



Accountants and Tone at the Top

A resource for accountants to address
Tone at the Top with clients



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1 | Introduction

'The accountant should at least have given signals with a degree of persistence to non-executive directors concerning the lack of control mechanisms (...) and about the tone at the top.'

Editorial comment in Het Financieele Dagblad (FD, daily Dutch financial newspaper), June 2013

The accountant must become more relevant. This is the most important objective of NBA policy. The signalling role of the accountant must therefore be shaped further. According to the NBA, the accountant can increase his¹ social relevance and give substance to this signalling role by giving attention to Tone at the Top.

For this reason the NBA published a discussion report in 2012 on the significance of Tone at the Top and the role accountants can play in it. The NBA advises its members to discuss that Tone regularly with top management and internal supervisory bodies. The aim of this brochure is to assist them in this respect.

Accountants require knowledge, tools and guidance from their professional organisation in order to discuss Tone at the Top. This was a significant result of a survey undertaken by the NBA among its members. Accountants see the great importance of Tone at the Top, but pay insufficient attention to it in their reporting and discussions. Accountants who actually do so, experience that it is generally received positively by clients.

This NBA brochure addresses the requirements of accountants outlined above, by investigating further the way in which they² can observe and discuss Tone at the Top with their clients.

¹ The terms 'his' or 'he' are used throughout this document and should be interpreted as 'his or her' and 's/he'

² Wherever this publication mentions 'accountant(s)', this should be interpreted as 'professional accountant(s)'. The audience for this brochure consists primarily of public accountants, internal auditors and government accountants involved in the audit of annual accounts of public interest entities (listed companies and financial institutions) and organisations in the semi-public sector such as educational, care and housing corporations. But accountants in SME, non-executive directors and supervisory bodies can take note of the contents as well.

2 | Tone at the Top

Tone at the Top concerns the (role model) behaviour of management (or directors) in both public and private sectors. An effective Tone at the Top fulfils three conditions:

1. **Walk the talk:** directors must practise what they preach to the rest of the organisation. The perception of role model behaviour is very important.
2. **Visibility:** the (role model behaviour of) management must be visible to personnel.
3. **Open culture and trust:** this is about scope for opening up dilemmas for discussion and whether the top is open to criticism.

Tone at the Top is an important factor in the achievement of the organisation's goals. It is not so much about concrete management measures like procedures, job specifications and physical security, but is more about factors that influence the behaviour of people within organisations - the so-called soft controls. Tone at the Top is an essential element of these soft controls and is mainly to do with conduct, whereby top management must provide a good example.

The behaviour of top management is of essential importance to management quality and ultimately to the continuity of the organisation. The vision, values and strategy of the organisation become hollow concepts if they are not visibly implemented and promoted by executive directors and management.

The importance top management attach to these aspects can be expressed in various ways:

- Concrete decisions that explicitly display the values of the organisation, like setting up a cultural change programme. The real test comes when profitable initiatives are ignored, in favour of other values like integrity or client interests.
- Measures that cause employees to pause for thought when implementing policy in everyday practice, such as being held accountable or a periodic discussion of compliance with the code of conduct.
- Measures that cause employees to place greater focus on organisational values, like periodic dilemma training and mandatory internal consultation concerning dilemmas.
- Actions that clearly demonstrate that non-compliance with rules in an organisation will not be accepted, with the accompanying monitoring and enforcement.

In addition to definitive measures taken by management, management style is also an important component of Tone at the Top. A dominant leader can be very effective in some organisations or phases, and precisely the opposite in other situations. The ideal type of leadership is also subject to change over time.

3 | Social relevance of Tone at the Top

Tone at the Top is a very relevant topic from a social point of view. It is a topic to which several parties (should) pay attention, such as accountants, non-executive directors, shareholders and external supervisory bodies.

Accountants

The (public) accountant aims to be seen as the trustee of public interest. Stakeholders do not always recognise this and expect the accountant to timely signal things which (threaten to) go wrong. The public also expects the accountant to make better use of his signalling capacity for the benefit of executive and non-executive directors and other stakeholders. The social relevance of the accountant therefore needs to increase. More attention to Tone at the Top with accountant's clients will yield an essential contribution to this.

