



COMMITTEE OF SPONSORING
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Looking at Corporate Governance and Ethics Through the Prism of Information Integrity

Sri Ramamoorti – University of Dayton

Paul Sobel – Chairman, COSO



DEDICATION

This presentation is dedicated to honor the memory of
Mr. Madhavan K. Nayar, a brilliant entrepreneur,
co-author of an article on information integrity and Co-
Founder of the Information Integrity Coalition

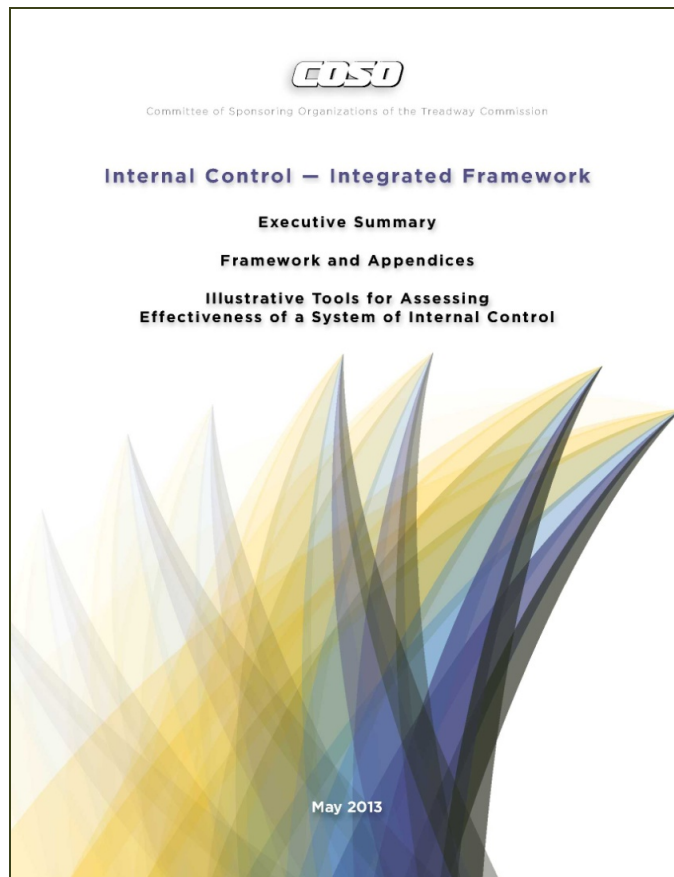


Topics for Today

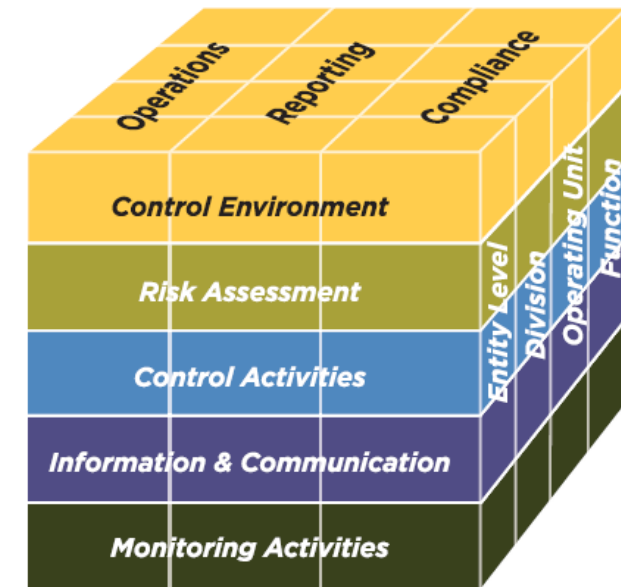
- COSO Perspective on Ethics and Information Integrity
- MOAR: “Information for Decision Making Risk” (GIGO, DRIP)
- Need information integrity (I*I); improve signal-to-noise ratio
- What aspects of information are the most pertinent?
- Analyzing corporate governance failures
- Concluding thoughts



Internal Control-Integrated Framework (2013 Edition)




- Consists of three volumes:
 - Executive Summary
 - Framework and Appendices
 - Illustrative Tools for Assessing Effectiveness of a System of Internal Control
- Sets out:
 - Definition of internal control
 - Categories of objectives
 - Components and principles of internal control
 - Requirements for effectiveness




Principles of Effective Internal Control


Control Environment

1. Commitment to integrity and ethical values 
2. Exercises oversight
3. Establishes structure, authority, responsibility
4. Commitment to competence
5. Enforces accountability

Risk Assessment

6. Specifies suitable objectives
7. Identifies and analyzes risk
8. Assesses fraud risk 
9. Identifies and analyzes significant change

Control Activities

10. Selects and develops control activities
11. Selects and develops general controls over technology 
12. Deploys through policies and procedures

Information & Communication

13. Uses relevant information
14. Communicates internally
15. Communicates externally

Monitoring Activities

16. Conducts ongoing and/or separate evaluations
17. Evaluates and communicates deficiencies

Enterprise Risk Management – Integrating with Strategy and Performance



Governance & Culture

- 1. Exercises Board Risk Oversight
- 2. Establishes Operating Structures
- 3. Defines Desired Culture
- 4. Demonstrates Commitment to Core Values
- 5. Attracts, Develops, and Retains Capable Individuals

Strategy & Objective-Setting

- 6. Analyzes Business Context
- 7. Defines Risk Appetite
- 8. Evaluates Alternative Strategies
- 9. Formulates Business Objectives

