



Wearing SOX Inside Out

Creating a Culture of Transparency

By Roy Maurer, Senior Advisor of The Clarion Group

Face the Reality of SOX

Sarbanes-Oxley (“SOX”) has been dominant in the US business landscape for the past three years. Much is said of the unproductive cost of this compliance to American businesses (now estimated to run as high as \$15 billion annually). As is frequently the case with new regulations, figuring out how to implement it has been far from clear and has been enormously time consuming for all.

Leaving aside the difficulties and costs associated with the outward compliance with the law, it is our belief that the deeper intent of SOX is inherently good for all business endeavors. Worn correctly, SOX can be a very pragmatic source of discovery and transformation to strengthen those norms and behaviors that lead to financial success.

SOX is here to stay. A leader’s challenge is to turn this to advantage, to turn a cost into an opportunity. Turn SOX inside out. Here is one view of what that might look like.

Seize the Opportunity

The deeper intent of the Sarbanes-Oxley law is to create – or assure – transparency for investors in the market. Investors have lost faith due to misinformation or fraud. The law was created to make sure investors get truthful financial information about the health of companies.

In order to accomplish this transparency, companies will hold individual employees

to greater accountability. Procedures require that company employees, from the CEO on down, formally sign off on the accuracy of information that is material, or “of significance,” to investors. By doing this, SOX is essentially saying:

- You are accountable, so act like it
- Take responsibility not only for your own personal work but also for the work of your colleagues
- Make it your business to know whether or not the work of your company is accurate and truthful
- If something is wrong, don’t just ignore it; it is your responsibility to disagree and take action to correct it
- Be honest
- Be transparent

One impact could be that employees will be forced to think and act more like owners: responsible, accountable, and knowledgeable across the business, whether it is in their job description or not. Now, that’s not necessarily a bad thing. Imagine what companies would be like if their employees acted more like fully responsible owners in all aspects of business decisions, from strategy to research and development, to innovation, etc.

SOX is kind of like being required to sign off on your annual physical. Any health risks we should know about? But the act of having a physical does not make anyone healthy and being honest and transparent about the results does not create good

health. As we all know, good health comes from the personal choices we make around lifestyle – how we act and live each day: exercise, diet, exposure to risks, etc. SOX is more about the reporting, and less about creating health. This is where we begin to turn our SOX inside out. What leadership should really care about is *being* a healthy company.

Going Deeper: Creating the Right Climate

Our message here is simple: the attributes of honesty, transparency, and corporate responsibility required by SOX for reporting purposes are not different from the kinds of leadership and employee behaviors that build healthy and successful companies in the first place.

Breakdowns in organizational culture are where disease starts. If your employees are not being honest and forthright about discussing and reporting financial results with each other (and ultimately with outside investors) you need to know. You need to know not just because of SOX, but because the same incapacity to engage in honest and forthright debate about financial results is bound to show up around tough decisions in the rest of your business.

Strategic Thinking: Companies, like people, develop habits, or paradigms, that can be difficult to change. Group think can be insidious. Many strategic efforts lack robust thinking because employees assume that it is too risky to question pet projects. Or Strategic Planning is directed from the top or begins with assumptions that carry over from past years; the process itself makes it difficult for employees to raise questions about “what is.” It takes a strong behavioral norm of openness for individuals in the organization to challenge the status quo and avoid the pitfalls of “group think.”

Executive Leadership Development: Nowhere is it tougher to be honest and forthright than when giving your boss per-

sonal performance feedback. This is a tough problem in executive leadership development. The higher up in the organization, the less candid (and less helpful) the development feedback received from fellow employees. Nowhere does behavior need to be exemplified and modeled from the top more than here. Mean it when you say: “Give it to me straight.” A CEO who accepts, encourages, and rewards honest and constructive input, even when personally difficult to hear, does more for the organization’s culture than can be imagined.