Exuberant behaviour

Several years ago Professor Kees Cools of the RUG studied 25 major accounting scandals such as Enron, Worldcom and Ahold. He compared management at these companies with that of 25 similar companies where fraud was not encountered. Fraud did not appear to be caused by the absence of formal governance structures. The most significant causes were the exuberant behaviour of CEO's, excessive variable remuneration and the issuing of unrealistic targets. Among the fraudulent companies, there were many heroes; people with excessive popularity in the business world and beyond. The cheating CEO's were quoted in the press around three times as often as their fellow chairmen of the board and had parted company two to two and half times more often. The biggest problem with a 'Sun King' however is not lust for glory, fame and hero worship. No, it is that he tolerates no criticism, and that is much more serious, according to Cools. In that case, all checks and balances disappear and power is no longer controlled. Success itself becomes the root of the problem. Other scientific research has shown that fraud is more often encountered when CEO's have a high level of narcissism, compared to CEO's who achieve lower scores for a narcissistic personality. This results in declining financial performance, less resistance and higher susceptibility to fraud.

Non-executive directors

Non-executive directors expect more from an accountant, when it involves sharing of impressions that the accountant has of the Tone at the Top. In their discussions with the accountant - without the presence of management - subjects can be discussed more explicitly. The accountant can share his impressions freely and must in any case, if applicable, express his

concerns to the non-executive directors. He must also make contact proactively if he has serious reservations about the Tone at the Top; normally speaking this is following discussions with management. In such a case the accountant is not so much asked for a definite judgement, but more an opinion, a so-called soft opinion. According to non-executive directors, accountants are still too restrained on this issue. Non-executive directors must however ask questions more actively of accountants about Tone at the Top. This is in line with corporate governance developments in which society places increasingly higher demands on supervision by supervisory boards. In response to this non-executive directors are becoming increasingly professional and strive to fulfil their supervisory task to the best of their abilities.

“What the accountant can do is share information with non-executive directors, for example on risk management and tone at the top. This is happening more and more often. It is a change compared to a few years ago, when non-executive directors and accountants worked less closely together. At that time non-executive directors received their information predominantly from boards of directors.”

Bart Jonker (partner Grant Thornton) at Accountant.nl, based on research carried out in 2013 amongst non-executive directors

According to the NBA accountants must have more intensive contact with supervisory boards³. Accountants and non-executive directors are in any case allies⁴. With the intensification of mutual discussion, more natural opportunities arise to discuss Tone at the Top. This is in the interest of both parties and naturally also in the interest of the organisation concerned and its stakeholders. There must be sufficient time to exchange ideas about the internal control of the organisation, in which Tone at the Top must be a permanent item on the agenda.

Shareholders

That Tone at the Top is considered an important topic is also evident from the fact that shareholders in 2013 annual shareholder meetings of Dutch listed companies asked questions about the Tone at the Top⁵.

External supervisory bodies

Also external supervisory bodies such as De Nederlandsche Bank (DNB, the Dutch Central Bank) and Autoriteit Financiële Markten (AFM, the Dutch Financial markets Authority) pay increasing attention to the Tone at the Top in the organisations they supervise.

DNB has established, due in part to the crisis, that behaviour and culture are a major influence on a financial institution's results⁶. For this reason DNB has in recent years given its supervision of behaviour and culture strong impetus. By signalling and tackling ineffective behaviour and an unhealthy culture early, major financial risks can be avoided. The role model behaviour of management forms a significant part of DNB's assessment framework.

³ NBA Advisory Report The Supervisory board as the accountant's client, September 2011.

⁴ See also Allies in Governance, study report IIA/NIVRA.

⁵ See NBA publication Accountant, what do you have to say? The accountant in the annual shareholder meeting (AVA), Practical study in 2013 (November 2013).

⁶ See DNB brochure Supervisory methods, behaviour and culture, August 2013.



4 | What can you do as an accountant to address Tone at the Top with clients?

4.1 How do you acquire information about Tone at the Top?

It is important that you collate sufficient information, impressions and opinions to be able to share your observations with directors and internal supervisory bodies. To that end you instruct the audit team in the pre-audit meeting to be alert to signals from the organisation in their contacts with personnel members of the client.

