

# Hypegiaphobia

In search of the balance between rules and trust



***hypegia*·phobia**  
the fear of responsibility

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# 01

## Introduction

Hypegiaphobia. Most people are not familiar with this word, but it is a phenomenon that is widespread in today's society: fear of responsibility. It is all down to the way in which risks are controlled in our society.

Nowadays, many organisations either want or need to be 'in control' of a lot of risks, and they make great sacrifices in order to achieve this objective. The positive effects of this include more clarity where tasks and responsibilities are concerned, as well as improved accountability. The investments also raise two questions: whether investing in risk management is effective and actually leads to a lower risk profile, and whether risk management can actually miss its goal and lead all too often to undesirable negative effects such as decreased entrepreneurship, increased willingness to take legal action, a culture of fear and potentially a harmful effect on the competitive position.

Organisations can then find themselves doing the splits. On the one hand, in this day and age it is essential to be able to anticipate the high demands of the market and the rapidly-changing environment with sparkling new, original ideas. This requires a lot of creativity. On the other hand, creativity ends up being quelled because of the efforts to eliminate all risk: after all, being 'in control' often leads to a lot of things being turned down, which can see creative ideas frequently killed off in the embryonic stage.

KPMG believes that this needs to change, and indications from the field suggest that we are not alone in this. The aim of this manifesto is to investigate how change can be introduced. We are looking for the value that represents an appropriate level of control for executive directors and supervisory board members, but we will also analyse the undesirable reflexes that are currently occurring in practice. And we will especially be looking for inspiration from interviews with real-life experts from both within and outside the business world.

There are many parallels between managing a motor-racing team and being ‘in control’ of a company. Jan Lammers has 35 years’ motor-racing experience. As well as being a racing car driver, since 2001 he has also been the manager and owner of the Racing for Holland team, which takes part in the 24 Hours of Le Mans race. He is also the director of the popular A1 Team Netherlands, in which he owns a 20% stake. He analyses the similarities and differences.

“Mario Andretti expressed it very well some years back: if you think you are in control, you are not going fast enough. Of course, that does not mean that risk-taking should be unrestrained in racing: on the contrary, you try to take risks in a responsible way, so that you do not end up in the gravel trap or have to pull out because of technical problems.

**In order to do this, you need to have outstanding brakes as well as a powerful engine. Anyone who boosts their engine capacity will not be able to go much faster unless they also invest in other things such as better road-holding and braking capacity.** Of course, this also applies to business: if you are growing fast in terms of your activities, you need to build in the right controls so as to steer the growth in the right direction.

Ultimately, the success of a motor-racing team, just as that of other organisations, depends mainly on having the right people. Money is the result of success and not – as is still

sometimes thought – the other way round. In order to be successful at racing, therefore, you need a talented driver who has trained for years to improve his abilities; however, you also need a skilled team around this driver, because it is only possible to deliver an optimum performance if all the cogs in the process interlock smoothly.

How do I as the manager ensure that my team works as a collective unit? This is largely down to choosing the right people: I look for people who, as well as having the necessary knowledge and experience, also have character, morals and decency. They need to be immune to stress and prepared occasionally to work around the clock for days at a time. They also need to be aware that they have a responsibility to help make the situation as pleasant as possible for everyone involved. Johan Crujff once said he could not stand people who were part of an institution but did not contribute anything. I completely agree: you are not going to win anything with that sort of person.

You therefore need to choose the right people for your team and then dare to let go a bit. As a manager, the main thing I need to do is create a climate in which both individuals and the team as a whole are able to perform to the best of their abilities.

**A good racing car driver is no control freak: he trusts the people around him.** Ultimately, he weighs up risks using feeling and intuition. Intuition is also an important factor in many other situations: it can even play a role when you are choosing an engine manufacturer for your sports car, although the opportunities to limit risk by means of thorough research – reason therefore, rather than intuition – have improved greatly over the past ten years as a consequence of unprecedented communication opportunities.

In short, anyone who follows their instinct and uses this as a basis to take calculated risks with complete conviction cannot blame themselves for anything. Even if things go wrong. Because that is the dynamics of motor racing.”



# In control in the world of motor racing

Jan Lammers: "A good racing car driver is no control freak"

# 02 Appeal to people involved in society

The result of our analysis is that we are convinced things can be different. We believe we need to shake off our hypegiaphobia and make way for people to take responsibility. However, this process can only begin if everyone involved is behind it. As things stand at the moment, it is quite possible for one party to have another in a stranglehold from time to time. We should all be in favour of change, but nobody can do that on their own. With this manifesto, we are appealing particularly to executive directors and supervisory board members, controllers, politicians and auditors to embark upon on a new course together. We are calling on them to unite to create more room for people to take responsibility.

# appeal:

## In summary:

### **Executive directors and supervisory board members**

need to provide good leadership, show that they are working from their own strength, and allow entrepreneurship to prevail. In order to be 'in control', they need to develop a system of rules that is based not on legislation but on their own strategy and the development phase of the organisation. They need to take clear responsibility for this, so that they are able to win the trust of their stakeholders. They should not be frightened by rules and legislation, because not only is fear a bad counsellor, it is also harmful to creativity.

**Regulators** need to monitor companies and auditors according to the spirit rather than the letter of the law. They should focus on the aim of the legislation, and encourage companies and auditors to respect the law in material terms. If laws and regulations leave room for interpretation, regulators should pass this room on to executive directors, supervisory board members and auditors.

**Politicians** need to resist public demands for new measures following an incident, unless there is a need for such measures. They need to have a clear policy and stick to it when the media dives into a subject. This could break the cycle of further juridification, but it requires firm and above all consistent leadership.

**Auditors** need to show more nerve by putting the principles of rules and legislation first, and by forming opinions on these rules and legislation where possible. Laws and regulations – for example IFRS – offer room for customisation. Auditors also need to demonstrate more authority in the area of external reports. They need to use their expertise and influence to increase the information value of the financial statements.

Moreover, auditors need to take more of a top-down approach to the subject: it is company managers who make choices about the risks to be taken, and these choices should provide guidance as regards setting up measures to manage risk, including on behalf of auditors.

The subsequent chapters underpin this appeal further.

A portrait of Theo Poolen, a middle-aged man with short, light brown hair and a slight smile. He is wearing a dark suit jacket, a white shirt, and a dark red tie. The background is dark with vertical light streaks, possibly from window blinds.

# In control at the Dutch Tax and Customs Administration

**Theo Poolen: "We need to get rid of the 'us against them' mentality"**

Theo Poolen is a member of the management team at the Dutch Tax and Customs Administration; and as such responsible for the development of horizontal supervision, a way of working that is based on mutual trust between the taxpayer and the Tax and Customs Administration.

**“Mutual trust between the taxpayer and the tax authorities; to many people that sounds a bit mad.** We have been laughed at for our ideas about horizontal supervision fairly often and have to swim against the tide; nevertheless, I am convinced of the potential of this way of working. Of the people within our organisation who have had experience of horizontal supervision, 95% are in favour of it. Not only because it is pleasant to work in a state of mutual trust, but also because this idea fits in perfectly with ongoing efforts towards deregulation.

Horizontal supervision is really another way for taxpayers and the tax authorities to communicate. We choose to step back a bit from traditional auditing and instead enter into an agreement with taxpayers that they will alert us to any tax or other problems they may encounter. The big advantage of this is that problems can be dealt with straight away, whereas according to the old way of doing things, it could take five or six years before a taxpayer had ‘tax security’.

The idea emerged a few years ago following a report from the Scientific Council for Government Policy which suggested that the idea of an all-powerful government with a monopoly on knowledge was not tenable. Governments needed to work together with social partners

on the basis of equality. At the same time, the VNO-NCW (Confederation of Netherlands Industry and Employers) produced an assessment which did not beat around the bush, claiming that our control process was much too long-winded, that we were sometimes around seven years behind the facts, and were burdened by a point-scoring, ‘us against them’ mentality.

So we began to enter into agreements with a number of large companies which would enable them to ‘work in the present’: provided they kept the agreements with the tax authorities, they would not need to worry about running into problems years down the line. The covenant approach has proven successful, and we would like to begin to open it up to smaller companies. Regarding SMEs, we are starting by drawing up agreements with intermediaries such as auditors, tax specialists and industry organisations.

