistakenly classify a financial related concern by seeing it simply as a communication issue with a supervisor.

Thank you for contacting the Office of Business Practices. Please raise this matter to the attention of your local Human Resources Manager to address- especially if you are not comfortable following the direction of your supervisor.

For this type of issue, we suggest you work with your local HR representatives.

Notably, these were exceptions to the more typical responses to Inquiry 2. Many of the responses explicitly showed that firms specifically sought to understand the issue and desired to investigate the allegation (“We spoke to our Corporate CFO regarding your question...”, “I spoke with our Vice President, Finance of North America...”, “the Company has engaged the services of a third party forensics expert to perform further analysis”) However, for these two firms, the hotline inappropriately viewed the issue as one related to HR rather than accounting or auditing. To the extent that the alleged misconduct was true, these examples indicate how such issues could potentially be missed or overlooked as a result of a firm’s hotline response.

5. Hotline Providers

Who should answer integrity lines to encourage reporting has been the subject of considerable work by psychologists. Most of this work has concluded that there are potential adverse consequences associated with outsourcing hotlines to third-party consultancies and security firms. Treviño et al. 1999, for example, state that “the findings of this study suggest that it is better for the company to keep responsibility for reporting and investigation in-house.” To investigate who manages the hotline, I examine both the hotline and website providers of hotlines.

In Panel A of Table 6, I find that the vast majority— more than 90%— of phone hotlines are managed by third-party providers. One reason underlying the desire to outsource appears to be the considerable fixed costs (e.g. phone/email reporting available 24 hours a day, routing of requests, underlying recording infrastructure) associated with managing a hotline which could be more efficiently managed to outside parties.

Curiously, eleven hotlines would note that they were a representative from a third-party provider (i.e. not a firm employee), but would not name which company they worked for. The inability to ascertain who one is giving potentially sensitive information to potentially undermines the comfort a reporter could have in providing information on such a line. Four firms also utilized answering machines/services where allegations of misconduct could be left. In such instances, while reports of misconduct could be made anonymously, there was no way for the firm to collect additional information without the caller exposing his or her identity.

The diversity of website providers shown in Panel B is even more limited. More than 90% of firms in the sample utilized the services of two firms, NAVEX and Convercent, to run their web reporting. The use of third-party providers to create website creates a strong degree of homogeneity across the different reporting pages. In particular, the pages required the same information and similar issue identification. In most instances, differences were only distinguished by a company logo and in some instances an introductory message. I found only one firm that actually created and maintained its own website for reporting.

For most firms, the managing of integrity hotlines has become a process to outsource. While academic work in psychology suggests that such a process may hinder reporting, at least some anecdotal evidence suggests that the impartiality and professionalism offered by third-party providers may improve comfort with reporting. Moreover, as viewed by the responses, most of the actual investigation work appears to be done by the firm itself. Thus, the third-party may be viewed as simply providing the recording mechanism. In this regard, an external party could actually be advantageous. As one attorney

who represented several whistle-blowers noted, third party providers were “like calling in a car insurance claim” reflecting the degree of impartiality they strive to provide (Scheiber 2017). Ultimately, further research would be needed to fully assess the benefits and costs associated with employing external parties to support the reporting process.

6. Conclusion

Integrity hotlines provide an opportunity for alleged misconduct to be reported and organizations to more rapidly address misconduct. Despite their ubiquity, little is known about how such hotlines perform on average. By conducting a field study, this investigation explores how firms actually respond to inquiries of alleged misconduct. The results indicate considerable obstacles associated with reporting, but a high degree of responsiveness once an allegation is reported.

This investigation raises numerous questions for further inquiry. The frequency that a reporter would encounter an obstacle if trying to report on a hotline is troubling. One plausible hypothesis is that firms initially create a well-functioning hotline that over time degrades and loses functionality. In this regard, it is not a matter of firms deliberately trying to obfuscate or hinder their reporting process, but rather a failure of maintaining all their reporting channels. More research that tracks firms’ hotlines over time would help elucidate this phenomena. Moreover, it would be worthwhile to examine whether firms themselves understand that they have these impediments.

The investigation found a limited ability to explain the difference in responses through firm characteristics. Given that firms have different processes and types of people (e.g. compliance officer, HR representative, etc.) involved for examining and resolving hotline inquiries, examining how the process itself influences how they respond may better illuminate this decision making process. In this regard, this analysis seems to suggest that it is not a firm level characteristic, but rather something related to the individuals or underlying firm processes, that are driving different responses. Exploring whether it is more of a function of the process of individual people would illuminate why some firms are more responsive than others.