The use of other specialists such as behavioural scientists can be considered in some larger organisations. Important sources of potential signals relating to Tone at the Top may be:

Governance

- The minutes of the Supervisory Board, incorporating the results of the annual evaluation of management:
 - Are there sufficient indications from which it is evident that the Supervisory Board included the effectiveness of Tone at the Top in their evaluation of management?
 - Is the Supervisory Board sufficiently critical in terms of top management?
 - Is there sufficient open communication and trust between the Supervisory Board and top management?
- Budget discussions: is there too much pressure to achieve agreed targets? Could these incentives result in reports being manipulated?
- Conclusions and recommendations in reports from Internal Audit, Compliance and Risk Management departments, if present.
- Any reports from whistleblowers and the way they are handled.

Management

- Contents of the remuneration policy: does it possibly contain incentives to top management which could lead to inappropriate behaviour?
- Several randomly selected expenses declarations by top management, to gain insight into their declaration behaviour. Is there evidence of excessive expenditure? Are private expenses declared?
- Media publications: does management display exuberant behaviour? How big are photos of management in annual reports and the organisation's other publications? Does a director regularly appear in the press and do these appearances relate to the organisation or him as a person?
- Head office, office size and layout, executive cars: do these match the values of the organisation?

Personnel

- Results of employee satisfaction survey; how high was the level of participation?
- The way in which these results are followed up, including internal communication.
- Information about (short term) sickness absence, compared to the national percentages for the sector; including analyses by the HRM department.
- Reports of discussions between the director and the Works Council and an (informal) interview with the chairman of the Works Council.
- (Electronic) bulletin board/intranet: what communications are presented here?
- (Informal) interviews with officials other than those in financial administration. Naturally this applies to specific departments such as Internal Audit, Control, HRM, Risk Management and Compliance, but also conversations with less obvious officials, such as warehouse personnel (during inventories), project leaders and even secretaries and receptionists sometimes provide useful information.
- The informal circuit, accountants must use their eyes and ears well. What are people talking about in the corridors, the company restaurant and at the coffee machines?

4.2 What are points requiring attention and potential questions?

The following questions and attention points will help you to pay more focused attention to the Tone at the Top of your clients/principals and to give substance to your signalling role. However it is absolutely not the intention that you use this summary as a simple checklist.

4.2.1 Walk the talk: role model behaviour of management

- Are there examples from which it is evident that during the decision-making process top management is allowing financial objectives to prevail over the organisation's core values?
- Does top management have excessive involvement or bias in reporting selection or in the determination of important estimated entries?
- Were the assumptions behind the estimates in the previous year correct and complete?
- Is there a risk that segregations of duties are breached by top management or by an informal organisation?
- Is the importance of good internal control sufficiently identified and endorsed by top management?
- Does top management distinguish between commercial and private transactions?
- Is top management under a lot of pressure to fulfil expectations of third parties, including the achievement of financial objectives such as turnover and profits?
- Does top management have an unusual high interest in share price rising or profit trends?
- What is the attitude of top management in respect of compliance with relevant laws and regulations?
- Do leaders exercise great pressure on management and employees to achieve financial objectives?
- Is remuneration received by top management higher than usual and/or strongly dependent on profit?
- Does top management make time to reflect on their cooperation, leadership and decision-making process? Is sufficient time taken for this? Is use made of an external specialist in this process?
- Is there evidence of dominant leadership? Or is top management in a position to apply several leadership styles flexibly?
- Is there evidence of mostly informal decision-making?
- Is there evidence of opportunistic deviations from strategy or organisational objectives?
- Are there symptoms of group think⁷? Is there a tendency toward consensus?
- Have measures been taken to apply balanced decision-making? For example by organising contradiction or anonymous voting on important decisions?

⁷ Group-think is a psychosocial phenomenon, in which a group of inherently competent people are influenced by group processes to the extent that the quality of group decisions diminishes. It occurs when group members primarily concentrate on preservation of consensus and unity in decision-making process, instead of a critical consideration of the facts.

4.2.2 Visibility: behaviour must be visible to personnel

- Is it visible to employees that top management complies with its own standards?
- How does the work floor perceive the Tone at the Top?
- Is there evidence of a united image and actions by directors toward their organisation? Are employees involved in daily decisions?
- Does top management appear regularly in the company restaurant and do informal conversations take place with employees?
- Does top management make decisions, assumptions and forecasts available for discussion in an open environment?
- Does top management make use of social media, such as a personal blog, to share personal opinions and experiences within the organisation?

How do you act as a role model in practice?