A first concrete step would be an agreement between the Dutch Tax and Customs Administration and the SRA (Dutch network of auditing companies). We are currently running a pilot scheme involving a handful of Brabant-based companies to find out to what extent auditors can cooperate with the tax authorities in the area of payroll tax and social security contributions. Another example is the agreements made

between the tax authorities and an umbrella organisation for housing corporations, which are now obliged to pay corporation tax and as a result must include real estate on the balance sheet. One covenant concerns the way in which this real estate is valued, among other things. This delivers enormous cost savings and reduces the incidence of legal tugs of war.

As to where we want to go with this concept in the future, we do not have a master plan. Employees from the organisation sometimes ask us for a memorandum about horizontal supervision, but we do not even have one of those. We want to develop a memorandum gradually, and allow both sides the freedom to be creative. The speed of development will be determined by what we can cope with as an organisation, among other things. It is basically a completely different way of working. **Inspectors used to be proud of the fact that they could make an adjustment of € 50 million after months of work. This reflex needs to go.** We need to replace suspicion with trust within our organisation. The new way of working also requires specific personal skills on the part of inspectors, and to be honest, we have neglected to develop personal effectiveness in the past. We are now providing a high level of support to the change process.”

# 03

## What is being 'in control'?

How one perceives the idea of being 'in control' is largely dependent on one's line of approach. In this publication, we would like to give a brief outline of what being in control means:

What is being 'in control'  
**according to society?**

What is being 'in control'  
**according to rules and legislation?**

What is being 'in control'  
**according to executive directors?**

What is being 'in control'  
**according to auditors?**

### What is being 'in control' according to society?

Society wants to feel safeguarded against unpleasant surprises. Moreover people often think of certainty in absolute terms, i.e. they expect nothing to go wrong. Companies need to ensure continuity, that the figures they publish are correct, that there is no fraud, and that all the rules and legislation are complied with. No mistakes are allowed, resulting in a 'zero tolerance' approach to mistakes or rule-breaking on the part of others.

The key words of this line of approach are therefore: **security, protection, integral and insurance policy.**

### What is being 'in control' according to rules and legislation?

The concept of being 'in control' has also become fashionable as the result of all kinds of new rules and legislation. All companies quoted on a US stock exchange are subject to the Sarbanes Oxley Act (SOX), according to which the executive directors of these companies must declare that they are personally 'in control', and this declaration must then be tested by an auditor. The law further requires that companies implement all kinds of control measures with regard to processes that produce financial information, and that they report any flaws in the annual report.

The Dutch corporate governance code has less strict requirements. Although companies have to include information about their internal control system in their financial statements, an auditor's report is not necessary. Moreover, the code defines the concept of being

'in control' more widely than the simple management of financial processes.

The key words of this line of approach are therefore: **compliance, rules, formal.**

### What is being 'in control' according to executive directors?

An executive director or supervisory board member needs to realise the organisation's objectives (continuity, yield). Any factors that can hinder the realisation of these objectives – risks, in other words – need to be managed in an appropriate manner. For executive directors and supervisory board members, this is the essence of being 'in control'. As well as good internal control measures and reliable internal information, the main thing that executive directors need if they are to be 'in control' is a sound knowledge of market demands and of how the world is changing around them.

## It is a matter of tough measures and controls, but also of softer issues such as integrity, corporate culture and morals

They need to be unerringly able to receive weak signals – both internal and external – and to make adjustments based on these if necessary. Finally, they need to be able to paint a variety of future business scenarios in order to be able to anticipate unexpected events (trend breaks, bankruptcies, disasters).

The key words of this line of approach are therefore: **enterprise, balance, strategy, top-down, continuity and future.**

### What is being 'in control' according to auditors?

Auditors who inspect financial statements think mainly in terms of financial streams and responsibility for recent events. According to this line of approach, an organisation that is 'in

control' needs to have adequate control measures and segregation of duties so as to demonstrate that the financial and other information about processes is reliable. The checks that are carried out for this purpose need to be performed in a demonstrable way, so as to enable the auditor to confirm that the tools have worked.

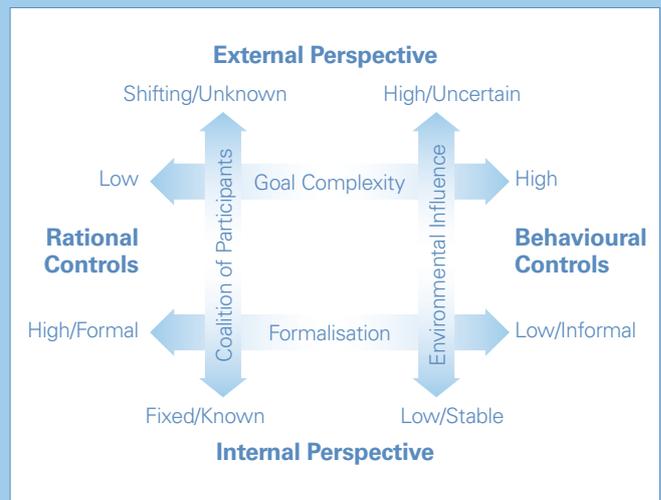
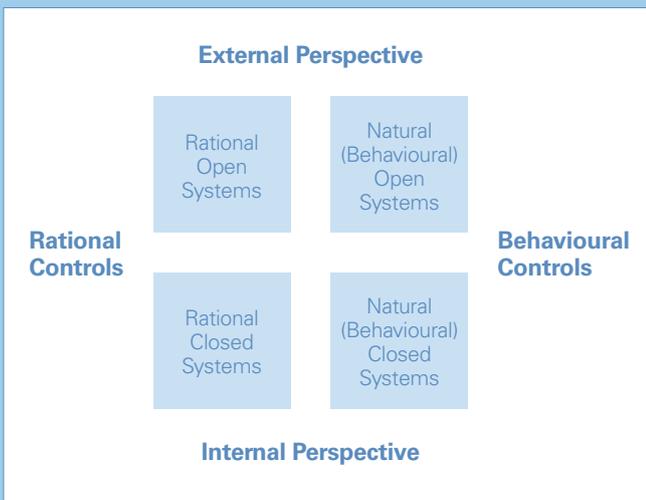
The accounting scandals at the beginning of this century have increased the attention paid to this line of approach, resulting in higher requirements regarding the reliability of financial information.

The key words of this line of approach are therefore: **internal, financial and past.**

### What is 'in control'?

The above shows clearly that there can be an economic, a social and a legal perspective to this question. The precise definition is not particularly important: what matters is that the concept of being 'in control' needs to be understood in a broad sense. It is just as much about being certain that reported figures are accurate as it is about the desire to control external risks. It is a matter of tough measures and controls, but also of softer issues such as integrity, corporate culture and morals.

The four-field model gives a clearer insight into the different dimensions of being 'in control'.





# In control in the fight against terrorism

**Tjibbe Joustra: "Phasing out a package  
of security measures is unbelievably difficult"**

Tjibbe Joustra is the National Coordinator for Counterterrorism. We asked him about parallels between being ‘in control’ in an organisation and dealing with the risk of a terrorist attack.

“It is evident that terrorism has been a major theme in politics and the media in recent years. What people sometimes seem to forget, however, is that the phenomenon is not new. In the 1970s, for example, we had to deal with the Moluccan train hijack, attacks by the Basque separatist group ETA and the IRA, and the occupation of the French embassy by the Japanese Red Army. At that time therefore we were dealing with a variety of groups, whereas now there is the feeling that there is a common threat. The franchising of the Al Qaeda brand has led to a situation where all terrorist actions are attributed to a single concept.

Our task is to coordinate activities aimed at reducing the risk of terrorism and at the same time to give the public a feel for what we are doing. We believe that ignorance and secrecy breed fear, so we want to be as open as possible about what we are doing. Of course, we can never completely rule out the risk of an attack. **Take for example the American president Ronald Reagan: when he was shot at the beginning of the 1980s, he was by far the most heavily guarded person in the world. This shows that it is impossible to have zero risk.** What is more, in our experience society understands this: our research shows that around 70% of citizens believe that it is impossible for the government to rule out all risks. **However, opposed to this rational approach there is the strong emotional reflex that**

**occurs as soon as an incident takes place somewhere.** Then the question immediately arises of whether the authorities could or should have prevented this. It is in this area of tension between reason and emotion that we operate. We adjust the level of measures to the perceived threat, and are influenced by lots of different factors: aviation security measures, for example, are affected by international developments, and if the American authorities introduce certain requirements affecting air traffic in American airspace, as they did last summer following an acute threat to Heathrow, there is not much else we can do in Europe other than follow them.

