

Corporate Governance

**You Know It Is There
But How Do You Audit It?**

Why the emphasis on Governance ...

From a company perspective...

When Bad Things Happen You have to get around Internal Controls...if they are there

Be Better, Be Smarter, then Cheat

All the **Red Flags** came up and nobody did anything

Do we live in an “Era of Fraud?”

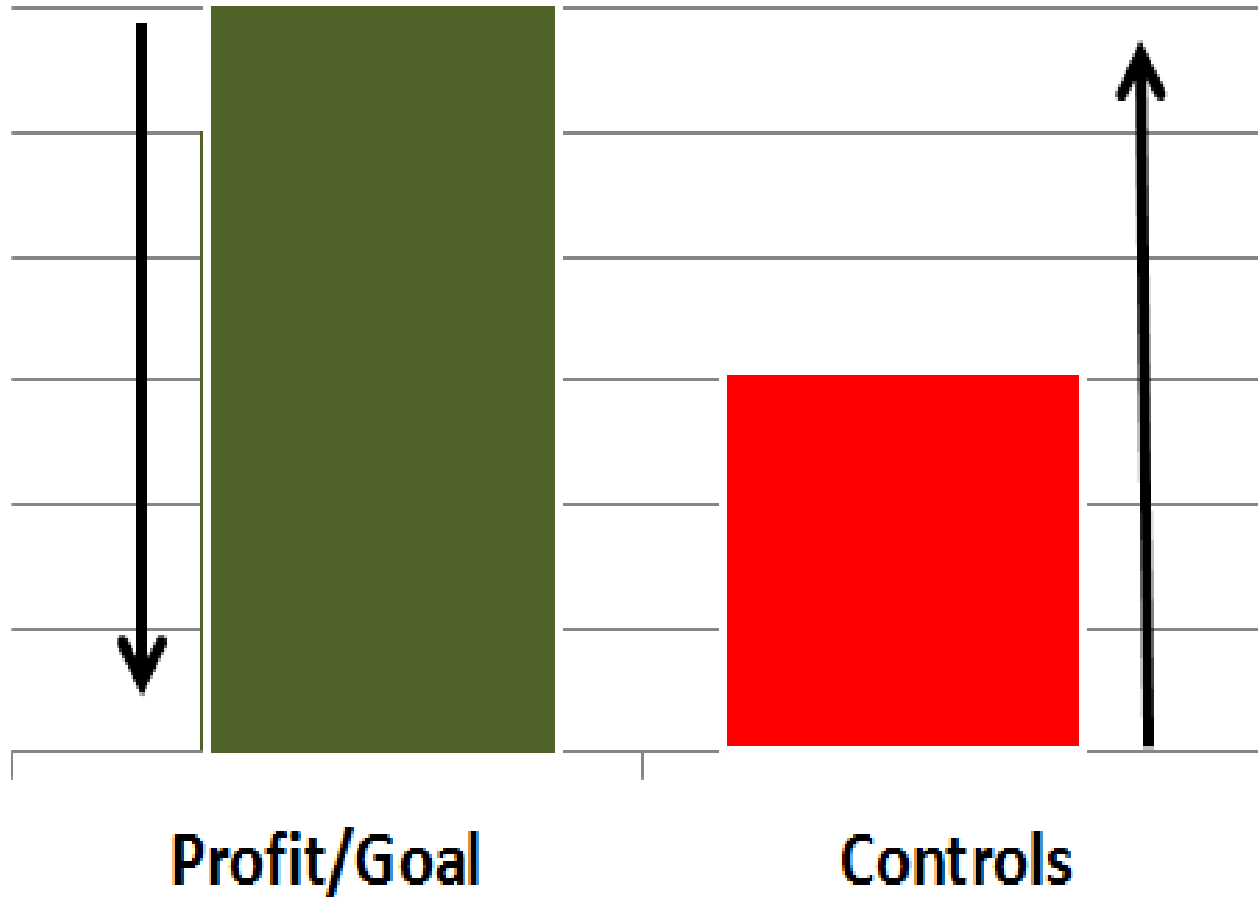


- Enron
- Madoff
- Mortgage Crisis
- How Many More Can You Name?

