



Chartered Institute of
Management Accountants



Why more rules do not always mean better behaviour

“One has a moral responsibility to disobey unjust laws.” (Martin Luther King Jr)

Provocative and practical advice to CIMA members and other financial managers on why and how to find more effective ways to tackle fraud and corruption.

By Yuval Millo and Nigel Iyer

Most people would agree that fraud and corruption are a huge growing problem for companies and public sector organisations alike, but has the tsunami of new rules and regulations over the past two decades, brought in to combat fraud and corruption, really helped?

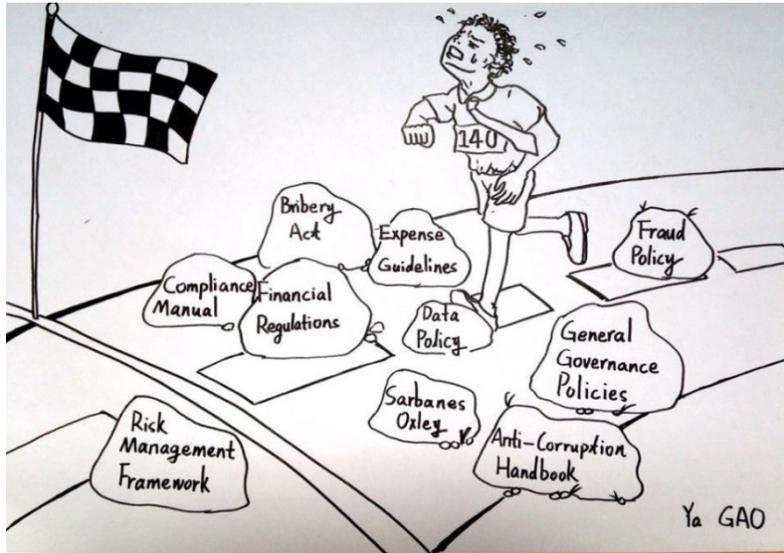
More rules do not always mean better ethics!

Surveys today indicate that the real cost of corruption and fraud is high, perhaps equating to as much as 5% of turnover or costs.¹² As a consequence, classifying fraud and corruption as “risks” does feel like a bit of a misnomer. It happens all the time, right under our noses. Since it does happen, most organisations and governments dedicate a large and increasing amount of energy to combatting fraud and corruption by applying and attempting to comply with rules and regulations dealing with the defining, detecting, prevention and the investigation of fraud and corruption. The UK Bribery Act of 2010 and the Sarbanes Oxley Act of 2002 are just examples of the tip of this “regulatory iceberg”.

In spite of these efforts, there is little evidence that the costs of fraudulent and corrupt behaviour are falling. It seems that fraud and corruption is a constant companion – it follows us and it follows where the money is. Sometimes it’s exposed and put in the limelight, but usually it is latent and hidden.

¹ The Association of Certified Fraud Examiners (Report to the Nations on Occupational Fraud and Abuse – 2014) estimates a median loss of 5% of revenues in an organisation due to fraud (which per the ACFE’s own definitions includes and corruption).

² Estimates show that the cost of corruption equals more than 5% of global GDP (OECD Report “CleanGovBiz” – Yermo and Schroeder 2014)



Is there a better way for our finance director to outrun corruption and fraud?³

So if a rule-based approach to fraud (and corruption)-fighting is proving to be ineffective, then we need to ask ourselves the two immediate questions.

1. Why are conventional approaches to combating corruption and fraud failing?
2. What potential alternatives can be suggested to the problem?

To answer question 1 fully, we first we need to identify who are the main beneficiaries of corruption and fraud? The politically "incorrect" answer is that those who benefit consistently from fraud and corruption are not (just) the fraudsters themselves, but the rule-makers and the interpreters of these rules and regulations. Put simply, as long as fraud and corruption is recognised as a growing problem, rule-makers and their followers are always in demand to produce even more rules, constantly improve these rules and implement compliance monitoring systems.

If rule-makers and compliance officers do not have a direct incentive to abolish fraud and corruption, then surely external auditors, whom management expect would detect major fraud and corruption, are able to find it? Well, not quite... Auditors' professional training revolves around finding mismatches between pre-defined formats of recorded organisational behaviour and actual records. For example, auditors are concerned that monetary figures in a certain document should be echoed in all documents reciprocating that initial examined document and that they should do so in the right context. The exact organisational meaning of these monetary figures is less important to the auditors, as long as the formatting rules are not breached. Occurrences of fraud, however, may not violate such formatting rules: For example the audit trail may look in perfect order, but the underlying invoices, may be for services that were not provided in reality.

So, if rule-makers produce more rules, but do not extinguish fraud and corruption and auditors do not detect it, then what can we offer as an alternative? Our alternative is based on a real-life case.