Of course politics, too, plays an important role, and this is another area of tension, for as long as there are no incidents, politicians sometimes ask whether the measures are still necessary, but as soon as something happens, they immediately question whether it could have been prevented. Another factor is that no country wants to be known as the country with the weakest counterterrorism measures.

All of these factors make it unbelievably difficult to shrink the package of measures that we have in place if we believe that the situation merits it. Take for example the attacks on the London underground: the terrorist threat level in the UK had been lowered just one week before the bombings took place. In April

2007, we lowered the National Terrorist Threat Assessment from ‘substantial’ to ‘limited’. It is of course always tense in the weeks afterwards as one waits to see what will happen.

I believe that one of the biggest challenges in the fight against terrorism is to develop a solution that enables us to do more with the information that we already have. The ‘human factor’ is still very important. Although data mining offers outstanding opportunities to identify risks early, the systems are less cohesive than many realise. We have a lot of information but it can be difficult to use it effectively. We also collect a lot of information that we do not use, or from which false conclusions are drawn. A famous example of this is when the US senator Ted Kennedy ended up on a ‘no-fly’ list because of combined data mining from different systems, while ten of the eighteen perpetrators of the September 11 attacks on the World Trade Center had already been screened and identified as a risk before they bought their tickets. Despite this screening they were nevertheless still able to go on board. I personally am in favour of focusing very carefully on specific threats rather than using thousands of employees to gather masses of information.”

# 04 'In control' in a perfect world

## **In a perfect world...**

... an organisation's measures for being 'in control' would be in keeping with its risk approach;

... there would be optimum accountability between an organisation and its stakeholders;

... a company's financial statements would inspire trust;

... an organisation would have a scenario for every possible disruption.

### A theoretical approach to risk

Anyone who does not take any risks is robbing his own purse, because it is not possible to be a successful entrepreneur if you do not take risks: after all, profit is a reward for risk taking. The fact is that entrepreneurial activity implies uncertain consequences, both within and outside an organisation.

Risks are potential happenings that, if they were to occur, would hinder the

achievement of goals, such as profit making. Every organisation has to deal with such so-called inherent risks.

Risk analysis and the subsequent implementation of targeted measures can reduce these risks. The residual risk remains. The risk measures are aimed at both minimising the impact of the risk and reducing the likelihood of it occurring.

Take for example someone who lives in an area that is regularly hit by hurricanes. They could reduce the inherent risk of the hurricanes by building an emergency shelter or constructing a strong building. The impact of any hurricane is then likely to be less, although the probability remains the same: this will only change if the person moves to a different area.

### In control in essence

In Russia, oil is pumped out of the ground and transported by pipeline to Poland. The divisional director of the oil company would really like to be 'in control' of his stream of oil.

Should he ask one of his people to check whether oil is actually being pumped out of the ground in Russia? This sounds absurd, because if this were not the case then no oil would come out of the pipeline in Poland.

Should he ask his people to inspect the entire pipeline to see if any oil is being tapped illegally? This also sounds absurd: it would be much easier to check by simply installing a meter in Russia and Poland.

Should he draw up scenarios for all possible forms of disruption to the supply, from earthquakes to wars? Should he perhaps even draw up scenarios for the event that the world ceases to require oil?

This sounds sensible, and is actually a completely normal business activity.

Should he order inspections to test the quality of the pipeline, so as to ensure that the supply will not be disrupted by a leak or an explosion? Should he designate someone to formally confirm the existence of these inspection reports, so that his auditor can confirm that the inspections were carried out? Or should he perhaps make regular visits to Poland to chat with his people about the problems they encounter on a daily basis?

These may sound like ridiculous questions but they reflect the essence of the being 'in control' concept that has had the business world in its grip in recent years, and that, according to many people, has resulted in fear and an obsession with organisation.

In theory, there are four ways to deal with risk:

**Accept it:** be aware that risk exists, but accept it.

**Control it:** take measures to reduce or mitigate the impact and/or probability of the risk.

**Avoid it:** adjust activities or the organisation in such a way that the risk no longer applies.

**Share it:** share the risk with another party.

**Ideally, an organisation's measures for being 'in control' are in keeping with its risk approach**

Being 'in control' means trying to find the right balance so that the residual risk fits in with the approach that the organisation (the management) has to risk. This is also called the 'risk appetite'. This 'risk appetite' can be dependent on factors such as personal characteristics, but it is also influenced by the economic parameters of the industry in which a company is operating, the attitude of the shareholders in the company, and the life phase in which the organisation finds itself. This means, therefore, that any steps a company takes in order to be 'in control' should optimise entrepreneurial activity rather than restrict it. Being 'in control' is consequently not the opposite of risk taking, but should be part of the risk-weighting process. Being 'in control' also requires that risks are re-assessed at intervals because they are susceptible

to change over the course of time.

The management can take action as and when necessary – this may mean that more measures need to be taken (in an 'under-controlled situation'), or fewer (in an 'over-controlled situation').

**Ideally, there is optimum accountability between an organisation and its stakeholders**

In an ideal world, the management of an organisation would give its stakeholders insight into how it deals with risks: then, if something goes wrong at a later stage, at least this possibility has already been pointed out. Put simply, directors can then only be made responsible for things that go wrong as a result of their actions, not as a result of the risk approach they shared with their stakeholders. They will be assessed on their actions in the context of a deliberately chosen risk approach.

**Ideally, a company's financial statements inspire trust**

Good management of financial processes leads to reliable financial statements. The risk of mistakes in the report is lower, as is the chance of fraud or of adjustments being made to the report. This also reduces the chances of negative publicity and possible negative effects on the share price. The more a company proves itself to be trustworthy, the easier and less expensive it becomes to tap external

capital. Directors can also include details of their risk approach in the financial statements, thereby fleshing out their above-mentioned accountability.

**Ideally, an organisation has a scenario for every possible disruption**

Finally, in a perfect world, an organisation would be prepared for every possible disaster, crisis and calamity, not because of some controlling desire to be prepared for anything and everything, but out of a need for self-preservation. Directors need to consider scenarios in the event that a disaster did take place, for example: what would we do if oil prices doubled within a month, or if half the workforce became ill as the result of an epidemic? In times of crisis, companies that have considered such questions will be ahead of organisations that have not made sufficient preparation. In short, the real motivation for business continuity planning does not come from any legal obligation but from the desire to always provide a good service to stakeholders, even in times of crisis.

For example, what would we do if oil prices doubled within a month, or if half the workforce became ill as the result of an epidemic?

Tijs Goldschmidt is a behavioural biologist and is primarily known as the author of the book 'Darwin's Dreampond: Drama in Lake Victoria'. We asked him for inspiring parallels between nature and the economy with regard to the urge to survive and dealing with risks.

"There are lots of studies that show that risk taking also has a significant influence on patterns of behaviour in the animal kingdom. One of the best known experiments concerns an investigation into the behaviour of macaques which was carried out on the Japanese island of Koshima in the 1950s. A group of researchers scattered sweet potatoes around on the beach to lure the macaques into the open. Not long after, they noticed that a young female was taking the potatoes that were under the sand and washing the sand off them in the sea. This was surprising, because macaques had always been afraid of water. **What was also striking was that more and more animals began to adopt this young female's good habit, but that the old leaders chose *not* to imitate their subordinates.** Now, fifty years on, not only has the whole ape colony acquired this custom, but the macaques have completely overcome their hydrophobia and are even able to swim and thus tap new food sources. This teaches us therefore that daring to stray from the beaten track can have far-reaching consequences.

It is even possible that the change in the macaques' behaviour will ultimately lead to anatomical changes. The macaques may evolve to have flippers, for example. Evolution is often presented in the popular media as 'survival of the fittest', but that is an oversimplified rendition of the facts. This can be proven if one considers the bird species that live on very remote islands. It is striking that these islands are often home to birds that either cannot fly at all or cannot fly very well because their

wings are underdeveloped. From an evolutionary perspective, this is because the specimens that had strong wings tried to fly away from the island they lived on and often died in the process. The specimens with weaker wings did not attempt to leave their island but were well suited to their environment and thus able to survive. They were 'in control', although stuck in their own biotope.