Good News - Integrity delivers business benefits

- Real business benefits can be achieved by companies that act with integrity:
- Two-thirds of our respondents agree that there are commercial advantages for companies with strong reputations for ethical behavior.
- 45% would be unwilling to work for a company involved in a major bribery or corruption scandal.
- 53% of respondents state that they would be unwilling to hire suppliers or agents involved in a major bribery or corruption case.

Who Wins?



You Want to Improve Governance

- Lead a debrief at meetings on poor governance issues around the world
- Gauge employees perceptions of Organizational culture
- Review the misconduct reporting process
- Look outside the box for risk information
- Reevaluate incentive structure
- Update Ethics training



FIFA

For the Game. For the World.

Volkswagen reported a record loss for 2015.

- The VW car brand's operating loss of €4.1 billion (\$4.7 billion) for 2015 was the biggest annual loss in its 79-year history, after setting aside €16.2 billion in charges following the emissions-rigging scandal.
- VW still found it within itself to pay the 12 current and former members of its management board €63 million.



Cost cuts aren't always a good idea,

- Circuit City, a former consumer-electronics retailer that went bankrupt made a similar error in the previous that helped hasten its demise.
- Thousands of its highest-paid store employees were fired in that year in an effort to slash costs and improve the bottom line. Unfortunately, those well-paid employees were also the most effective at making sales, and the company quickly lost market share to [rivals](#) that had better-trained employees.