The sample selection weighted toward larger and more established firms. However, smaller firms still have the same hotline requirements and guidelines (i.e. SOX, NYSE/NASDAQ, USSC), but likely have fewer resources to support hotlines (e.g. even if using a third-party service to answer calls, internally smaller firms are less likely to have a dedicated compliance team). How smaller firms differ in their responsiveness and support of their hotlines would improve our understanding of how firms of different scale manage their compliance programs.

Finally, this investigation shows how firms depict their compliance practices on paper may differ from how they actually function in practice. Understanding where and how such differences arise in other areas of firm processes would provide a greater understanding of potential gaps in regulation that lead to less effective programs than might be sought by legislators, regulators, courts, and prosecutors.

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Table 1: Descriptive Statistics

Table 1 provides descriptive statistics for major variables used in the hotline analysis. Section 3.1 of the paper describes the selection process leading to the final hotline sample (n=250). Variable definitions are describe in Appendix 2.

Variable	N	Mean	SD	Q1	Median	Q3
Revenue (millions)	250	15,578	31,402	2,213	4,890	12,020
Firm Age	250	40	22	24	35	51
Excess Returns	250	0.05	0.23	-0.09	0.05	0.18
Sales Growth	250	0.02	0.19	-0.04	0.02	0.07
Violation (1/0)	250	0.27	0.45	0.00	0.00	1.00
Criminal Violation (1/0)	250	0.04	0.19	0.00	0.00	0.00
Total Violations	250	0.62	1.98	0.00	0.00	1.00
Firm Rating	250	3.4	0.4	3.1	3.4	3.7

Table 2: Discouraging Anonymity

Table 2 examines firms that discourage anonymous reporting on their hotline. Panel A shows the number of firms that encourage or discourage anonymity as discussed in Section 4. Firms that have a fully anonymous hotline, but do not provide any language referencing it are classified as ‘agnostic’ in regards to anonymity. Panel B regresses firms that discourage anonymity on firm characteristics. Discourage anonymity is an indicator equal to one if the firm discourages anonymity when reporting on the hotline. Additional variables are described in Appendix 2. All models are probit and ***, **, * indicate statistical significance at the 1%, 5% and 10% level respectively.

Panel A: Firm Language around Anonymity

	N	%
Encourage or Agnostic Anonymity	217	87%
Discourage Anonymity	33	13%
Total	250	100%

Panel B: Firm Characteristics & Anonymity

	(1)	(2)	(3)
	Discourage Anonymity	Discourage Anonymity	Discourage Anonymity
Revenue (log)	0.0385 (0.102)	-0.0890 (0.111)	-0.0695 (0.113)
Age (log)	-0.0474 (0.296)	-0.0661 (0.297)	-0.0419 (0.297)
ICW Rank	0.554*** (0.178)	0.628*** (0.185)	0.621*** (0.185)
Excess Returns	0.157 (0.486)	-0.112 (0.491)	-0.0753 (0.492)
Sales Growth	0.736 (0.479)	0.867* (0.472)	0.854* (0.476)
Violation	-0.137 (0.268)		
Total Violations		0.131*** (0.0481)	
Total Financial Violations			0.149*** (0.0541)
Total Employment Violations			-0.00933 (0.169)
Firm Rating	-0.0631 (0.275)	-0.0514 (0.280)	-0.0827 (0.283)
Constant	-1.907 (1.490)	-1.061 (1.541)	-1.135 (1.538)
N	250	250	250
R-Squared	0.09	0.12	0.13

Table 3: Obstacles to Reporting Allegations of Misconduct

Table 3 investigates obstacles to reporting on web, phone, and e-mail based hotlines. Panel A describes the number of each type of obstacles encountered. Obstacles are described in additional detail in Appendix 4. The sample includes all firms that have at least one hotline available, n=231 (see diagram in Appendix 5 for the number of firm with each hotline type available). Panel B shows the number of firms with at least one obstacle in the sample. Panel C regresses whether a firm has an obstacle on firm characteristics. Obstacle to reporting is an indicator variable equal to one when any of the obstacles described in Panel A are present. Broken reporting channel is an indicator variable equal to one when misconfigured e-mail accounts, must use internal e-mail address, incorrect phone number, phone line disconnected, firm contact unaware of hotline, redirect to incorrect webpage, or website errors are present for a firm. Additional variables are described in Appendix 2. Models (1) and (2) are probit and ***, **, * indicate statistical significance at the 1%, 5% and 10% level respectively.