“By being visible. Management of a business must not be portioned off from the rest of the organisation. I quote (...) as an example. In this case the board of directors decided not to occupy the top floor of the head office any longer. Board members now sit on the ground floor, behind glass and visible to everyone. There is no additional shielding. That may not be possible in every company, but it is a clear signal to employees.”

FD 28 December 2013: interview with Tom de Swaan, Chairman of Zurich and professional non-executive director

4.2.3 Open culture and trust

Culture

- What evidence is there that top management motivates employees to discuss dilemmas and express criticism?
- Is it apparent from the employee survey that they feel sufficiently appreciated and involved? Was the response to the survey in line with expectations?
- Is there evidence of a relatively high turnover of key members of staff? Are exit interviews held? By whom? And what are the most significant outcomes?
- To what extent is top management focused on the task-related aspect and to what extent is management based on human aspects?
- Do managers feel secure in giving their opinions in meetings with top management? Are there guarantees that all of the involved group members and key members of staff participate in the preparation leading up to a decision?
- Is there evidence of a culture in which people dare to speak to each other about behaviour, in situations in which this behaviour is undesirable or ineffective?
- How do important decisions come about? Are there constructive discussions? Are people sufficiently challenged?
- Have measures been taken to allow structurally for organising contradiction at the top of the organisation?
- Are difficult, emotional, human issues and/or fundamental choices discussed or simply ignored?
- To what extent are errors which have been made discussed openly with the aim of learning from them as an organisation? Is there scope for the discussion of taboo subjects and different views?
- Are employees encouraged to have a positively critical attitude? If so, how is this evident?

Core values/code of conduct

- Are core values of the organisation sufficiently clear to employees? How has top management established that?
- Are there training programmes for employees which support the core values of the organisation? Is participation compulsory? If not, how high is the level of participation?
- Has an internal code of conduct been set up? In this, is attention paid to integrity and ethical values?



- In what way is that code communicated to employees?
- What is done to keep the code 'alive'? (training sessions, on the agenda of departmental meetings, sharing best practices, etc.)
- Does top management take disciplinary action against employees who fail to abide by the principles of the code? If so, how is this communicated internally?
- In what way does top management communicate the importance and promotion of integrity and ethical values?
- Is the risk appetite of top management clearly communicated to employees?

4.3 In what way can you address Tone at the Top and report any major findings?

The NBA recommends that at the very beginning of the audit you announce in discussions with management and internal supervisory bodies that you intend to pay more attention to Tone at the Top, so that this does not come as a surprise to them. Depending upon the responses you can provide further information about the aim and the background, also with the aid of this brochure.

It is absolutely not the intention that you issue an audit opinion about the Tone at the Top. No standards exist for Tone at the Top and as an accountant you are also (probably) not trained to do so. That does not detract from the fact that you can provide added value in this area. Naturally you will come into contact with many different organisations. As an outsider you may encounter things which are considered normal within the organisation. It is recommended that you emphasise that you will first discuss your observations with management and that you do not directly set them out in your reports, with certain exceptions. Only major findings warrant inclusion in the management letter or audit report. Naturally you may include positive impressions of the Tone at the Top in your discussions.

Consult on which meetings of management and internal supervisory bodies lend themselves best to discussion of Tone at the Top. It is important that sufficient time is made available for this purpose. For public accountants it is also advisable to discuss your observations with the head of the Internal Audit department and, if present, the Compliance department, prior to discussing them with management. This may reinforce your observations and is appropriate to the way in which accountants cooperate with these departments.

Also discuss Tone at the Top regularly with the Supervisory Board. Subjects which may come up for discussion are exuberant behaviour, bribes, incorrect incentives in a bonus policy, directors' expense accounts, pressure to drive results, management culture, consideration of strategic objectives and risk management. You should not be afraid to speak your mind, even if it is not asked for. In the event of more serious findings, verbal discussion will not suffice. You must then produce a written report and in the event of inadequate follow-up, use the escalation ladder, as described in best practice 5 of the NBA-brochure 'The signalling accountant' (November 2013):