Business Acumen

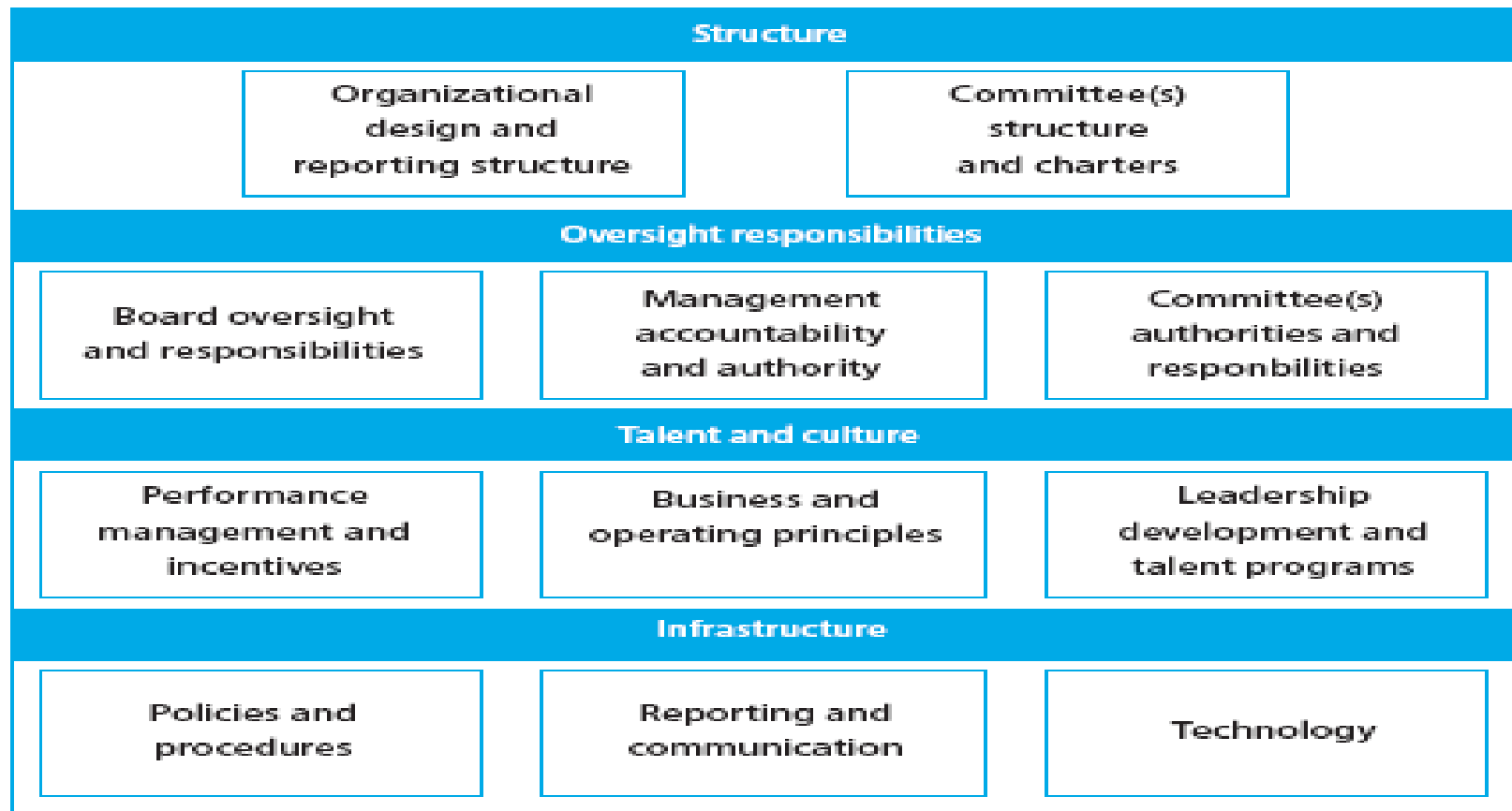


Corporate Governance is:

- Board of Directors
- Policies and Procedures
- Hotlines
- Ethics training
- Approval Levels
- Culture
- Tone at the Top
- Is success more important than Risk?
- What are employees, customers, suppliers, and creditors doing?

Your Company Needs a Governance Operating model

Illustrative governance operating model

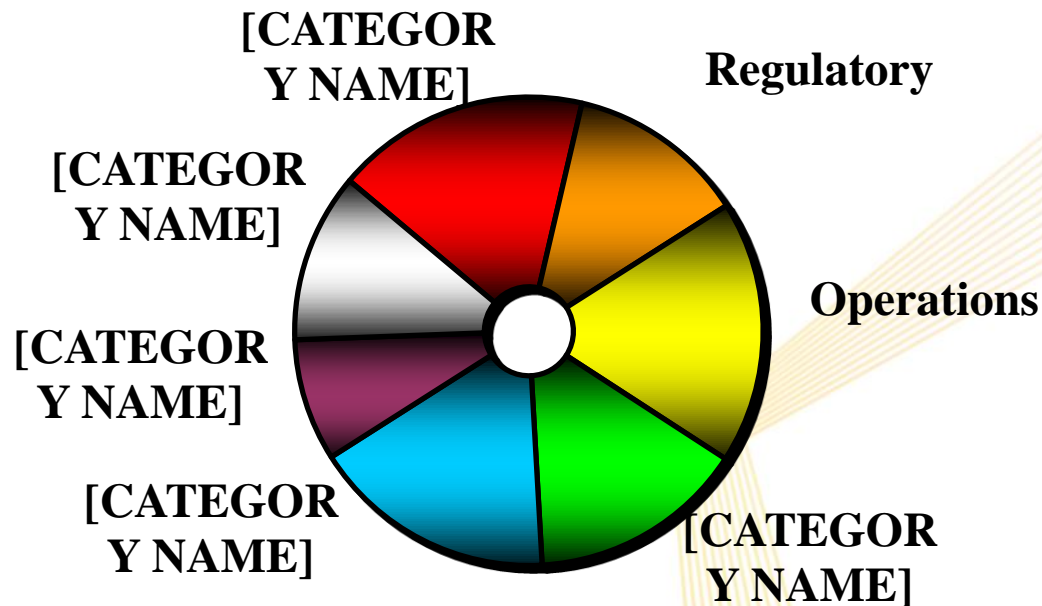


Remember Governance Changes

- US Secret Service takes over a year to fix ex President's home alarm.
- Agency will improve its process for tracking maintenance problems with security equipment and keeping it up to date
- Bank Loans
- Technology Threats
- Greed & Fraud

What is a Company?

Where is Governance, Risk & Control?





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Governance Framework



How Do you Audit Governance?

- Look for Governance Issues
- Incorporate Governance Considerations in your Audit Programs:
 - Approvals
 - Decisions
 - Ethics
 - Culture
 - Succession Planning

Do the Right Thing

- There is a level of confidence that is associated with a company that is known to have good corporate governance.
- Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals.

“MY BANK”: WHAT HAPPENED AND

What Happened at “My Bank” ?

1. What Did Employees Do?

- “My Bank” employees applied for approximately 565,000 credit card accounts and created fake email addresses to enroll customers in online banking services without their consent.
- Without customer authorization, employees opened more than 2 million deposit accounts and transferred funds from existing accounts into them. They also issued and activated related PINs.

2. What Was the Impact on Customers?

- Customers of existing accounts were penalized for insufficient funds and/or overdrafts due to interest charges and other fees on the new fake accounts.