There are lots of other examples that offer food for thought. The study into a herd of African buffalos, for example. **Herd is basically a risk-avoiding measure: physical dispersal offers better protection for the animals, while the more eyes and ears a herd has, the greater the likelihood of picking up on danger signals.** Nevertheless, it was observed that there were a number of males who chose to remain outside the herd. Research showed that these were males who were not strong enough to beat the other males in the herd in the intense competition to fertilise the females, and so decided to try their luck outside the herd. This also has advantages with regard to food, in that the grassland is better outside the herd. But it is clear that a solitary existence like this goes hand-in-hand with a higher risk profile. In this example, we see that the male buffalos are able to implement a flexible strategy, which is typically something that intelligent beings do.

Risk thinking can also be seen in how animals choose partners. In many species, it is the female who chooses her partner. There have been lots of experiments that have demonstrated that females often prefer a male partner

who has already been chosen by another female. The female is actually reducing her risks in doing this, because she is choosing a male that is very likely able to fertilise her. I do not have scientific proof of this, but from personal experience I would suggest that this is also a factor for humans: a man who walks around with a bicycle fitted with a child seat can flirt more easily than a man without a child seat, as the seat is a symbol of his fertility.

As a neo-Darwinist, I believe that evolution is a blind, passive process in which chance plays the major role. What I am worried about is human activity interfering with chance in the evolution process. Take for example the high volume of trade between China and the US. This is watched with interest by biologists because it concerns regions with similar living environments. Hardly any checks are being made as to whether species are being transferred from one continent to another in the context of this trade. There is the potential for an evasive species to turn an entire ecosystem upside down, as happened in the 1950s when Nile perch were introduced into Lake Victoria. A few decades later, all other fish species previously present in the lake had all but disappeared. I think we should try and stop species 'leaping over' as much as possible by introducing checks on transport. I am also in favour of better risk management in China."



# In control in nature

**Tijs Goldschmidt: "We can identify risk management strategies among a herd of African buffalos"**

# 05 Why the perfect world does not exist

## Why does the perfect world not exist?

- Legislation leads to suboptimisation
- Fear leads to excessive control
- Rules dominate principles
- Accountability has been devalued
- The concept of being 'in control' is not approached from a top-down perspective
- Legal 'in control' requirements are not sufficiently integrated into management processes
- People do not take enough personal responsibility

There are a variety of factors that explain why the perfect world does not exist so far as being 'in control' is concerned. The main problem areas are as follows:

#### Legislation leads to suboptimisation

"Rules are made for fools." If you were to carry out an opinion poll to find out whether the public wanted more rules, you would discover that the vast majority of people are not at all in favour of this. This is because there are already too many rules,

and people are suffocating because of them. But if you were to conduct such a survey in response to some kind of social incident, which could be anything from a collapsed bridge to the discovery of a minister who does not observe public tender procedures, you would be likely to find a lot of support. This is because of a social reflex which is ingrained into both ordinary citizens and politicians and which results in a vicious circle of a mania for organisation followed by criticism of excessive rules.

The development of the Sarbanes-Oxley Act (SOX) is a classic case in this context. This law was created in a record six weeks in response to the crisis of confidence that arose as a result of the Enron scandal. Since 2002, SOX has had major consequences for companies listed on US stock markets. The main aim of the law is that directors take express responsibility for financial reporting within their organisation.

#### Are Dutch companies really top of the class?

As far as SOX is concerned, it is not surprising that not one Dutch company with SOX obligations has reported so-called 'material weaknesses' to the SEC. Statistically, and if one considers the number of material weakness disclosures by US companies, it is unlikely that this reflects reality. It is more likely that the companies meet

all the requirements on paper and are afraid of disclosing any weaknesses because of potential reactions from the stock market and in the media. If this is the case, then this law is clearly failing in its objective of creating openness and trust. Of course, there is always the chance that the Dutch companies concerned are more 'in control' than their US counterparts.

Two sections are well-known in this context: Section 302, which obliges directors to carry out regular assessments of internal controls with regard to financial reporting, and to inform controllers and the public of any deficiencies; and Section 404, which is also notorious in the Netherlands, and which requires a similar sort of declaration to be checked by the company's auditor every year. This section also applies to foreign companies listed on US stock markets.

by the fact that people were not formally in control, but by behaviour at the top of the company that led to wrong incentives.

Such suboptimisation as the result of legislation is of course unavoidable, as the consequence of a stubborn reflex to create security through rules and legislation. One law leads to another. According to an article in The Conference Board Review, there were talks about extending SOX to include

Another thing to consider is that extensive rules and legislation can give the public the impression that a company has every possible risk under control and that supervisory board members can control everything, which is not necessarily the case. Business activity usually involves a certain amount of chaos, and there will therefore always be risks that you cannot foresee, but when people do fail to predict unforeseeable events, they are often criticised for this after the event. One effect of the blame culture is that directors are providing increasingly less information about profit forecasts because they can 'already feel the gun against their head' if they do not hit their targets. This feeds a tendency to be creative with the figures for which one is responsible.

## At the time when the first cars were built, no-one had thought about traffic rules

SOX is a classic example of legislation that leads to suboptimisation for two reasons:

- First of all, the requirements of SOX are very stringent, and nearly everyone agrees they lead to excessive control. Shortly after the law was first introduced in the United States, the University of Illinois carried out research into how much effort its introduction had required. The figures showed that in the first year, companies and auditors spent 132 million hours on Section 404. The total cost was \$10bn.
- Secondly, and more significantly, the law does not appear to have dealt with the problem. After all, the situation at Enron was not caused

the obligation to develop scenarios for disasters and crises. Fortunately this did not get any further than the consultation stage, as this is clearly a matter for individual organisations.

It is true that legislation almost by definition can never be up to date. This is not the fault of the legislators, as it is an unavoidable pattern that can be observed in all big social developments. Put simply: at the time when the first cars were built, no-one had thought about traffic rules. And when the first traffic rules were introduced, they were already out of date because the volume of traffic had increased in the meantime.

### Fear leads to overcontrol

According to many entrepreneurs and top managers, there is a sense of excessive control in this current climate of compliance. Some even use the term 'puppet show'. It is too easy to attribute the 'puppet show' that surrounds the idea of being 'in control' to overreaction on the part of legislators. Because the puppet show is also a result of the way in which rules and legislation are handled in the broader context.

Take for example – in no particular order – IFRS, SOX, the Dutch corporate governance code, new rules of conduct and professional guidelines for

## “The things we most fear in an organisation – fluctuation, disruption and imbalance – are the main source of creativity.”

auditors, Basel II, the Dutch Financial Supervision Act, new international auditing guidelines, and all kinds of industry-specific developments such as the requirements of the Food and Consumer Product Safety Authority. It is clear that the fear factor plays an important role in this legislation. Many auditors, executive directors and supervisory board members are driven by this and do everything in their power to avoid being accused of not having complied with rules and legislation: after all, this could result in negative publicity. If they can be proven to have observed the regulations scrupulously, they cannot be accused of anything, even if things go completely wrong. However, closely following regulations requires a lot of time and energy which, from a strategic point of view, could be better spent on other matters.

This approach leads to a situation where projects that are concerned with being ‘in control’ can evolve into an enormous burden for the whole organisation. Managers of compliance departments can be made to feel responsible for ensuring that the company is ‘in control’. Their departments can often grow out of all proportion because of the enormous importance that directors attach to complying with the law in a verifiable way. A compliance manager who wants more people has only to strike the right chord with the management board, i.e. play on the fear of breaking a rule, and he will be successful.

Fear is after all a poor counsellor for managers. Or, as Het Financieele Dagblad described the modern business paradox in July 2007: “While companies have to become increasingly creative and innovative if they are to survive in this world of faster and greater competition, controls on companies and their employees have grown because of the demands made by shareholders and controllers. Creativity can only thrive in a free, perhaps chaotic environment where people allow things to happen: however, apart from a few exceptions, most companies have not been doing that for a long time. As the American management consultant Margaret Wheatley says: ‘The things we most fear in an organisation – fluctuation, disruption and imbalance – are the main source of creativity.’”