³ From "Actions speak louder than rules", by Millo and Iyer first published in Fraud Intelligence May 2015. Illustration by Ya Gao.

Intuition and Values verses Rules - A Case in Point⁴

“Nordic Waste” is an international waste-management corporation headquartered in Scandinavia country. The company had been audited and regulated for years. Some years ago Nordic Waste was acquired by a private-equity company, Forvaltor Funds. One of Forvaltor’s associates, “Stefan” took on the post as interim CEO at Nordic Waste. Having no prior experience in waste management Stefan spent his first few months in the company learning the business and observing, noting meticulously what he found.

It did not take Stefan very long to realize that operations in Nordic Waste were not going well after he identified numerous fraudulent and corrupt practices. He encountered a strong set of norms that demanded silence and miscommunication among managers with regard to the prevalent frauds. When he spoke with us, more than three years after he started, he still remembered vividly the sleepless nights he spent trying to think about a solution to the rampant corruption and fraud in Nordic Waste which had been going on for years but never been detected, in spite of all the rules, auditors and compliance. Stefan also shared his private thoughts and deliberations with his most trusted collaborator on the board of Nordic Waste. He knew that Nordic Waste already had an impressive set of rules that were supposed to prevent the exact behaviour he witnessed in the company, but this knowledge came with the painful realisation that more rules and regulations were more likely to be evaded or circumvented just like the ones that they already had.

This realisation led Stefan to turn away from what existed in the company and focus on things he knew well: his beliefs. Stefan began to write down in a notepad what values he wanted to see the company he ran. These were values he believed in not only as a manager, but were the personal values he had acquired through his own life. They included transparency, collaboration, commitment, responsibility, and compassion (which lead him to implement a slightly controversial but successful amnesty for certain cases of corruption and fraud)⁵. Stefan noticed immediately that such values, although expressed in general terms, evoked in him specific feelings, images and modes of understanding. This first, almost banal understanding led, however, to an important insight. Stefan understood that the potential strength of the values he identified – the values he wanted to see expressed in Nordic Waste – was their ability to evoke in people images that were very personal and therefore very effective.

Stefan decided to develop a value-driven management tool. Top managers were asked to distribute to the people they managed and onwards all the way to shop floor workers, tables where they would note what the different values Stefan identified meant to them as they operated in the company. These interpretations were attached to performance measurement which fed into bonuses and promotion decisions.

Alongside the establishment of value-driven management where all employees were encouraged to consider their own values and interpret them, Stefan also managed to expose the fraudulent activities in Nordic Waste to the public. It was a risky and painful move that was accompanied by struggles within the company, but Stefan and other managers managed to sail through that period with little damage to the company’s reputation and financial and business performance. Three years on Stefan the “interim-turned-permanent” CEO of Nordic Waste is still there. He told us that he loves every minute of the challenges and we would like to thank him for sharing his experiences with us.

⁴ A true case. Pseudonyms have been used throughout.

⁵ The amnesty was for a limited period of time and lead to the discovery of numerous new cases which would otherwise have remained undiscovered and hampered the transformation of Nordic Waste and is today the subject of teaching case study

So what can the experiences of Stefan in Nordic Waste teach us about fighting fraud and corruption? Firstly, instead of telling employees specifically what they should not do, as compliance-related rules and regulations do, value-driven management as we call it, provides them with the freedom to implement their own relevant, context-related versions of instructions and follow these behaviours. Secondly, it encourages adherence to the self-developed rules by following positive examples from higher-level managers.

Based on these points, we want to begin by providing some general advice to managers about the underlying nature of value-driven managerial efforts against fraud and corruption.

Lead employees to show you what they can do – do not only tell them what not to do!

Managers at all levels need to have direct experience in interpreting general values into specific modes of desired behaviour. The process may expose uneasy facts about the company, but will also provide managers with insight on how to deal with such revelations.

Introduce few values, but make sure that they pervade the whole organization.

The list of values should be short and precise so as to provide a clear focus and also to encourage effective discussions about what such values mean to different people in the organisation. This should also be accompanied by repeated manifestations of the values across different areas of activity.

The values may be right, but implementation may be wrong!

Not every value-driven interpretation will be effective, but if managers monitor this and offer quick and effective remedial action, then it will help others to continue believing in the approach and carrying on.

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This short article is designed to stimulate, provoke and invite all parties, including the rule makers, compliance profession and auditors to what we feel is a necessary debate. It is our intention to follow up this piece with additional short pieces such as "Don't wait for the whistle-blower - the layman's guide to spotting fraud and corruption", and more about how to encourage the values you want/need.

*** A version of this article was published in CIMA's Financial Management magazine online, February 2016 issue. To read the article go to**
<http://fmapp.cimaglobal.com/seven/financialprototype/index.html#issue/february2016/portrait/31>