3. What Was the Impact for “My Bank” ?

- “My Bank” paid over \$185 million in fines to the Consumer Protection Bureau, the Los Angeles City Attorney, and the Office of the Comptroller of the Currency. They also set aside more than \$5 million for customer remediation.
- The bank’s stock has dropped to its lowest level since 2014, falling 10% since the beginning of September.
- “My Bank” is clawing back compensation valued at \$41 million from its chairman and chief executive,
- The bank fired close to 5,300 employees and managers, and a class action lawsuit alleging wrongful termination is currently seeking damages of \$2.6 billion.

Sales targets and incentive programs coupled with pressure from leadership, including senior leaders and direct managers, fostered an environment of ethical pressure in which employees felt forced to engage in unethical business practices.

Key contributors to the overall environment of ethical pressure include:

- **Sales Targets:** “My Bank’s” pursuit of the cross-selling strategy resulted in a target of 8 different accounts per customer, while other banks similar in size average 3 accounts per customer.
- **Tone at the Top:** Employee complaints point to questionable tone at the top. For example, branch managers were pressured to reach 120% of their daily quotas and regional managers scheduled hourly check-in calls to measure employee’s progress on daily quotas.
- **Direct Manager Leadership:** Employees also allege that managers pressured new hires to meet sales quotas in their first two months, and that managers frequently suggested improper methods of conducting business as a means to increase sales.
- **Fear of Retaliation:** Former “My Bank” employees are alleging that they were terminated for reporting concerns to the company’s helpline.

A CULTURAL FAILURE

Key Attributes That Impact a Culture of Integrity

RiskClarity: A Corporate Integrity Service™

DEFINITION OF A CULTURE OF INTEGRITY

Comfort Speaking Up

Employees' degree of agreement that they can report unethical behavior without fear of retaliation, and that they feel comfortable seeking advice about ethical dilemmas.

Trust in Colleagues

Employees' degree of agreement that their colleagues engage in ethical behavior and value honesty more than results.

Direct Manager Leadership

Employees' degree of agreement that their manager possesses integrity, holds people accountable, and respects employees.

Tone at the Top

Employees' degree of agreement that senior leaders possess integrity and take appropriate action when faced with unethical or inappropriate behavior.

Clarity of Expectations

Employees' degree of agreement that the company has clearly communicated ethical expectations and disciplinary guidelines, and that they are aware of the consequences of misconduct.

Openness of Communication

Employees' degree of agreement that they are encouraged to share their opinion and managers are transparent with their staff.