The fear is fed by the speed and omnipresence of the media. With the advent of information technology, the world has been transformed into a global village. No sooner has something happened in one part of the village than the rest of the village knows about it within five minutes. The speed and omnipresence of the media ensure all major events happen on a global scale. The increased power and impact of the media also contribute to the blame culture. Professor of Public Administration Jouke de Vries likened the situation to one where “SBS firecrackers can come from nowhere and go off in a

minister’s face.” Not only can these firecrackers go off in ministers’ faces, they can also go off in the faces of executive directors and supervisory board members if there is or appears to be a problem. And in the discussions that follow, there is never much room for nuance. Emotion and polarisation run rampant. For directors, it is a reality that they have to learn to live with.

### Rules dominate principles

In this climate, hardly anyone is going to ask themselves whether a literal interpretation of the law is the right way to proceed. If the focus was on the principles of the laws, there would probably be a lot less pressure than is currently the case, where legislation – fed by fear – is followed to the letter. This would require an organisational culture where principles are used to steer actions.

There are actually often possibilities to comply with the spirit rather than the letter of the law. Not for nothing is the guiding principle of the Dutch corporate governance code ‘comply or explain’. Organisations are explicitly given the room to deviate from specifications in the code. However, this requires courage. Fear prevents people from standing up and saying: “We are doing it differently because we believe in it and we would be more than happy to explain our reasons to you.” Even SOX, which is seen by many as the classic example of an

obsession with organisation, offers room for manoeuvre: in the first year, enormous control frameworks were set up to implement the control measures; now, however, new guidelines seem to suggest that people should feel free to use their own judgement a bit more when considering a specific situation. When the law was first introduced, no-one in the business world had the courage to do this because of fear of the SEC.

difficult to persuade specialised officials and/or departments that the system of measures is excessive in some places and that it would be better if it were less so. After all, this would remove some of their *raison d'être*.

#### **Accountability has been devalued**

The financial statements are bursting at the seams in terms of size and complexity, among other things as a result of reporting requirements

The obligation to produce financial statements in this form has turned the process into a drill carried out in a negative atmosphere, as if the finished document were not a valuable piece of information, something of which an organisation could be proud. The question then also arises as to whether the financial statements are not overshooting the mark. In this context, it is worth pointing out that a number of companies also produce an abridged, popular version of the financial statements, in addition to the formal version. This shows there is a growing gap between the practical value and the legal status of such documents.

## We talk each other into seeing these laws as a nuisance

In short, we talk each other into seeing these laws as a nuisance. The stringent requirements aimed at ensuring companies are 'in control' are partially the result of our anxious interpretation of the rules and legislation, thus we are largely responsible for the situation ourselves. This can also be seen in the way financial departments can grow and grow within many organisations without anyone asking the fundamental question of whether the business and the top manager really need them. The fact that the problem keeps changing is also significant. Experience has shown that a number of companies would be happy to get rid of the control measures system, and struggle to do that internally. It can sometimes be

and the obligation to provide risk information. Here, too, the aim is valid, namely to give more insight. The reality, however, is that few people have the time to go through a 300-page document, and even fewer are able to interpret the basic assumptions of IFRS or to understand dozens of pages explaining about risk. The requirement for comprehensive information appears to be completely counterproductive for two reasons: firstly, because completeness is not desirable since, understandably, companies do not want to share sensitive information with their competitors; and secondly, because larger organisations are not able to manage an excess of information.

There is another undesirable side effect, in that the people responsible for producing the financial statements often request interpretations of IFRS reporting standards from the relevant authorities to make sure they are meeting the requirements of controllers. They dare not therefore apply their own interpretation on the basis of the principles in the rules. The paradox is that if there are a large number of interpretations, reports end up being determined by rules and not principles. And that is precisely what the report producers do not want, and is also not the intention of IFRS. Each side has the other in a stranglehold, as it were.

# Creativity thrives in chaos Creativity thrives in chaos

## **Creativity thrives in chaos**

Control freaks can stifle a lot of creativity before it leads to results. A certain amount of chaos stimulates the creative process. The perception is often that chaos equals bad management; however, this is not necessarily the case. Take for example the development of Linux software: this operating system is developed and maintained by a large group of unpaid volunteers, without a central controlling mechanism. This appears to work exceedingly well, with a large group of individuals apparently able to achieve objectives together despite relative chaos and a lack of structure. This way of working – the open source concept – is also slowly becoming popular in other sectors. A well-known example is Wikipedia, the free online encyclopaedia which is maintained by tens of thousands of volunteers. Anyone can write an article for this encyclopaedia, or modify an article written by another volunteer. In such an anarchistic

cooperating structure, the volunteers seem to keep a sharp eye on each other's work, resulting in good quality control.

The younger generation is one of the factors that makes this concept possible. They tend to think in terms of networks rather than in a linear way. Examples of this can be seen everywhere in society. Alongside Wikipedia and open source software, another good example is the way in which the US space agency NASA allows students to participate in some of its projects. The thread that runs through all these examples is that fixed structures and hierarchical relationships are not necessary to obtain collective knowledge from a disorganised group of people which can then be used to produce a high-quality result. The ability of such networks to organise and regulate themselves appears to be very strong, provided modern technology offers the right support.

Marcel Smits is CFO at KPN. He does not believe that laws and rules curb the desire to do business and take risks. There are still plenty of opportunities to develop and implement new plans in a hard world where legislators, regulators and other stakeholders are on your tail.

"Any discussion about being 'in control' will soon move onto the Sarbanes-Oxley Act (SOX). This law gives our financial processes a quality impetus. I welcome this because I think we should strive to ensure that financial obligations are met at the highest possible level. I often draw an analogy with bank statements: if you are an account holder, you expect the figures on your statement to add up to 100%. I cannot think why people would not have a similar approach to company financial information. So I am not going to complain about the SOX requirements, although I admit that the law does break down here and there, for example with regard to the documentation of control measures.

I mainly believe SOX could be very beneficial. I believe it delivers a lot. First of all, quality of information. The best proof of this is that in the first year after it was introduced we found three mistakes in our figures totalling EUR 23 million. Secondly, I am convinced that we can bring the cost of financial obligations down, precisely because SOX forces you to organise things as simply as possible. Uniformity is the key concept here.

In my opinion, it is also of vital importance that we start to put our administrative people on a pedestal again. We have told them that things must become much more efficient

over the coming years, and that there will doubtless be less work. The good news is that they will henceforth 'be allowed to have an opinion'. What do I mean by that? Basically, that we are giving our financial people the space and authority to resist the desires of the business. Because if we continue to examine all the specific requests from the various units, we will create more complexity in no time at all. Then there will be another complicated administration factory, and this is what we want to get away from.

What is more, I think you should try and make it enjoyable for the people who work in this area. A CFO who is constantly criticising SOX in the media cannot expect to get any enthusiastic professionals for the project and probably *will* have trouble with it. I am trying to turn things around, and it seems to be working. As we unfolded our plans for the acquisition of Getronics, quite a few people put up their hand to say they wanted to help with the implementation of SOX there.

From a managerial perspective, the concept of being 'in control' has taken on a completely different dimension over the past ten years. Banks, supervisory board members, shareholders, controllers and other stakeholders now follow management teams closely as they make plans and take decisions, whereas ten years

ago supervisory board members would have been more interested in if there was any coffee left. However, even as far as this development is concerned, I do not think that directors should complain that pressure from stakeholders combined with the stringent requirements of law and regulations curb the desire to do business. This may sometimes be true, but complaining about it is highly impractical. It is not going to change, so you just have to live with it.

It is true that business is now a tougher, Darwinian world. The pressure on directors to deliver, to take the right decisions, is greater. However, maybe this too is a good thing. Not for nothing has the Forbes list of the biggest companies comprised mainly US companies for decades. Of course, the tough Darwinian culture has been around in business for much longer. In my opinion, directors need to have different skills today than they did ten years ago: they need to be able to convince stakeholders and give them the right impression so as to ensure that they support the management's ideas and plans. It is therefore essential to spend a lot of time communicating in order to win their trust. Only then can directors begin to steer a different course."