Panel A: Categorization of Obstacles

Obstacle Type	#	%
<u>Web-based obstacles</u>		
Website Error	6	14%
Generic third-party link	20	47%
Intermediate accessibility	2	5%
Redirect to incorrect webpage	1	2%
Incomplete/non-functioning website	13	30%
Conflicting links	1	2%
	43	
<u>E-mail-based obstacles</u>		
Misconfigured e-mail account/bounceback	4	80%
Must use internal e-mail address	1	20%
	5	
<u>Phone-based obstacles</u>		
Incorrect phone number	1	20%
Phone line disconnected	2	40%
Firm contact unaware of hotline	1	20%
Intermediate accessibility	1	20%
	5	
Total Number Obstacles	53	100%

Panel B: Firms with Obstacles

Firms with Obstacles	# Firms	%
No obstacles with reporting	182	73%
Some obstacles (>=1)	49	20%
Unable to test hotline	19	8%
Total	250	100%

Panel C: Firm Characteristics and Obstacles to Reporting

	(1)	(2)
	Obstacle to Reporting	Broken Reporting Channel
Revenue (log)	-0.149* (0.0844)	-0.0595 (0.108)
Age (log)	-0.232 (0.296)	-0.201 (0.425)
ICW Rank	-0.282** (0.140)	-0.426** (0.191)
Excess Returns	0.260 (0.432)	0.536 (0.635)
Sales Growth	0.412 (0.459)	-0.803 (0.912)
Criminal	0.781* (0.444)	0.675 (0.505)
Firm Rating	0.162 (0.237)	0.212 (0.323)
Constant	0.751 (1.266)	-0.773 (1.654)
N	231	231
R-Squared	0.05	0.08

Table 4: Firm Responses to Allegations of Misconduct

Table 4 examines how firms respond to the two financial related inquiries (Inquiry 1 and Inquiry 2 as described in Appendix 2). Close financial inquiry is equal to one when company ended the investigation without any follow-up (as shown on its website) or no response was provided within two weeks of the inquiry’s submission. In Model (2), ‘response yes’ is equal to one when a firm responded affirmatively to Inquiry 1 as described Section 6. The sample includes all firms that provided an answer to Inquiry 1. In Model (3), ‘response serious’ is equal to one when a firm responded that the allegation presented on the hotline was serious in response to Inquiry 2 as described Section 6. Additional variables are described in Appendix 2. All models are probit and ***, **, * indicate statistical significance at the 1%, 5% and 10% level respectively.

	(1)	(2)	(3)
	Close Financial Inquiry	Inquiry 1: Response Yes	Inquiry 2: Response Serious
Revenue (log)	-0.0884 (0.107)	-0.270 (0.198)	-0.0113 (0.134)
Age (log)	-0.444 (0.335)	0.243 (0.502)	0.0986 (0.566)
ICW Rank	-0.389** (0.185)	0.688* (0.379)	-0.0503 (0.216)
Financial Violation	0.160 (0.437)	-0.650 (0.884)	-0.465 (0.613)
Excess Returns	-0.159 (0.563)	0.444 (1.029)	0.464 (0.677)
Sales Growth	-0.299 (0.666)	-1.828 (1.718)	-1.215 (0.856)
Firm Rating	-0.521* (0.291)	0.00540 (0.598)	0.152 (0.398)
Inquiry 1 response personalized		0.186 (0.437)	
Inquiry 2 response personalized			0.818*** (0.285)
Constant	2.885* (1.687)	0.874 (3.079)	-2.292 (2.371)
N	187	46	187
R-Squared	0.05	0.20	0.11

Table 5: Comparing Financial and HR Inquiries

Table 5 compares difference in responses to hotline inquiries related to financial (e.g. bribery, financial manipulation) and HR (e.g. harassment, discrimination) matters. Panel A shows whether an inquiry was closed, the response time, and the length of response for each inquiry (as described in Appendix 2). A closed inquiry is one in which the company ended the investigation without any follow-up (as shown on its website) or no response was provided within two weeks of the inquiry’s submission. Response time is the number of days between the submission and first, non-automated, response by the firm. Length of response is the total length, in words, of all non-automated responses by the firm to each inquiry. Panel B shows a multivariate regression of closure, response time, and response length. Closure is equal to one if an inquiry was closed and the regression is a probit model. Models for response time and response length (logged) are OLS. Inquiry 1, 2 and 3 are indicator variables for responses related to each inquiry. Additional variables are described in Appendix 2. All models cluster by firm. ***, **, * indicate statistical significance at the 1%, 5% and 10% level respectively.