Use an escalation ladder in the event of signals not being followed up

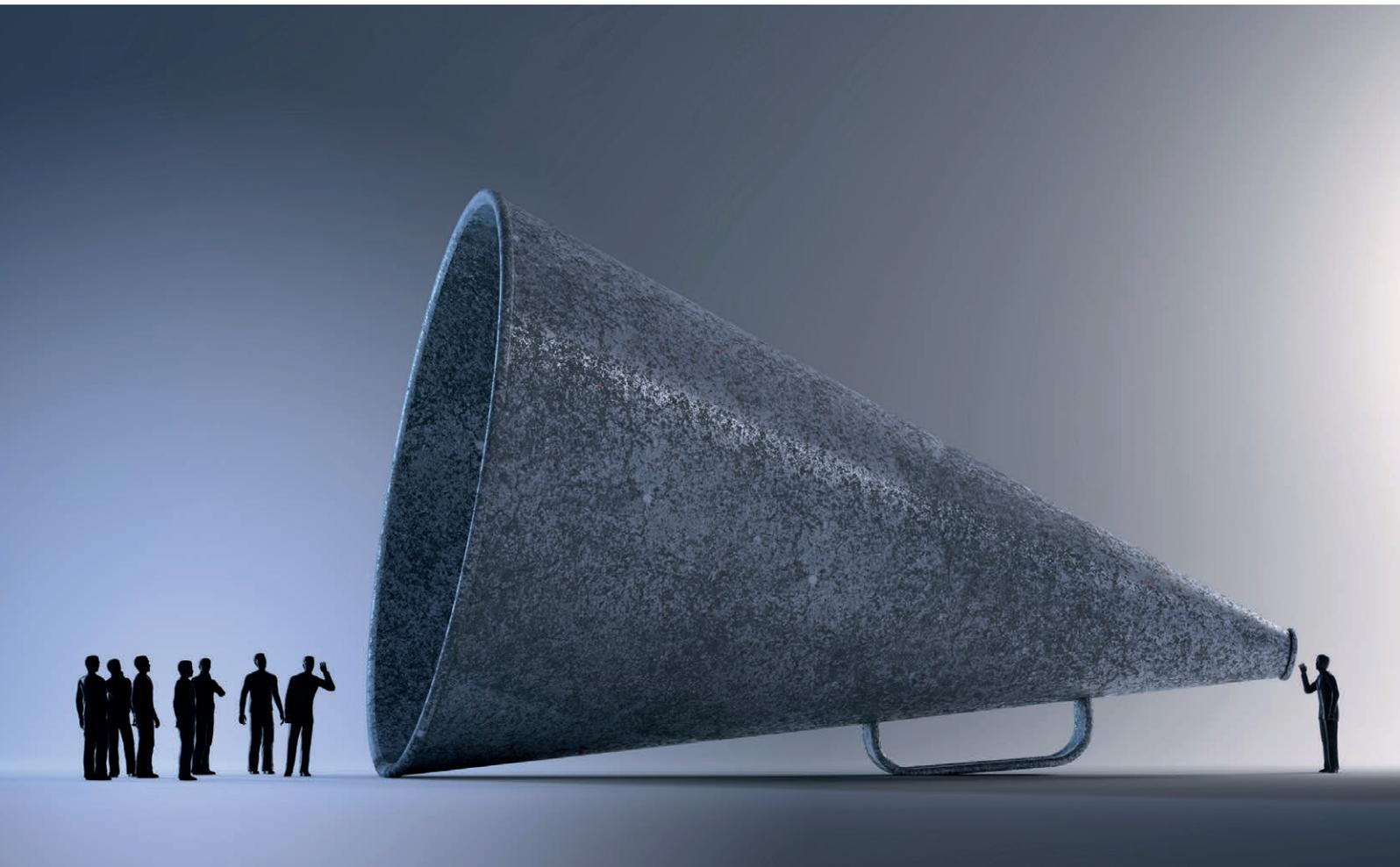
The accountant uses an escalation ladder in the event of inadequate follow-up of his signals and preferably establishes this in his audit assignment. This escalation ladder begins with a verbal discussion of relevant signals with the CFO. The following phases in the escalation ladder include written reports to management and supervisory board, inclusion in the audit opinion and ultimately the decision to terminate the assignment, including a report to the external supervisory body. Depending upon the seriousness of his findings, the accountant selects the required step in this escalation ladder.

5 | Conclusion

This NBA brochure is a sequel to the discussion report '*Tone at the Top: Can accountants make a difference?*', published by the NBA in September 2012.

This brochure was compiled with the assistance of the NBA Identification Board, and also with Mazars, BakerTillyBerk, EY, KPMG, DNB, Reed Elsevier and Group Audit ABN AMRO.

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