A middle-aged man with short, light brown hair is smiling warmly at the camera. He is wearing a dark grey pinstriped suit jacket over a white dress shirt and a blue tie with a pattern of small red and white dots. He is standing outdoors in front of a modern, multi-story building with large windows and a curved facade. The lighting is bright, suggesting a sunny day.

# In control in international business

**Marcel Smits: "Complaining about excessive controls may be justified but it is highly impractical"**

### **The concept of being 'in control' is not approached from a top-down perspective**

As described earlier in this paper, this concept exists in relation to a variety of different situations. It is clear that auditors and compliance professionals are particularly keen to nail down processes by means of control measures. Sometimes an almost military programme of measures can be rolled out across an entire organisation on the basis of legislation.

Directors tend to have a bird's eye view, and often react to completely different signals than those about how formal internal controls work. These situations are thus remote from each other.

It is precisely because of this that the concept is scarcely as familiar to directors as some other topics. And because of this, the 'in control' specialists have a free hand, with directors not knowing exactly what they are doing. They will of course know the costs, but not necessarily the benefits of being 'in control'; and there should be plenty of benefits, because being 'in control' – as described earlier – is a completely normal part of being in business, but nobody really knows whether it is worth the millions or not.

This is not the case for other subjects. Take for example security at chemicals companies: this is a key issue for directors. Mistakes are not acceptable, and a top-down approach is used to

develop a framework of measures to ensure maximum security. The fact that such a framework is expensive is scarcely relevant. Such companies do not use rules and legislation but their own policies as the point of departure. Or take the subject of ISO certification, which was a hot topic around ten years ago. Here too, the creation of a quality programme was not based around rules and legislation but rather around individual company strategies, in response to the demand from the market for certification. Finally, take the subject of information security: here too there is a regulatory framework in the form of the Information Security Standard. However, an organisation that wants an optimal policy with regard to information security has to begin by adapting the standard to fit its own specific situation. The standard is not a straitjacket, but rather a building block for good risk management.

What these examples have in common is that they show companies using their own strategy 'from above' as a point of departure, rather than legal requirements 'from below'.

### **Legal 'in control' requirements are not sufficiently integrated into management processes**

Organisations often implement the legal requirements concerning being 'in control' by creating an 'extra layer' above the existing management processes. This means that reports, ranging from management reports about the performance of internal controls to, for example, alerts about

old claims against debtors, can assume a life of their own at this point, their only objective being to see to it that rules and legislation are observed. This is an undesirable situation.

The aim of 'in control' measures, among other things, is to guarantee the quality of the information provided. However, many companies are not able to actually use the information to steer their organisation. The end result is that the information is only used as accountability information and not to provide direction. In practice, directors and managers often make important decisions on the basis of information gathered on an ad hoc basis from a variety of sources, the quality and reliability of which can be dubious. The challenge is to use the quality check required by laws and rules with regard to the reliability of financial and other information to one's own advantage by actually including this information in the governance cycle. Incidentally, this is also the point of departure of the COSO framework, which states that "control should be built in rather than built on." This requires controls to be 'built in' in an efficient and clever way. Experience has shown that this may not be simple but it is possible. More importantly, experience has also shown that managers then become enthusiastic about being 'in control', because they can see its added value.

### **People do not take enough personal responsibility**

Almost no-one can deny that society increasingly resorts to legal measures

# However, the side effect of increased legal action is that people are less inclined to take responsibility themselves

and that there are more tiered controls all the time.

The result is a blame culture, sometimes also referred to as an alibi culture, where everyone is always on the lookout for people or authorities that can be blamed in the event that, Heaven forbid, something should go wrong. The answer to the question as to whether a certain way of behaving is ethical is increasingly sought in rules and legislation: "If it's legal, it's ethical." Reasonableness and fairness then fade into the background.

The development is society-wide, varying from the explicit obligation that financial service providers have with regard to consumers to the regulations that children's daycare centres have to comply with in order to guarantee the

safety of toddlers. One good example is recent research showing that the average hospital can expect no fewer than forty different visiting inspections to confirm whether or not it is working as prescribed.

In most cases, the aim of rules, inspections and supervision is completely legitimate: to increase the quality of a product or service or to reduce the number of incidents. However, the side effect of increased legal action is that people are becoming less inclined to take responsibility for things. The main reflex after an incident is often to look for guilty parties against whom one may be able to make a successful claim, whether the incident is insufficient investment revenue or an injury to a child.

For example, nowadays there are more and more weather alerts, with urgent advice not to set off on journeys. There is also a UV alert that warns against the dangers of the sun on particularly hot days. Not so long ago it was one's own responsibility if one wanted to expose oneself to the harmful effects of the sun. Nowadays, the government obviously thinks it needs to protect people from such potential harm. The most recent example in this context was the warning from the government to drivers not to pull up on the hard shoulder during the annual Dutch remembrance day on 4 May. Ten years ago, drivers could decide this for themselves.

Frank Heemskerk is State Secretary for Economic Affairs and as such is responsible, among other things, for the matter of regulatory pressure.

“One of the aims of this cabinet is to strengthen trust in society. We want to express rules and legislation through guidelines and principles, and to allow trust to play a major role in how these are worked out.

This is easier said than done, and must begin in any case with a consistent dissemination of the message. Initiating mutual trust also requires nerve: we have to dare to be honest in what we are doing. And we need to be prepared for things to go wrong from time to time. **If things go wrong despite good intentions and starting points, we have to accept that.**

This also requires well-considered reactions to incidents. Take for example the fuss that was made around the import of dangerous toys and poisonous mattresses from China. What is necessary in such a situation is to separate the facts from fantasy and to take action on this basis. This may mean that as a member of the government you need to resist calls for more controls: in such cases you need to stand your ground. However, there may also be circumstances where it is necessary for you to take direct action and that require additional supervision or controls. It rather depends on the circumstances. In the case of the Chinese imports, I have stressed publicly that companies themselves have a large interest in making and

importing safe products. It is also in China’s interest to do this. In other words, the Dutch government needs to be alert, but it should also be able to rely on companies themselves making changes.

During a trade mission to China, I managed to gain some insight into how the Oriental culture works. I learnt two important lessons there: firstly, that the informal communication style employed in the government organisation system worked very well, with everyone being very well informed; secondly, that China is very good at maintaining a long-term view. People are not ruled by short-term cycles such as a four-year cabinet term or the pressure of the quarterly figures on financial markets. This gives room to work consistently on a strategy without being distracted by short-term developments.”

Of course, for the government to be ‘in control’ we too must make preparations for possible scenarios, which we most certainly do: for example, the cabinet was recently engaged in a large-scale exercise to prepare for a scenario where a number of major IT facilities break down. Such exercises are invaluable, and raise important facts and dilemmas for discussion.

Risk taking is part of enterprise after all, profit is a reward for taking risks. Rules

and legislation should not be allowed to disrupt this mechanism because this puts pressure on entrepreneurship. Lots of entrepreneurs want fewer laws and regulations, and in recent years discussions on reducing the administrative burden have taken place in a somewhat negative atmosphere. This cabinet is also committed to reducing the administrative burden, and we are still focused on achieving a reduction of 25%, this time compared with the situation as at 1 January 2007.

However, I think the focus should be on quality rather than quantity. **After all, it is not that entrepreneurs are against rules and laws, far from it, they just want them to be clear and relevant. I want to put an end to the complaining atmosphere – not all rules are bad, you see – and to begin to talk about how things could be better.** I have noticed in discussions between councillors that this seems to work: sometimes it is almost as if they are trying to outdo each other in terms of the success they are having in their local area, and this in turn provides further inspiration. In the meantime, we have set up two committees to look at the quality of legislation in the transport and construction sectors. Being ‘in control’ can sometimes also mean daring to let go.”

A portrait of Frank Heemskerk, a man with dark, wavy hair, wearing a grey suit jacket, a white striped shirt, and a red tie. He is looking directly at the camera with a neutral expression. The background is a blurred, light-colored wall with architectural details.

# In control in the political arena

**Frank Heemskerk: "We need to focus on the quality rather than the quantity of rules"**

# 06 And now?

As an organisation that provides auditing and management consultancy services, we are trained to analyse problems and then offer our clients solutions. However, we do not believe there is a ready-made answer to the undesirable reflexes displayed by those concerned with regard to the subject of being 'in control'. Such a ready-made answer would namely fail to take into account the fact that any actions taken will depend on the situation and that problems can have several dimensions that are all closely linked.