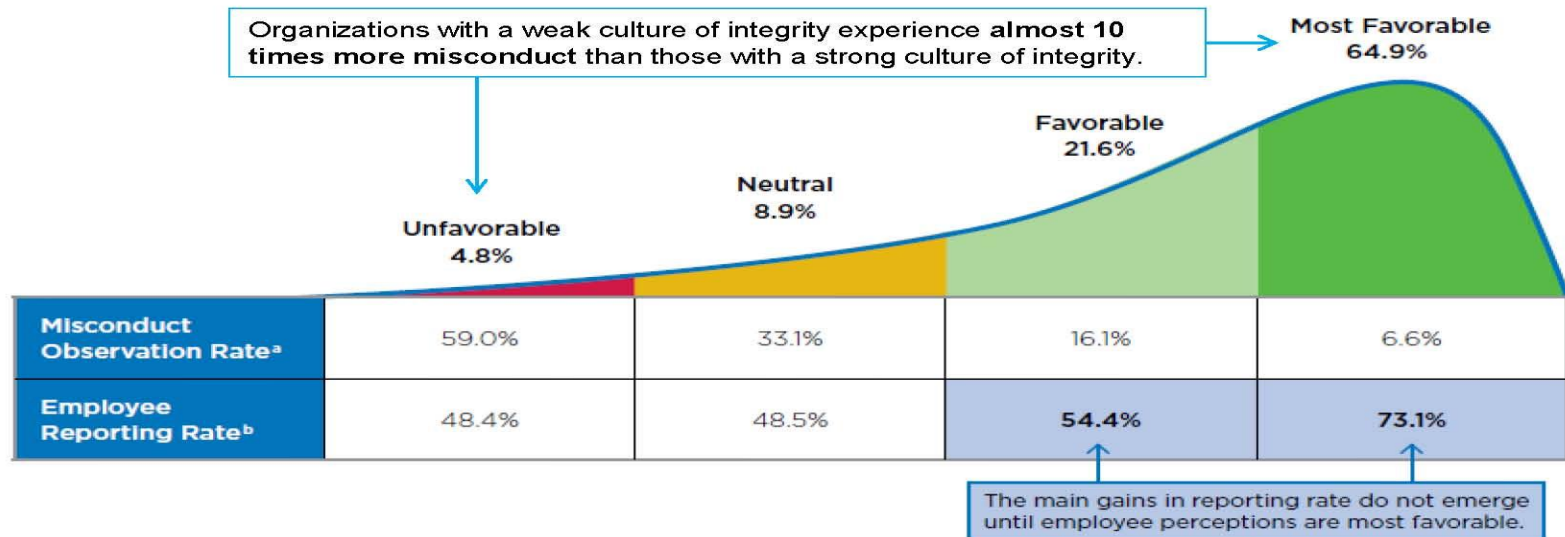
Organizational Justice

Employees' degree of agreement that ethical behavior is not tolerated and their company responds quickly to verified misconduct.

The events at "My Bank" reveal weaknesses in at least three of the major drivers of a culture of integrity that contributed to employee misconduct.

FACT #1: IN ALL ORGANIZATIONS, CULTURE MATTERS

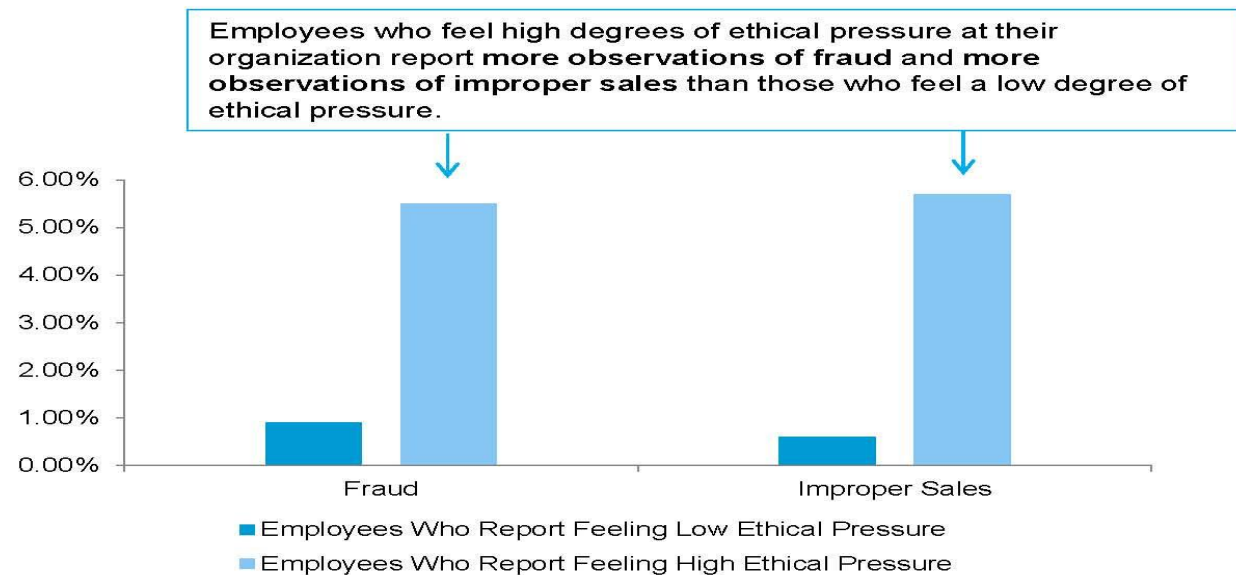
The Impact of Culture on Observed and Reported Misconduct
Percentage of Respondents