Panel A: Descriptive Statistics of Closure, Response Time, and Response Length

Closed Inquiry	N	closed	%
Inquiry 1: Bribery	152	15	9.9%
Inquiry 2: Financial Manipulation	161	12	7.5%
Inquiry 3: Harrassment	164	19	11.6%
Inquiry 4: Discrimination	161	18	11.2%
Total	638	64	

Response Time (days)	N	Mean	SD
Inquiry 1: Bribery	152	5.1	4.9
Inquiry 2: Financial Manipulation	160	4.1	4.4
Inquiry 3: Harrassment	160	4.2	4.7
Inquiry 4: Discrimination	156	5.3	4.9
Total	628	4.7	4.7

Length of Response (words)	N	Mean	SD
Inquiry 1: Bribery	146	116	85
Inquiry 2: Financial Manipulation	157	175	130
Inquiry 3: Harrassment	150	135	99
Inquiry 4: Discrimination	145	145	94
Total	598	143	106

Panel B: Regression Analysis of Closure, Response Time, and Response Length

	(1)	(2)	(3)
	Close Inquiry	Response Time	Response length
Revenue (log)	-0.109 (0.0817)	0.0168 (0.205)	-0.0662* (0.0365)
Age (log)	-0.308 (0.249)	-0.798 (0.627)	-0.0354 (0.153)
ICW Rank	-0.233 (0.161)	-0.180 (0.414)	0.0200 (0.0704)
Excess Returns	0.0594 (0.306)	0.384 (0.909)	-0.420* (0.226)
Sales Growth	0.385* (0.214)	1.899** (0.765)	-0.0752 (0.167)
Violation	0.325 (0.200)	0.502 (0.600)	-0.0399 (0.101)
Firm Rating	-0.379 (0.249)	-0.195 (0.646)	0.0531 (0.113)
Inquiry 1: Bribery	-0.0632 (0.173)	-0.109 (0.479)	-0.306*** (0.0858)
Inquiry 2: Reporting Manipulation	-0.241 (0.176)	-1.170** (0.475)	0.142** (0.0684)
Inquiry 3: Harrassment	0.0356 (0.160)	-1.058** (0.473)	-0.122* (0.0682)
Constant	1.895 (1.508)	7.654** (3.845)	5.239*** (0.707)
N	638	628	598
R-Squared	0.05	0.03	0.06

Table 6: Hotline Providers

Table 6 describes the frequency of different hotline providers. Panel A shows different phone hotline providers. The sample includes all firms with available phone hotlines (i.e. Appendix 6 diagram: regions A, B, E, D) Panel B shows the number of website based hotline providers. The sample includes all firms with available phone hotlines (i.e. Appendix 5 diagram: regions B, C, E, F). Major provider includes NAVEX and Convercent. Other third-party includes all others that would disclose their company name with “will not say” and third-party companies that would not disclose their name. Company includes all firms where the firm itself runs its own hotline. Answering machine includes all firms that utilize a pre-recorded message followed by an opportunity for an individual to leave a report on the machine or answering service.

Panel A: Phone Hotline Providers

Phone Hotline	N	%
Major provider (NAVEX, Convercent)	175	81.8%
Other third-party provider	8	3.7%
"Will not say" third-party	11	5.1%
Company	16	7.5%
Answering Machine	4	1.9%
Total	214	100%

Panel B: Website Based Hotline Providers

Web Hotline	N	%
Major provider (NAVEX, Convercent)	140	90.9%
Other third-party provider	13	8.4%
Company	1	0.6%
Total	154	100%

Appendix 1: Integrity Hotlines and Corporate Compliance: Background

In 1991, the United States Sentencing Commission amended the Federal Sentencing Guidelines to create incentives for firms to create “effective compliance programs.” Among the initiatives that the Commission stated that firms should design were hotlines where individuals could anonymously report misconduct and seek guidance. Specifically, the Commission’s Guidelines stated that firms should “have and publicize a system, which may include mechanisms that allow for anonymity or confidentiality, whereby the organization’s employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation.”(USSC Chapter 8 Sentencing of Organization, §8B2.1) If a firm later found itself in the position of potentially being prosecuted, the firm could face considerably fewer sanctions if the firm had an anonymous reporting hotline— along with other components of an effective compliance system— at the time of the misconduct.²⁰ Fines, for example, could be reduced by as much as ninety-five percent if the system was in place at the time of the alleged misconduct (Soltes 2018).