However, we are obviously not writing this manifesto just to describe a situation and then leave it at that, in the hope that someone else will solve the problem. We want to make an appeal to all parties concerned. It is our hope that this appeal will help people to get the idea of being 'in control' back into perspective in actual practice.

Furthermore, we believe that the following points should be taken into consideration in any discussion of the topic.

### **Uncertainty and complexity require leadership**

The world is becoming ever more complex. This can be seen in the nature of financial markets and products, in the rapid changes that occur in organisations, in modern technology and also in legislation. Take for example the problem of climate change: the increased interest in this has stimulated innovation in a variety of economic sectors, but a lot of creativity and daring is still required if these innovations are to have an effect on daily life. There is not much certainty in our complex world, and this in itself makes good leadership necessary. A good leader is able to reason and draw conclusions from his own strength, including where being 'in control' is concerned. Together with fellow managers, he is able to determine what he sees as important

strategic and operational risks, and how he thinks they should be dealt with within his organisation. In practice, however, when people are trying to be 'in control', they tend to use statutory regulations as a starting point, which leads to the implementation, possibly in a blind panic, of a framework of measures which do not achieve the desired objectives and which do not take the organisation's risk profile sufficiently into account.

We believe that things can be different, and that leaders can establish standards for being 'in control' on the basis of their strategic objectives. Leaders should establish a satisfactory level of information provision and then ensure that the framework of measures provides them with information which the management can use to steer the organisation. Step two would be deciding on how this framework fits in with the relevant legislation. This does not mean that leaders must break the law. What matters is placing importance on or restoring importance to the ability to think for oneself. A leader who does this will be highly esteemed by the stakeholders in his organisation. Furthermore, there is one essential condition: any leader who approaches the topic of being 'in control' based on his own choices must answer for these choices and their consequences with complete

transparency. Only then will he gain the trust of stakeholders.

### **Soft factors need to be given a prominent place**

Discussions about being 'in control' usually focus on 'hard' control measures. The current COSO framework, for example – which is used a lot as a guideline by people trying to ensure they are 'in control' in their organisation – attaches limited importance to informal behavioural controls, such as are scientifically recognised in social organisation. The influence of the environment on the internal management of an organisation (contingency factors) is also not discussed enough.

Experience has shown time and time again that hard controls are fairly meaningless unless they are implemented in the context of the right organisational culture. Regulations are after all no more than toothless paper tigers if most of the employees in an organisation do not take them seriously. There is therefore a need for a culture in which people attach a lot of importance to achieving goals, both collectively and individually. A culture in which both the management and the employees have the right approach with regard to aspects of internal management. A culture where integrity is paramount. The integrity climate comprises the perceptions

and opinions that management and employees have about the way in which the organisation is organised and how the organisation guides and influences their behaviour. The integrity climate is also about how people within an organisation experience how they are encouraged to behave in an honest way and how they are discouraged from fraudulent and corrupt behaviour.

The integrity climate determines the effectiveness of the control measures system to a large extent. If employees have the impression that fraudulent practices are not punished and are even rewarded within their organisation, they may take advantage of this.

Many people recognise this. There is also the need to move from a state of compliance, i.e. with rules and legislation, to a corporate culture where being 'in control' is an established part of employees' culture and values. However, few organisations are able to actually implement this change in practice. The problem is often that they are inclined to use these 'soft' factors in an instrumental way, in an attempt to show that they are 'in control'. This can lead, among other things, to the creation of codes of conduct that have not been developed specifically for the

company, or that are just paper tigers that don't seem to have any practical use.

### **Breaking the fear culture requires courage**

We are convinced that the fear culture that is becoming more and more dominant is not tenable in the long term; however, breaking free of it will require a lot of courage.

One of the ways in which the current spiral can be broken is if people begin to have faith in other people taking responsibility. Traffic experiments have shown that when there are no rules and regulations, people are more inclined to follow their own instincts. If traffic signs are removed at roundabouts, this can actually lead to improved safety, as people are forced to take responsibility for themselves. Too many regulations, on the other hand, suffocate people's natural instincts. The 'art of omission' can also be useful when it comes to being 'in control'. A good example in this context is the comment made by Arthur Docters van Leeuwen, the outgoing chairman of the AFM (Netherlands Authority for the Financial Markets), and published in *De Telegraaf*, in which he called on people to take more responsibility themselves and not

deposit everything with the AFM: "If people want to invest their money in unusual tree species, or even ostrich eggs for all I care, they are welcome to do that, but I would prefer it if they left us out of it. Otherwise all they are doing is giving themselves a false sense of security."

The trust factor therefore plays a crucial role. There is a well-known mantra that goes: "Trust is good, control is better". In his book about corporate governance, Professor Kees Cools turned this around to say: "Control is good, trust is better". It is an intriguing idea, the truth of which stands or falls with the above-mentioned soft factors. The trust factor seems to be catching on more and more in management literature, as a counterbalance to the current obsession with organisation as described. In his book 'The Speed of Trust', Stephen M.R. Covey argues that organisations can achieve unprecedented levels of productivity and satisfaction if they have trust as their foundation. A quotation from him: "I would rather trust people and be disappointed every now and then than distrust people and feel miserable all the time."

# Can people be trusted?

## Can people be trusted?

This paper is about encouraging people to start taking responsibility again and about reviving trust. But can people be trusted? Such a question can lead to all sorts of philosophical observations which we will spare you here, but we will share an amusing experiment from the management book *Freakonomics*:

Paul Feldman, an American company employee, decided to take a bag of bagels with him to the office every morning. His colleagues were allowed to tuck into them but were expected to put one dollar in a pot per bagel taken. There was no-one checking whether people actually paid.

Feldman, “the bagel man”, decided to start a company based on this model. At one point, he was providing hundreds of companies with a box of fresh bagels every morning. Employees at the

companies were allowed to take the bagels, and were expected to put a dollar in the box on the basis of their own moral obligation. Again, there was no-one monitoring payments, so it was impossible to know who paid and who did not. Feldman kept rigorous data on his business, which showed that an average of 87% of people paid of their own accord. What was striking about the statistics was that the more ‘high-ranking’ the department where the bagels were, the lower the percentage of paying bagel eaters; in small offices, the payment total was between 3% and 5% better. Also, the payment total dropped by about 3% on days when the weather was unexpectedly bad.

Of course, it is not about the figures. It is about the way in which the climate, or the ‘organisational culture’, influences the behaviour of the bagel eaters. Trust works.

# Trust takes courage

Of course it is nice to write about trust, but building trust in practice requires a lot of courage.

An interesting case in this context is the development of horizontal supervision at the Dutch Tax and Customs Administration, which is discussed in one of the interviews in this manifesto.

The concept of horizontal supervision is the result of mutual trust between taxpayers and the tax authority, of each party notifying the other of responsibilities and possibilities related to uphold the law, and of the creation and observation of mutual agreements. This puts the government and the public on a more equal footing as regards their underlying relationships and the communication between them.

Jenny Thunnissen, the Director General of the Tax and Customs Administration, described the horizontal supervision concept as follows in the KPMG magazine ZOUT last year: "If you ask people around the world, they think we are being rather naïve, because taxpayers are crooks after all. We, on the other hand, are convinced that it works. We have had enforcement agreements with a number of large companies for some time, and now other companies are also beginning to express an interest in this. This way of working gives them legal security while saving us time. We are moving towards a similar set-up for the general public. It fits in with the development towards giving the public greater personal responsibility. In this sense, we are doing our bit to help build trust in our society."

## **Finally: every link in the chain needs to take responsibility**

After the accounting scandal surrounding Enron at the beginning of this century, the American senator Joe Lieberman looked into the causes of this debacle. One of his main conclusions was that several "links in the chain" had not fulfilled their roles properly, and that directors, auditors, supervisory board members and investors should all take some of the blame. It is possible to draw an analogy with this: in order to get the idea of being 'in control' back into perspective, there also needs to be a breakthrough at the level of several of the links in the chain.

## In summary:

**Regulators** need to monitor companies and auditors according to the spirit rather than the letter of the law. They need to keep the aim of the legislation at the forefront of their minds and be prepared to enter into a dialogue with any organisation that may not be formally complying with the requirements but that is trying to respect the law in a substantive way. This does not mean we are asking regulators to tolerate situations, rather we are referring to the actual common sense application of laws and regulations. If laws and regulations leave room for interpretation, regulators should pass this room on to executive directors, supervisory board members and auditors.