Performance

- 10. Identifies Risk
- 11. Assesses Severity of Risk
- 12. Prioritizes Risks
- 13. Implements Risk Responses
- 14. Develops Portfolio View

Review & Revision

- 15. Assesses Substantial Change
- 16. Reviews Risk and Performance
- 17. Pursues improvement in Enterprise Risk Management

Information, Communication, & Reporting

- 18. Leverages Information and Technology
- 19. Communicates Risk Information
- 20. Reports on Risk, Culture, and Performance



Strategy in Context



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What is Information Integrity? (I*I)

Information (technical) + Integrity (behavioral) = Information Integrity

I*I implies the following characteristics--

1. **ACR:** Accuracy, consistency and reliability of information across content, process, system and environment that pertain to one or more decision contexts.
2. **Suitable & Sufficient:** Fit-for-purpose, usable, adequate, timely, etc.
3. **Credible and Relevant:** Understandable, available, and useful for decision makers

In general, I*I refers to the trustworthiness and dependability of information



Information (technical) + Integrity (behavioral) = Information Integrity

Given today's digital information environment, the understanding, definition, and analysis of information integrity can be challenging and complex.

DRIP environments, when uncontrolled for errors and potential fraud:

- create information errors, disrupt processes and systems, and pollute the information environment - there's an urgent need for appropriate "data governance" and I*I standards
- data science is not enough; we need to value humanity over technology, and people over process (i.e., ethics over mathematics, algorithmic bias)

Only sentient human beings can extract meaning and make interpretations, especially on matters of ethics and morals



A careful root-cause analysis of any corporate governance failure will lead to the inevitable diagnosis: **information errors, integrity lapses, or both.**

OBS 1: An information problem may or may not be an integrity problem; nevertheless, depending on its size and other ripple effects, it could lead to an information integrity failure.

--During the Wall Street financial crisis, AIG simply did not know the magnitude of its exposure from selling credit default swaps (later estimated as > \$450B)

OBS 2: An integrity problem will almost always result in an information problem, and thus, sooner or later will lead to an information integrity failure.

--The significance of behavioral and integrity risks is mostly a qualitative judgment; you cannot trust someone who is honest only 99% of the time—what if you are the 100th client?



Examples from Corporate Governance Failures...1

THERANOS:

- “Fake it till you make it” philosophy of Elizabeth Holmes (mostly an elaborately enacted integrity failure)
- Governance failure in that the Theranos Board composed of highly distinguished, older men such as George Schultz, Henry Kissinger, Jim Mattis had little idea of the technology being touted (IFDMR, governance)
- No psychological safety for whistleblowers (Toxic culture, integrity)
- But Dr. Phyllis Gardner, Stanford Professor of Medicine, was skeptical and figured her out

WELLS FARGO:

- Cross-selling and incentive compensation strategy drove employees to open over 2 million unauthorized customer credit card and deposit accounts (IFDMR); CFPB fined \$185 million, later over \$1B in penalties
- Aftermath of Wall Street financial crisis, merger with Wachovia—lot of things going on; internal controls in disarray; internal audit may not have been focusing on the right issues or were sidelined (IFDMR, controls)
- Over 5,300 employees let go in 5-year period; VUCA environments can help mask fraud



Examples from Corporate Governance Failures...2

VOLKSWAGEN:

- Use of “cheating devices” to hoodwink EPA about nitrogen oxide emission levels--\$17B in fines (integrity)
- A family-controlled company with a fractious and unfocused board, it was accountable to no one, except perhaps its trade unions--Board support (governance, culture problem)
- TGTBT syndrome—needs skepticism from regulators too

WIRECARD:

- US \$2B missing in decade long fraud—but auditing cash should be easy, no? But we have Parmalat (\$5B), Satyam (\$1B), MF Global (\$1.6B), Peregrine Financial (\$215m), etc.
- Auditor did not pursue whistleblower complaints (ignoring information, trust but verify)
- Former COO Jan Marsalek still absconding, wanted by Interpol; former CEO Markus Braun charged with inflating revenue to deceive investors



Dan Davies in his book, "Lying for Money" (2018, p. 2)—

* A lot of bank regulation deals with numbers: measures of capital, measures of risk, probability distributions, and ratios.

* Yet, when a bank goes spectacularly bust, "you'll probably notice that the reasons why everything went wrong usually have very little to do with those numbers--they tend to be very human in nature and made up of varying proportions of incompetence, dishonesty, and bad luck."

* This is where psychology trumps economics...consider the John Maynard Keynes quote (attributed), "The markets can remain irrational far longer than you and I can remain solvent!" (irrational behavior is studied by psychologists, solvency by economists)



Closing Thoughts

- COSO has a long history of developing frameworks with principles supporting integrity and ethics and strong information integrity (I*I)
- In the long run, internal control systems that have been designed and implemented using I*I are much more likely to be robust and effective
- Why? They incorporate both the “information” and the “people” dimensions of decision-making



Thank You



University of
Dayton

Sri Ramamoorti, Ph.D., ACA, CPA, CIA, CFE, CGFM
Associate Professor of Accounting
Sustainability Scholar, Hanley Sustainability Institute
University of Dayton, Ohio

sramamoorti1@udayton.edu

[Sridhar Ramamoorti : University of Dayton, Ohio
\(udayton.edu\)](http://udayton.edu)



Paul J. Sobel, CIA, QIAL, CRMA

COSO Chairman

770-313-1110

paulsobel@coso.org

www.coso.org