FACT #2: ETHICAL PRESSURE HEIGHTENS RISK

The Impact of Ethical Pressure on Observed and Reported Misconduct

Percentage of Respondents, 2015

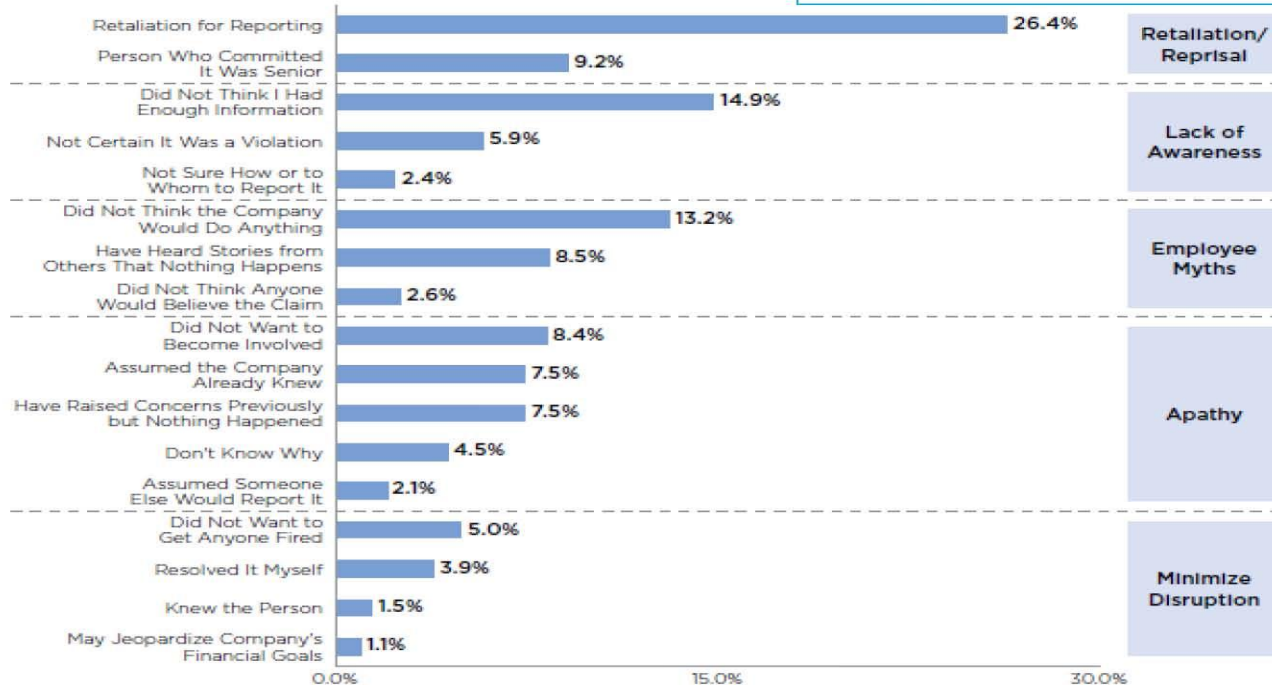


¹ The ethical pressure index is comprised of the following two statements: "I feel pressured by my manager to perform job -related tasks that I believe may be unethical" and "I feel pressured to compromise my company's code of conduct, company policy, or the law in order to achieve business goals."

FACT #3: FEAR OF RETALIATION SUPPRESSES EMPLOYEE REPORTING

Reasons for Non-Reporting of Observed Misconduct
Percentage of Respondents

Fear of retaliation is the main reason employees do not report observations of misconduct.



Reasons why employees leave (Benchmark Survey results)

Lack of faith in the leadership team – 22.58%

No belief in the company's service/product – 6.45%

Lack of financial reward – 12.90%

Feeling unappreciated – 19.35%

Travel/location – 3.23%

Clash with colleague – 3.23%

Redundancy – 9.68%

Poor relationship with line manager – 3.23%

Feeling disengaged/demotivated – 19.35%

It's Like Riding A Bike

- Board members have to focus on front-wheel functions while trusting management to power the back wheel. This will eliminate ambiguous ownership of projects and help the Company be more productive and successful.
- Board members focus on processes when they would serve better by focusing on outcomes. For this reason, role clarity is a critical issue for governing boards.

What is a governance operating model?

- Help people to answer questions such as:
- “Why are we doing this?”
- “Is this okay?”
- “Whose call is this?”
- “Who do we need to tell about this?”

And most importantly to know when to ask such questions

Governance Failures

- Lack of integrity (Tone at the Top)
- Weak control environment (CEO)
- Inconsistent objectives (Compensation Program-Stock Options)
- Poor communication (Up, Down, and Across)
- Inability to understand and react to changing conditions (Weak Economic Performance) on corporate governance: ***"By not asking the question, you're basically asking not to be told."***
- Avoid "Go to Your Room" Syndrome