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REVIEW ARTICLE

Determinants and Consequences of "Tone at the Top"

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Abstract

This paper aims to provide insights into the meaning, relevance and current academic debate around the concept of "tone at the top". Our paper is motivated by the desire to shed light on the complexities around this term with roots in the accounting field, especially by means of a review including some of the most important theoretical and empirical papers on this topic, and other connected streams of research relevant for our investigation. Tone at the top is analysed from three different, but highly interrelated perspectives in an organizational context – internal controls, ethical values, culture and behaviour. After that, we have looked into whether academic findings find support or contradiction in real case situations, In this respect, the paper follows its lead to an analysis of three relevant case studies in which the "tone" set at the top of the company is thought to have had a great impact on the overall organization. The main conclusion emerging from the paper encompasses the idea that the concept of tone at the top may not be so important in itself -as a theoretical construct – but its great added value and importance come from the practical implications which derive from the way the top propagates within an organization the right tone. Thus, tone at the top becomes one of the most important elements that contribute to a company's long term success. When the top of the companies portrayed as negative examples in our paper failed to set the "right tone", huge scandals have occurred or even demise of the whole organization.

Keywords: *Ethical values, Integrity, Internal controls, Moral reasoning, Organizational behaviour, Tone at the top.*

Introduction

It is generally believed that a strong tone at the top helps in creating and maintaining an effective internal control system, and this indirectly helps in preventing fraud and other unethical behaviours at all levels in the organization. Drucker [1] expressed this belief in a very plastic manner; he considered that people at the head of the organization can destroy spirit. Regardless of how knowledgeable, how brilliant or how successful a manager is, if he lacks character and integrity, he destroys people. And people are the most valuable resource in the organization. Particularly "If an organization is great in spirit, it is because the spirit of its top people is great. If it decays, it does so because the top rots: as the proverb has it 'Trees die from the top'" [1].

What is known as the "tone at the top" is the attitude of the Chief Executive Officer (CEO), board of directors, and other members of senior management, which communicates a strong message to employees, customers, and other stakeholders and the culture that the board of directors disseminates throughout the organization [2-3]. Tone at the top is best described as the consistency among statements, assertions and explanations of the management and its actions. At its origins, the concept of tone at the top can be traced to the accounting field, and it was generally used to describe an organization's ethical established climate. Built by developing and expanding the initial definition and meaning of the concept, a variety of definitions has emerged and is in circulation. Yet, tone at the top still is a complex construct that is not well-defined in the auditing literature [4]. In other words, a clear framework has not been identified. This makes tone at the top a very challenging and interesting theme, and approaching it for study a challenging task.

The National Commission on Fraudulent Reporting (Treadway Commission) released a study in 1987 that reported the casual factors that lead to fraudulent behaviour and financial statement fraud. According to the Tread way Commission "tone at the top is the most important factor contributing to the integrity of the financial reporting process" [5]. Therefore, the Treadway Commission recognised that tone at the top is a significant causal factor in the incidence of proper (fraudulent) financial reporting. In the same study, tone set by top management was considered to be the corporate environment or culture within which financial reporting occurs [5]. Since that time, the notion of tone at the top has been integrated into the Committee of Sponsoring Organizations (COSO) [6] internal control framework and the auditing standards.

The Association of Certified Fraud Examiners (ACFE) [7] stated that the tone at the top refers to the ethical atmosphere that is created in the workplace by the organization's leadership. Leadership is the key to organizations' effectiveness [8]. While good leadership facilitates the well-being of an organization's stakeholders, bad leadership, however, can bring destruction and misery to those subject to its domain [8].

Among professionals, regulators and academics, it is generally accepted the conjecture that the tone set by management will have a trickle-down effect on employees. If the tone set by managers upholds ethics and integrity, so will employees'. But, if upper management appears unconcerned with ethics and focuses solely on the bottom line, employees will be more prone to commit fraud because they feel that ethical conduct is not a focus or priority within the organization. In short, employees "follow the lead of their bosses". Tone at the top is about management giving the right example to their subordinates [9].

Management is expected to set the tone that honesty and integrity are valued and rewarded by the organization. According to the Treadway Commission, the National Commission on Fraudulent Reporting [5], a poor tone at the top plays a crucial and influential role in creating an environment ripe for fraud to take place. The 2010 Global Fraud Study of the ACFE [10] reports that one of the contributing factors in most fraud cases is a poor tone at the top besides the lack of internal controls, overriding of existing internal controls, and lack of management review. One of the reasons of the increasing attention given to tone at the top within organizations is represented therefore by its association with fraud [10] [11].