In the following years, a series of memorandums from different Deputy Attorney Generals furthered the potential advantages associated with having an integrity hotline and other components of a compliance program.²¹ In particular, prosecutors could take into consideration whether the firm had an effective compliance program when deciding to even charge a firm for wrongdoing. The rise of deferred and non-prosecution agreements spurred the use of court appointed monitors who oversaw compliance efforts that often created anonymous reporting hotlines as part of their court mandate (Garrett 2014, Khanna and Dickinson 2007). In an effort to help firms believe they had attained an “effective compliance program” and to satisfy the DOJ if they ever faced prosecution, a consulting industry blossomed to provide integrity hotline services (Haugh 2017, Wellner 2005, Laufer and Strudler 2007).

With the exception of corporate monitors who could require hotlines, neither the Sentencing Guidelines nor memos from the DOJ explicitly required integrity hotlines. Instead, by providing considerable incentives for firms to create strong compliance programs that included hotlines, the USSC and DOJ strongly encouraged their creation. The passage of the Sarbanes Oxley Act (SOX) in 2002, however, effectively mandated hotlines for publicly traded firms by stating that firms were required to have a process to receive “confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.” (Sarbanes-Oxley Act §301) In 1994, Weaver, Treviño, and Cochran (1999) found that only 51% of Fortune 1000 firms had some type of reporting hotline. Within a decade of their study, the changing regulatory and prosecutorial environment made having an anonymous hotline, at least on “paper”, a required reporting channel for all publicly traded firms.

Although SOX focused on encouraging reports of alleged financial misconduct, hotlines can also be used to report other kinds of misconduct that would be adverse to the firm. This includes, for example, bribery and workplace related problems. Harassment and discrimination create liability for firms under other regulation related to equal employment opportunity (Gruner 2001). However, firms can use the

²⁰ Even if a firm was prosecuted, the Sentencing Commission acknowledged that the firm could still have an overall effective compliance program. Specifically, “Such compliance and ethics program shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting criminal conduct. The failure to prevent or detect the instant offense does not necessarily mean that the program is not generally effective in preventing and detecting criminal conduct” (Chapter 8 Sentencing of Organization, §8B2.1).

²¹ Similar sentiments were expressed by several Deputy Attorney Generals. See Memorandum from Larry D. Thompson, Deputy Attorney General to Heads of Department Components, to United States Attorneys (January 20, 2003); Memorandum from Eric H. Holder, Deputy Attorney General, Federal Prosecution of Corporations to all Federal Prosecutors (June 16, 1999); and Memorandum from Mark Filip, Deputy Attorney General, Principles of Federal Prosecution of Corporations to Heads of Department Components, United States Attorneys (August 28, 2008).

presence of a hotline as part of a defense to mitigate their liability if a violation does occur.²² Across civil litigation, civil sanctions, and criminal sanctions, ultimately there are considerable benefits that incentivize firms to implement anonymous integrity hotlines.

The hotline itself (e.g. telephone, web-based, e-mail) may be run internally by the firm or outsourced to a third-party provider. When a report or inquiry is made on a hotline, it is routed to a division within the firm. At some firms, all hotline reports are sent to an ombudsman which may be the chief compliance officer or general counsel (Miller 2014). Other firms rely on the reporting service to appropriately delineate whether a report requires a response and from whom within the firm. If a report is about a financial accounting concern, it would be sent to internal audit. If it is a report regarding workplace harassment, it is sent to human resources. The most appropriate and efficient means of communicating reports is a topic of considerable discussion among compliance and human resources managers who often have dueling accountability over reports made on integrity hotlines (SCCE 2017).

