TONE at the TOP®
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Providing senior management, boards of directors, and audit committees with concise information on governance-related topics.

A Conspiracy of Silence?

When someone raises their hand to say something is wrong, how do you make sure something will be done about it? How do you ensure that anyone is even willing to raise their hand in the first place? Even the best companies can suffer when CEOs keep directors in the dark about culture.

The biggest corporate scandals in history often have striking similarities. At the start, the problems are almost always small. Then, as the damage grows, more and more people become aware of the situation. But nobody speaks up about the problem until it is far too late. In the really big scandals, the silence is a catalyst that enables wrongdoing to grow exponentially.

It's a surprisingly consistent pattern. At one major health-care company, the CEO allegedly told subordinates to make up numbers and transactions. That went on for years, but they kept silent while the fraud grew to billions of dollars. At another company, executives were eventually indicted on a variety of charges, but only after billions of dollars in stock value were destroyed. And at yet another company, stock values dropped by billions of dollars and thousands of workers lost their jobs as a result.

To most people, it seems incredible that more than a handful of people could be drawn into wrongdoing without anyone speaking up. But studies show that people in groups often act in ways that are very different from how they might behave individually. It's human nature.

It (Usually) Happens at the Best of Companies

Almost paradoxically, the problem of silence even crops up at organizations considered to be among the world's finest. Before the problems at Enron, *Chief Executive* magazine named the company's board of directors as one of the five best boards in the United States, and for six years in a row, *Fortune* magazine named Enron "America's Most Innovative Company." The year before Lehman Brothers hid over $50 billion in loans disguised as sales, *Fortune* ranked it as the "Most Admired Securities Firm." In 1998, *CFO* magazine's "Excellence Awards" recognized Scott Sullivan, CFO of WorldCom, in the "Mergers & Acquisitions Management" category. In 2000, the award went to Mark Swartz, CFO of Tyco International, and the 1999 Excellence Award for "Capital Structure Management" went to Enron's CFO.

About The IIA

The Institute of Internal Auditors Inc. (IIA) is a global professional association with more than 190,000 members in more than 170 countries and territories. The IIA serves as the internal audit profession's chief advocate, international standard-setter, and principal researcher and educator.

The IIA

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With decades of senior management and corporate board experience, the following esteemed professionals provide direction on this publication's content:

Martin M. Coyne II

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It seems ironic that the type of dynamic, inspirational leadership that normally motivates success can also work to motivate inappropriate behavior. When ill-defined loyalty equates to silence, trouble frequently follows.

Going Flat Out, Without Cutting Corners

According to Michele Hooper, president and CEO of The Directors' Council, three factors are often cited as the rationale for corporate fraud: personal gain, the need to meet short-term performance targets, and the desire to hide bad news. "It's a delicate balance," says Hooper. "When an organization is in a difficult situation, you need to be very focused on performance. The question is whether you have a culture within your organization that enables people to feel comfortable going flat-out but not cutting corners.

"Even when employees are going flat-out, if they encounter something that is inappropriate, two things must happen. One is that they must tell people about it, and two is that they must believe the situation will be heard and rectified by the executive team," says Hooper.

"In too many cases, people will say, 'Yes we knew, and, yes I told somebody, but nothing ever happened.' That's as bad as nobody saying anything," Hooper explains. "There has to be a belief that the culture of the organization will be supportive and that raising an issue is not a career-limiting move. In an environment where people do not believe in the culture, they might not try to be part of the solution even if they were not part of the problem."

Assessing Culture

When someone raises their hand to say something is wrong, how do you make sure something will be done about it? How do you ensure that anyone is even willing to raise their hand in the first place?

According to a recent survey by the National Association of Corporate Directors (NACD), 79 percent of directors expressed confidence in management's ability to sustain a healthy corporate culture. The caveat: Survey results indicate that confidence may be based on surprisingly limited information.

A very high percentage (92 percent) of surveyed directors based their impressions about culture on reports from the CEO. Few heard different perspectives from departments such as internal audit (39 percent), compliance and ethics (30 percent), or enterprise risk management (20 percent). Less than half had visited different company locations to gain a better understanding of culture or held confidential conversations about possible culture issues with non-executive employees.