To sum up, it is claimed that, in an organization, tone at the top is vital because it has a major impact on internal controls, ethical values, and nevertheless on the organizational behaviour. Moreover, it has a cascading effect, impacting the behaviour of all employees in the organization. Following on from that, through their decisions, actions and behaviours, business decision makers not only affect the business itself but the stakeholders and society at large. Taken them combined, all these reasons have build up our motivation to focus this paper on the concept of "tone at the top", and its implications.

The aim of this paper is to provide insights into the meaning, relevance and current academic debate around the concept of "tone at the top". Tone at the top will be analysed from the perspective of links with and implications on internal controls, ethical values, culture and behaviour in an organization. Support or contradiction of theoretical concepts and academic findings will be provided through an analysis of four particular business cases, in which the "tone" set at the top of the company is thought to have had a great impact on the overall organization.

Background and literature review

An organisation's tone at the top is primarily determined by the top level management in the organisation. Top executives can influence the ethical mindfulness of organizational members in a positive as well as in a negative direction [12].

D'Aquila and Bean [13] examined the influence of the tone at the top on financial reporting decisions based on an experiment that consisted of six different financial reporting scenarios. The authors start from the premises that, despite attempts by organizations to create ethical environments, people in charge with reporting are sometimes confronted with ethical dilemmas that may affect ethical decisions. The results of their study provide evidence on how upper management is able to influence organizational culture. Furthermore, the study documents that when employees are placed in a setting where tone at the top that does not foster ethical decisions, they are more likely to choose unethical responses. Overall, the results provide support for the position that tone at the top does relate to financial reporting decisions [13].

Culture is everything when it comes to organizational behaviour and the tone at the top has a critical influence on the employee's individual integrity, values, competence, and work environment, being at the heart of every organization [3].

A study by Thoms [14] was designed to determine whether there are linkages between organizational moral culture and the ethical or unethical integrity of leadership. Based on the analysis of a number of case studies, including

Salomon Brothers, Enron, WorldCom, Johnson and Johnson, and Pitney Bows, Thoms [14] documents in his paper that ethical integrity in leadership is directly linked to organizational moral structure, particularly where unethical leadership existed and that these case studies strongly suggest that highly ethical management practices lead to successful businesses.

Most ethical problems can be traced to greed, facilitated by incentives, opportunity and pressure [15]. Putting pressure on employees to meet unrealistic goals to yield profit for the company is forcing employees to do whatever it takes to achieve the goals, whether they achieve those goals improperly or not [7]. The more consistency there is between manager's behaviour and their statements the stronger the organizational culture [9]. In such an environment, employees know that doing the right thing is expected and will be supported by upper level management, even if it hurts the bottom line, whereas in a weak environment, control procedures are frequently overridden or ignored, providing an opportunity for fraud [16].

In a research about the relationship between individual values and business decisions, Barnett and Carson [17] provide evidence that as executives become older their subjective values become more ethical, especially when compared to managers in their early or middle stages of their careers. These findings found support in other similar studies. More precisely, when exploring the relationship between ethical sensitivity and age, Karcher [18] found that subjects' age consistently influenced and enhanced moral reasoning. Deshpande [19] also investigated this relationship and found that older managers consistently view various unethical situations as unacceptable.

At the other end of the age spectrum, Hunt and Jennings [20] found that younger age teams tended to make the most unethical decisions in their research analyzing performance by decision makers in groups.

Ethical judgment was also subject to various theoretical and empirical investigations. Weeks *et al.* [21] report in their paper that there are gender and career stage differences between male and female managers. The findings provide evidence that, on average, females adopted a stricter ethical stance than their male counterparts and that overall, it appears that managers in later career stages display higher ethical judgment than those in lower career stages [weeks]. Hence, the results of earlier studies provide evidence that supports the linkage between higher stages of moral reasoning and age or organizational level.

A recent study by Weber [22] explores the moral reasoning of the CEOs among the largest automobile manufacturers in the world. The paper was designed to rely on an expanded view of leadership and the moral reasoning framework developed by Kohlberg [23]. Weber [22] shows that, contrary to prior research, CEOs in the automobile industry do not exhibit moral reasoning at a higher level than a cross section of managers. Still, there are differences when looking at nationality. Asian CEOs demonstrate higher stages of moral reasoning than American or European ones.

From another strand of research studies, the paper by Skaife *et al.* [24] has documented that insider trading profitability is even greater when insiders are more likely to act in their own self-interest as indicated by auditors' weak tone at the top adverse internal control opinions. Moreover, they find that top managers lacking integrity, i.e. weak tone at the top, earn incrementally higher insider trading profits. Results are driven by the profitability of share sales, consistent with managers liquidating their holdings at inflated share prices when financial reporting does not fully communicate management's private information. Also, this paper provides evidence that weak tone at the top CEOs and CFOs engaging in more profitable insider trading are more likely to leave their firms' employment.