Firm managers are responsible for investigating and responding to reports made on hotlines. To facilitate dialogue with anonymous reporters, managers can design software to re-contact individuals. To the extent that anonymous reports are made, typically a pin and password is provided that can be utilized to facilitate dialogue between the firm and the anonymous individual making the report. Attesting to the value associated with reports to hotlines, senior firm leadership (i.e. CEO, GC) and boards of directors are often regularly appraised of the number and severity of reports made on integrity hotlines (DLA Piper 2017 Compliance & Risk Report).

To better appreciate the type and frequency of reports made on integrity hotlines, NAVEX compiles an annual survey of hotline reports of more than 5,000 clients including 95 of the Fortune 100 firms. In 2016, NAVEX found that for every 100 employees, firms received a median of 1.4 hotline reports suggesting that hotlines are commonly utilized reporting tools used by employees and agents of the firm. 58% of these inquiries are made anonymously.

Reflecting the diverse use of hotlines beyond those outlined in SOX (i.e. for accounting and auditing related matters), 72% of reports related to workplace concerns (e.g. harassment, discrimination, etc.), while only 2% relate specifically to accounting and auditing concerns. 14% and 5% of reports relate to business integrity (e.g. bribery, falsification of documents, etc.) and misappropriation of corporate assets respectively. Ultimately, however, less than one quarter (21%) of reports relate to matters with some direct financial reporting salience. The wide ranging use and type of issues raised on integrity

²² For harassment, for example, there are several related legal areas which create accountability for firms including vicarious liability, the 1964 Civil Rights Act, and the negligence standard. Employers may be held vicariously liable for actions of their employees (including sexual harassment) under the doctrine of respondeat superior (See *Vailey v. Filco, Inc.*). The standard in finding liability against the employer depends on the specific type of conduct, and is held to either a negligence standard (the employer should have known what was going on and have taken action, given the facts) or a strict liability standard (the employer is liable, regardless of knowledge of the conduct). Employers can use an affirmative defense in cases involving the negligence standard by satisfying a two-part test described in *Waffle House, Inc. v. Williams*: "1. [That the employer] exercised reasonable care to prevent and promptly correct any sexually harassing behavior, and 2. That the employee unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer or to otherwise avoid harm." Meeting this two part test is where a hotline can impact liability. If an employer advertises the hotline effectively to employees and puts effort into ensuring the employees know it exists, and then takes appropriate action once employees formally complain, then it can point to these actions as evidence of "exercising reasonable care" in its defense in a negligence-based suit. "Exercising reasonable care" can mean shifting employee's shifts so the victim and perpetrator no longer work side by side, terminating/re-locating the perpetrator, reprimanding the perpetrator, maintaining an effective hotline, or any other action that showcases the employer's efforts at eliminating the harassing conduct. See, for example, *Waffle House, Inc. v. Williams*.

hotlines is one of the reasons that firms engage both accounting/finance staff and human resources staff when responding to inquiries.

While reporting misconduct is often viewed as an appropriate response to observing misconduct both legally (e.g. required in a firm's code of conduct or employment terms) and morally (i.e. to the extent the alleged misconduct is an ethical violation), individuals have numerous incentives to not report violations. Perhaps the most salient is that individuals fear reprisal or retaliation (Glazer and Glazer 1989). Reporting allegations also takes time and effort which can become considerable if the misconduct is complex or requires follow-up. Potential reporters may view this as an inconvenience and unnecessary personal cost. In addition, individuals can also have psychological biases against turning on colleagues or friends who they may have a personal relationship with (Waytz, Dungan, and Young 2013, Treviño et al. 1999) or be concerned about facing retaliation (Filabi 2017). In an effort to mitigate some of these concerns associated with reporting, firms often devise reporting channels that are convenient (i.e. accessible by numerous mediums, available 24/7) and anonymous (Brown et al 2017, McHard and Mohr 2011). If effectively designed, the hotline serves as a channel to make allegations of misconduct known to an organization which can then take action or provide appropriate guidance to mitigate its impact on the organization and/or other individuals.²³

²³ Reporting hotlines that purportedly protect whistleblower anonymity are often undermined in practice. As an example, see "How the Whistleblowing Scandal at Barclays Unfolded," Ben Martin, *The Telegraph*, April 10th, 2017.