**Executive directors and supervisory board members** need to provide good leadership, show that they are working on their own strength, and allow entrepreneurship to prevail. In order to be 'in control', they need to develop a system of rules that is based not on legislation but on their own strategy and the development phase of the organisation. They need to be accountable for this, so that they are able to win the trust of their stakeholders. They should not be frightened by rules and legislation, because not only is fear a bad counsellor, it is also harmful to creativity.

**Auditors** are also not getting off lightly in this manifesto. It is our opinion that we are also to blame, and we believe that our profession needs to show more nerve by putting the principles of rules and legislation first, and by forming opinions on these rules and legislation where possible. Laws and regulations – for example IFRS – offer just the room for such interpretations. Moreover, auditors need to take more of a top-down approach to the subject: company directors make choices concerning the risks that are taken, and these choices should provide guidance as to the measures that need to be taken in order to manage the risks, including on behalf of the auditor. Auditors also need to show more 'thought leadership' in the area of external reports. They need to use their expertise and influence to increase the information value of the financial statements.

Of course it is nice to write about trust, but building trust requires a lot of courage.

**Politicians** need to resist public calls for new measures that can sometimes follow an incident, unless there is a need for such measures. They need to have a clear policy and stick to it when the media dives into a subject. This could break the cycle of increased legal action, but it requires firm and above all consistent leadership.

A man in a white martial arts gi and dark blue hakama is standing in a forest, holding a sword high above his head with both hands. He is looking off to the side with a focused expression. The background consists of many bare trees, suggesting a late autumn or winter setting. The lighting is natural, coming from the side, creating some shadows on his gi.

# In control according to the principles of martial arts

**Brent Hire: "It is better to act according to principles than rules"**

Sensei Brent Hire is European Chief Instructor at the International Shinkendo Federation. We asked him about parallels between being 'in control' in organisations and martial arts philosophies.

"You learn rules in order to eventually free yourself from them." This is one of the paradoxes from the world of the samurai, the Japanese warriors from the 19th century. This paradox teaches that by internalising a system of rules, it is possible to focus on the higher aims behind the rules rather than on the rules themselves. This means that strict rules can sometimes be pushed aside to make way for a higher goal. A classic story in this context is that of the 47 followers of the lord of Ako.

Ako had to appear in the palace of the shogun, the Japanese ruler, at an appointed time. Because he had not brought a gift with which to bribe the corrupt, greedy and unethical palace official, the latter taunted and challenged him unremittingly. This torment eventually led Ako to draw his sword, but because drawing one's sword in the presence of the shogun was a crime according to the law, Ako committed hara-kiri. Even though, he had only drawn his sword, and had not attempted to wound or kill anyone.

A group of 47 of Ako's followers swore to get revenge on the palace official and were finally able to behead him in a courageous, cunning act. This revenge was against the law, but they were acting in the spirit of the bushido code. When they handed themselves over voluntarily after the killing, the people received them as heroes and even the shogun was amazed

at their courage and perseverance. Nevertheless, the ruler was obliged by law to condemn them to death: they were given the opportunity to commit ritual suicide, in order to save their honour.

The bushido is a very rigid code that requires loyalty, trust, service, integrity and honour unto death. The code is very strict but is not made up of extensive, detailed specifications. It contains a high level of personal responsibility: you are not punished for your acts, but impose obligations on yourself. Both Ako and his followers broke the law, but acted according to the higher aim contained in the code.

**Their behaviour was ethical even though they had broken the rules: after all, ethics go further than rules (which are sometimes not sufficient), and are integrated into codes that pursue higher goals.**

Acting according to inner principles is usually much more difficult than following rules. Following rules is in many cases not so hard because there are clear instructions and it is simple to determine whether you follow these instructions or not. This is harder with regard to principles: here there is a lot more room for interpretation and discussion, especially when it comes to concrete application.

**As far as the subject of principles and control is concerned, the classic**

**Zen paradox that you will be more successful in achieving your goal if you do not try to achieve it is key.**

This paradox is directly linked to the paradox that began this article. Its basic principle is that you should try to free yourself from all fears and feelings that could distract you from what you should in essence be doing. If you need to do something really difficult, you should not direct your energy towards what could go wrong. You should not for example be afraid of losing your reputation: instead, you should reason and draw conclusions in your own strength and using your own skills, and make this a flexible and automatic reflex. Then you will not spend so much time thinking about achieving a goal per se, but that which you are doing will become automatic and will go well without you having to think about it.

Freeing yourself from your objectives also means freeing yourself from your ego. The paradox therefore lies in the fact that, by not serving your own interests, you are nevertheless serving your own interests, albeit in an indirect way. Translated into a business environment, this means you should do what is ethically right even if it seems to go against your own objectives. By focusing entirely on the needs of others – clients, shareholders, society and the environment – you will ultimately achieve your own ends through their success.

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“What I find striking is that when new rules are made people hardly ever ask whether we need them. New rules are often the result of mistrust, the fear of being called to account for something, and the need to be able to justify oneself. If the current trend continues, the whole world will soon come creaking to a standstill, as it were, because of the excess of rules. In my opinion, the basis for curbing the urge to regulate lies in raising awareness of the need to observe shared values. Only this can create the necessary trust. And the way to bring about these shared values is through upbringing and education.”

Prof. dr. Philip Wallage RA joined KPMG in 1990. He became a partner in the Department of Professional Practice in 1996. He is also affiliated to the University of Amsterdam as Professor of Auditing, in which capacity he publishes regularly in specialist magazines and scientific journals. He also has a number of executive positions both within and outside the accountancy profession: he is a member of the Commissie Eindtermen Auditorsopleidingen (Netherlands authority for the approval of foreign statutory auditors), a member of the supervisory board at AMS BV, and a member of the management board at the Netherlands Institute for Corporate Governance.

“More rules produce better behaviour? This is only partially true, based on the fact that the link between rules and good behaviour is not linear but curved. There is a point where rules cease to be effective and can even become counterproductive. I believe that we as a society have passed that point in some areas and now find ourselves in a negative spiral. If we want a society in which it is more pleasant to live and do business, we need to invest more in our social and moral capital. This requires different codes, regulatory arrangements and forms of leadership.”

Prof. dr. Muel Kaptein has been a management consultant in the area of business ethics, integrity and compliance since 1991. He is a director at KPMG Integrity & Investigation Services, a unit which helps organisations to measure and improve their hard and soft controls, among other things. He is also affiliated to the Rotterdam School of Management, which is part of Erasmus University, as Professor of Business Administration, in which capacity he conducts scientific research into measuring the compliance level of organisations and the optimal organisation of trust, rules and culture. He contributes regularly to leading scientific international journals, and is on the board at the Erasmus Institute of Monitoring & Compliance.



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“In our complex society, where organisations are highly dependent on one another, trust is often based on strict standard frameworks. What is sometimes forgotten is that lots of people do not need a rigid, detailed standard framework in order to be able to stick to agreements. If we do not make any room for faith in human nature, this will create a tension which will stand in the way of entrepreneurship and innovation. However, I believe that things go in cycles, and I see the beginning of a social movement towards more freedom and entrepreneurship. Things seem to be changing.”

Prof. dr. Edo Roos Lindgreen RE joined KPMG in 1996 and became a partner at KPMG IT Advisory in 2000. He advises government and business on the optimal use of ICT and the management and protection of automated systems. He is a member of the KPMG IT Advisory management team and the KPMG Netherlands shareholders’ board. He is also affiliated to the University of Amsterdam, where he is Professor of IT & Auditing.

### About KPMG

KPMG is a global network of professional firms providing audit, tax and advisory services. We offer our services to a broad group of clients: major domestic and international companies, medium-sized enterprises, non-profit organisations and government institutions. The complicated problems faced by our clients require a multidisciplinary approach. Our professionals stand out in their own specialist fields, but they also work together to offer added value that enables our clients to excel in their own environment. In so doing, we draw from a rich source of knowledge and experience, gained worldwide in a wide variety of organisations and markets. We provide real answers so that our clients can take better decisions.

### Colophon

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