In other words, most directors seemed to believe their organization's culture was appropriate primarily because the CEO told them so. But this is an area where directors need to maintain a healthy level of

> "Culture is the single biggest determinant of behavior in any organization….One thing that is clear — if you're not managing culture, culture is managing you."
>
> **Keith Darcy**
> *Independent Senior Advisor, Deloitte & Touche, LLP; Former Executive Director, Ethics and Compliance Officer Association*

skepticism. It is not easy to assess organizational culture, and not all CEOs are willing to admit — and may not even be aware — the organization's culture is unhealthy. Culture is not just about tone at the top; it is also about tone at the middle and throughout every part of an organization. Even when it is well-intended, feedback solely from the CEO can be limited or one-sided, and this is an area about which directors cannot afford to be ill-informed.

"What I find the best boards are doing now is setting aside time for major discussions on culture and values during at least one board meeting a year," says Marty Coyne, founder and chairman of CEO Learning Network. "The board has to ensure the values are appropriate and clearly articulated. We need to have meetings with the CEO and with the chief human resources officer at least once a year, when we say, 'Tell us about the cultural mindset of the employees. What do they believe? How are you assessing and monitoring the culture and behaviors in the company? Are you doing quarterly questionnaires of some groups? Are you doing an annual questionnaire? Are you doing small focus groups? How do you conduct a periodic assessment of how well the company really understands our values and lives the values that we have agreed to? What are the educational programs you are using to review the values and the behaviors?'

"From what I've found, just articulating the values in a handbook is not enough. You have to have an example. So if we will not allow gifts above a certain level, we need to have examples of what gifts above that level might be or might not be. Case studies and discussions are important."

According to Coyne, another way to gain assurance about organizational culture is for board directors to meet with employees throughout the organization. "For example, it's great to have dinner with the sales force at an annual sales meeting. If you sit at the table with the sales people, you'll find out a lot about what's going on out in the field. By asking open-ended questions, a director can get a very good understanding of what's going on in the company."

The Internal Audit Advantage

One of the most effective ways to ensure that organizational culture is appropriate is to give the internal audit function a clear mandate to evaluate culture. Because the internal auditors evaluate activities and processes throughout all parts of an organization, they are uniquely positioned to assess whether organizational culture is consistent and whether individual departments conform to expectations regarding culture.

Internal auditors can provide comprehensive audits of organizational culture on a periodic basis, and they can also build cultural aspects into every audit they perform. For example, the internal auditors can ask questions regarding how managers communicate, reinforce, monitor, and measure organizational values. The auditors can determine whether policy or control breaches are tolerated, and they have opportunities to observe whether individual managers throughout the organization are effective models of organizational culture. Because of their enterprise-wide view of an organization, the internal audit function may also spot cultural issues that might seem like isolated problems, but are in fact widespread patterns of behavior.

Stopping the Silence

We have made notable improvements in the past decade in providing means for whistleblowing disclosures. Hotlines are helping, particularly in industry and government organizations, but there is more work to be done.

For multi-national organizations that operate in diverse environments, it can be particularly challenging to ensure that reporting programs are effective. Regardless of language and cultural barriers, potential whistleblowers in all parts of the organization must truly believe that their contributions will be sincerely appreciated. They must be confident that they will always be protected from any type of retaliation or censure. They must be actively encouraged to share their concerns, and that encouragement can't be limited to an annual training session or a policy statement from the home office. Every employee must be confident that each reported issue will be investigated promptly, thoroughly, and discreetly, and that impropriety will be dealt with effectively.

It's time to discover if conspiracies of silence are killing organizations, and end the silence by tackling the problem at all levels. It's important for boards to talk with their CEOs about culture, but the conversation can't stop there. One of the best ways to stop the silence is to encourage more voices to speak up, throughout the organization.

Quick Poll Question

How does your organization's internal audit function assess organizational culture?

- ❏ The auditors conduct periodic audits of organizational culture, and questions about culture are built into every audit.
- ❏ The auditors do not conduct periodic audits of organizational culture, but questions about culture are built into every audit.
- ❏ The auditors conduct periodic audits of organizational culture, but do not formally evaluate culture in every audit.
- ❏ I do not know. It's time to find out!

Visit **www.theiia.org/tone** to answer the question and learn how others are responding.

Quick Poll Results: What is the most important lesson about the Carillion meltdown?

40% Clear understanding of how changing operational risks may affect financial assumptions.

34% Importance of an agile internal audit function that can investigate emerging risks and escalate concerns quickly.

26% An audit committee that has the time and focus to challenge auditors and management, and to gain the assurances they need.

Source: *Tone at the Top* June 2018 survey.