Appendix 2: Variable Definitions

Revenue	Total revenues from Compustat
Firm Age	The number of years prior to December 2016 that the firm has been on CRSP
Excess Returns	Return of the firm's stock over the equal-weighted CRSP index during 2016.
Sales Growth	The change in sales from 2015 to 2016 from Compustat.
Financial Violation	If the firm was sanctioned by the Southern District of New York, Office of the Comptroller of the Currency, Office of Foreign Assets Control, Federal Deposit Insurance Corporation, Commodity Futures Trading Commission, or Department of Justice (multi-unit) in the prior three years (i.e since 2014) the indicator is equal to one. Data on violations is draw from the Corporate Research Project of Good Jobs First's ViolationTracker.
Employment Violation	If the firm was sanctioned by the Equal Employment Opportunity Commission, Labor Department Wage and Hour Division, National Labor Relations Board, or Office of Federal Contract Compliance Programs in the prior three years (i.e since 2014) the indicator is equal to one. Data on violations is draw from the Corporate Research Project of Good Jobs First's ViolationTracker.
Criminal Violation	If any of the violations (as indicated by financial and employment violation) are criminal in nature, the indicator is equal to one.
Violation	If the firm has either a financial or employment violation, the indicator is equal to one.
Total Violations	The sum of financial and employment violations since 2014.
Firm Rating	Rating of firm (0-5) from Glassdoor.
Inquiry Personalized	If the firm's response had a named individual signing the response, the indicator is equal to one.
ICW Rank	As estimated by Doyle et al. (2007) and used in Bowen et al. (2010) the scaled rank of the fitted values from $ICW = \beta_0 + \beta_1 MARKETCAP + \beta_2 FIRM_AGE + \beta_3 LOSSES + \beta_4 SEGMENTS + \beta_5 FOREIGN + \beta_6 EXTREME + \beta_7 RESTRUCTURE + error$, where MARKETCAP is the log of the firm's market capitalization, FIRM_AGE is the log of the number of years the firm has CRSP data, LOSSES is an indicator variable equal to 1 if earnings before extraordinary items in the two most recent years sum to less than zero, and 0 otherwise, SEGMENTS is the log of the number of operating and geographic segments reported by the Compustat or manually looked up from the firm's 10-K if missing, FOREIGN is an indicator variable equal to 1 if the firm has non-zero foreign translation, and 0 otherwise, EXTREME is an indicator variable equal to 1 if year-over-year industry-adjusted sales growth falls into the top quintile based on SIC code, and 0 otherwise, and RESTRUCTURE is the aggregate restructuring charge in the two most recent years, scaled by the firm's market capitalization. ICW is measured as of the end of 2016. As in Bowen et al. 2010, I use coefficient values as reported in Doyle et al. (2007).

Appendix 3: Hotline Inquiries

Inquiry # 1: Benefits for a council member

A local city council member inquired about using one of our parking lots for some extra staging area for an upcoming event at one of the local schools. I know the council member would be very appreciative of our support and it would also be a big help to the school. The council is very involved in some of the zoning decisions so it's likely to be in our benefit to help him since it's likely we'll need his support in the future too. The event is effectively off business hours so it won't be a distraction to the business either. I mentioned this request to a colleague and she said it could be problematic since helping the council member with this request (the council member's child also goes to the school) could be viewed suspiciously if he sides with us down the road in a zoning dispute. My colleague said that we could avoid this if we just "officially" get the request from someone else at the school. The council member would likely be appreciative all the same, but this would avoid the perception that we're helping him and his child out personally in some way. Before I go ahead, I wanted to check whether this would be ok.

Inquiry # 2: Invoice timing

I want to bring up an issue anonymously without providing my name or rank in case I'm wrong about this. We didn't get a chance to open and pay all the invoices from last quarter until this quarter got under way since it was really hectic. Now those payments are affecting our budgeting this quarter. My supervisor said that I should hold off paying a similar amount of invoices this quarter to help us balance this out. This makes sense to me, but I also worry that if we start doing things like this, we might just keep doing it quarter after quarter, and what if one quarter doesn't have enough to cover the last quarter? Suppose I'm right about this, can you tell me if I should follow my supervisor's advice and hold off paying some of these invoices?

Inquiry # 3: Discriminatory rally participation

A friend showed me a photo on Facebook of someone that works for the company participating in one of the recent white-supremacist rallies and holding a sign that has a swastika on it. I've asked several others and people agree it's him. I've not heard that he's harassed anyone at work, but I do not feel comfortable working alongside someone who is expressing intentions to harm myself and others of a particular heritage. Does participating in neo-nazi rallies violate company policy?