Innovation: Everyone is hungry for innovation, but where does it come from? Much innovation is by nature discontinuous, disruptive. Unfortunately, the culture of large and successful corporations is all too often *not* fertile grounds for “difference” – different ideas, products, technologies, and ways of doing things. Companies that have learned how to be good at innovation have learned to manage structures and environments in which a creative cross-fertilization of ideas and experiments – and people – thrive. The leader’s challenge is to design a company culture in which diversity of thought and differences of opinion are seen to be part of the ongoing formula for success.

Does your company have the kind of culture that encourages constructive internal dialogue on a daily basis? Is it clear to your employees that what you want is for every employee to be rewarded for exercising responsibility and honesty in making the best business decisions possible? Is it reasonable to think that this kind of direct, objective, and honest dialogue would be the norm for decision making but then somehow mysteriously stop short of financial reporting? Not likely. These are not separate.

What You Can Do

The responsibility for creating health (and wealth) is where it should be and always has been – squarely in the hands of the

executives and employees. SOX didn't change that. SOX has forced companies to be disciplined around disclosing financial numbers. Executive leaders need to be just as disciplined in knowing their company's culture. If you agree that the capacity to be honest with each other about the hard reality of the business – despite personal power or position – creates success, then this is where the real focus should be.

At the very least, you need to know your company's real culture for protection. The general inability to engage in honest dialogue around tough business issues may be a better predictor of trouble ahead than the numbers. Such behaviors are an "early indicator" that your company could be vulnerable to the problems SOX is watching for. In most situations involving corporate fraud, there were people within the company who knew but were afraid to speak out. This is the kind of disease you need to stop before it is too late. Your company cannot afford the precipitous drop in stock valuation that comes with anything that even smells of SOX.

At the very best, you want to know in order to create a high performing and highly valued company. Developing and sustaining a company culture that fosters the open engagement of perspectives and ideas creates competitive differentiation in the marketplace. That is what investors really want – evidence of healthy and growing companies. They want to see cultures that excel at creativity, decision making, innovation and adaptability.

SOX is here to stay; use it to your deeper advantage. What to do?

1. *Comply*

Of course, comply with the financial reporting and disclosure requirements of SOX. That's a given. What we are talking about here goes well beyond compliance.

2. *Discover*

If you sit at or near the top of your company, don't assume you know what the culture is. Big mistake. Just as with personal performance feedback, getting useful data is a real problem. Too many employees down in the ranks assume it is just too risky to tell you the truth – especially if there really is a problem. But how will you know? Be as aggressive, disciplined, and precise in getting the disclosure you need around your own company's culture as you are in complying with SOX.

If you conduct culture surveys, you could find some indications in this existing data. Remember though that if there are concerns around openness, you need to go out of your way to assure safety through confidentiality and independence. Whoever oversees the discovery process must guarantee confidentiality and have the courage to deliver hard messages without fear of implied or actual reprisal. It is critical that senior management, including the Board, endorse the discovery process from the start and be able to hear the unvarnished truth at the end.

3. *Create a Culture of Success*

If it is necessary, make deep change in your company attitudes and expectations from top to bottom. Articulate, encourage, and reward the behaviors and norms that create a culture of success. If the unspoken culture of a company has created a fear in employees to speak the truth, whether about fraud or any other business decision, this is a serious concern. Whether it exists systemically or in isolated pockets, it is a problem that cannot be ignored.

SOX is all about transparency. With an enlightened leadership, this transparency becomes a conscious choice, not an imposed requirement. It includes an attitude of taking ownership and responsibility.

The organization is one in which honest consideration of differing ideas and opinions are welcomed, even expected.

An inspiring example of such leadership is demonstrated in Sam Palmisano's message to IBM shareholders in a document IBM calls a "prospectus," which by origin means "a distant view":

"Providing this kind of understanding is particularly important in business today. Indeed, it is a form of transparency and accountability – a deeper form than the usual questions about legal compliance or ethics. This is about a company's strategy, operations, culture, and values. Whether or

not you want to be associated with the IBM company, we think you should do so for the right reasons."

A culture of success exudes transparency, not just once a year, but day in and day out. Not because it is externally required by a regulator, but because it is the nature of an internally healthy company. If your company lacks this kind of health, turn your SOX inside out. Use SOX constructively as the platform for cultural change.

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