Inquiry # 4: Drinking with clients

I feel like I have to make a choice between succeeding in my job or upholding my religious beliefs. Let me give an example, in my mind, of why it feels like that. I went out to a bar with some coworkers. We ran into a client who bought some rounds of shots and made it a contest about who could drink the most, but I don't drink for religious reasons. I left because I didn't feel comfortable in this setting, but I also know that I missed out a good chance to socialize with clients (and it's the client who even bought the drinks). When everyone came back to the office the next day, I saw that people who had drinks had a great time with the client. It makes sense that we're going to generate more business when the client is happy, but that means we need to be able to drink with them. I brought this up with my supervisor and he said I don't have to drink if I don't want to, but he's obviously going to staff accounts with the people best matched to please the client. I see what's he's saying, but if I'm going to be successful here, it seems like I'm going to need to be willing to drink which doesn't seem fair. What would you suggest I do?

Appendix 4: Additional Information Provided for Inquiries

In reporting matters to integrity hotlines, firms often asked additional questions. These were normally framed as a series of questions:

Did the incident or violation occur more than once? (Yes/No)

What brought this violation to your attention?

...

To the extent that responding to such questions were required for submission, I supplemented as described below.

All inquiries: Location was United States; within the firm headquarters

For inquiry one, the inquiry was categorized as bribery. The violation was reported to occur once, a co-worker was aware of the alleged violation, the co-worker was aware because I told them, someone outside the organization (council member) was involved in the violation, the alleged violation has not been previously reported to management or outside the organization, and the date of the violation was noted as the date of the report.

For inquiry two, the inquiry was categorized as a financial reporting and accounting matter. The violation was reported as likely material, the violation occurred once, no one outside the organization or senior management was aware of the alleged violation, and the date of the violation was noted as the date of the report.

For inquiry three, the inquiry was categorized as workplace harassment. The violation was reported to occur only once, co-workers were aware of the alleged violation, the co-workers were aware because I told them, someone within the organization was involved in the violation, the alleged violation has not been previously reported to management or outside the organization, it occurred at an offsite location, it was unknown if any steps were taken to hide the violation, and the date of the violation was noted as the date of the report.

For inquiry four, the inquiry was categorized as discrimination. The violation was reported to occur only once, no one else was aware of the alleged violation, someone within the organization was involved in the violation, the alleged violation has not been previously reported to management or outside the organization, it occurred at an offsite location, it was unknown if any steps were taken to hide the violation, and the date of the violation was noted as the date of the report.

Appendix 5: Obstacle Descriptions

Web-based obstacles

Website Error	When the link for the anonymous reporting webpage is clicked, the page loads with an error (e.g. "The site cannot be reached.")
Generic third-party link	When clicking on the linking to a firm's reporting webpage, the homepage for a third-party site is encountered. Calls to the provider tell reporter to go back to the firm to provide correct contact information. At other firm, the third-party provider provides one link that fails to load, but another that will.
Intermediate accessibility	The website only loads periodically (e.g. based on time of day)
Redirect to incorrect webpage	The link identified as the reporting helping goes to the company's homepage. It is unclear how to navigate to the the hotline from the homepage.
Non-functioning website	The reporting webpage requires certain fields to be filled in (e.g. location), however accurate information pertaining to the firm is not listed.
Conflicting links	A firm provides conflicting web reporting links in the code of conduct where not all links function or direct to the reporting hotline.

E-mail-based obstacles

Misconfiguring e-mail	The e-mail bounces back (e.g. "our message couldn't be delivered to [firm name] because the remote server is misconfigured.")
Must use internal e-mail address	The e-mail bounces back from the "anonymous" reporting hotline with the message "[Firm e-mail address] only accepts messages from people in its organization or on its allowed senders list, and your email address isn't on the list."

Phone-based obstacles

Incorrect phone number	The phone number listed in the code of conduct as the hotline does not connect to the reporting hotline.
Phone line disconnected	When calling the hotline, the caller hears a message saying the phone number has been disconnected.
Firm contact unaware of hotline	When calling the hotline listed in the code of conduct, the person responding to the call is unaware that she has the responsibility for recording anonymous reports.
Intermediate accessibility	The reporting hotline is described as operating during specific times and during some portion of that time is still unavailable.

Appendix 6: Venn Diagram of Phone, Web, and E-mail Samples