Another relevant study for the purpose of our paper was conducted by Schwartz *et al.* [25], having as central focus the ethical obligations of directors, as opposed to their legal ones. Their study is based on the underlying assumption that ethical behaviour, especially the behaviour of corporate leaders leads to the long term interests of the corporation [25]. Thus, the study emphasises the fact that boards and directors play a critical role in overseeing the ethical performance of their organizations. Moreover, vigilant boards should be capable of preventing ethical disasters involving their firms. On the other hand, a board that must cut ethical corners in order to help its firm maximize financial performance should not be considered as an effective board. Furthermore, the paper by Schwartz *et al.* [25] describes a framework for a code of ethics for corporate boards and individual directors, as well as the issues that need to be dealt with in such codes of ethics. The promoted idea is that a code of ethics and ethics training specifically for directors, based on their unique setting the tone at the top should help companies to engage in establishing an ethical corporate culture. The study also concludes that ethical obligations and legal obligations are not mutually exclusive, but reinforce each other.

The study by Hunton *et al.* [26] contributes with empirical evidence to this research area, by associating tone at the top perceptions, seen as a key subjective aspect of the internal control environment, with archival indicators of earnings quality. More specifically, their research is concerned with the examination between tone at the top perceptions of mid-level financial reporting managers and earnings quality. This study is based on the premises that the perceptions of mid-level financial reporting managers reflect the tone at the top they have formed from observing the conduct of upper managers; hence the increased importance associated with investigating these perceptions. Moreover, this research is of relevance to our paper from another perspective too, since finding an association between perceived tone at the top and archival indicators of internal control and reported earnings quality can help explain the process through which tone at the top can affect organizational behaviour [26]. The results documented in the study show that higher-quality boards, greater CEO age, and lower CEO compensation are positively associated with tone at the top perceptions, after controlling for firm-specific factors. Interestingly, CFO factors (age, tenure and compensation) are not significantly associated with perceived tone at the top [26]. Findings further indicate that tone at the top perceptions and audit committee quality are positively associated with earnings quality [26].

It is also of interest to mention the results of a recent paper by Bédard [4] in that his study is not only focussed on the construct of tone at the top, but also on a discussion of current developments related to the topic, together with limitations of measures used to empirically test the tone at the top so far. The paper is mainly focussed on discussing the paper by Hunton *et al.* [26] presented above. While recognising the merits of Hunton *et al.* [26] for their study as a first from a series of studies on the topic, Bedard [4] considers the reported results to be mainly exploratory especially because the proxy used by Hunton *et al.* [26] to measure tone at the top lacks validation and there is an absence of a well-developed theory regarding the expected relationships. The author suggests that future researches can be developed starting from the empirical proxy used by Hunton *et al.* [26] to develop more complex and precise measures of tone at the top. Moreover, author's recommendations for future studies to focus on the examination of the factors with influence on the development of tone at the top and how it influences the financial reporting process provides evidence on the current developments in the field and in the novelty of research on this particular topic. What the author tries to emphasize is not only the absence of empirical evidence and well-established measures to obtain it, but also, in spite of a fairly extensive literature on the control environment, the existence of only little research evidence on the nature of this construct and its association with the quality of financial statements [4].

Linking Tone at the Top with Internal Controls, Ethical Values and Organizational behaviour

Tone at the Top and Internal Controls

One of the main elements that contribute to the reliability of the financial reporting is represented by an entity's internal controls. Since the attitudes and behaviour of top management and the board of directors are essential to a healthy system of internal controls, we will start by analyzing the impact that tone at the top can have on the internal controls system in an organization, according to COSO internal control frameworks. Our analysis will first consider the COSO Internal Control Framework [9], and reference will be made subsequently to the COSO Enterprise Risk Management (COSO ERM) [10] in order to identify how tone at the top is seen and defined from an internal control perspective, and how is it expected to interact with other components in the framework.

The COSO internal control framework consists of five interrelated components. At a broad level, tone at the top is part of the first component of an internal control system, i.e. Control environment. The control environment is the foundation for all other components of internal control, the basis for all internal controls in an entity influencing the structuring of business activities and risk assessment [2]. As Hunton *et al.* [26] suggest, by extension, the tone at the top as part of the control environment, can have a pervasive impact on the overall system of internal controls, affecting in the end the reliability of the external financial reporting process and the quality of earnings.

The board and senior management establish the tone from the top regarding the importance of internal control and expected standards of

conduct. The control environment provides discipline, process, and structure [6]. It reflects the overall attitude, awareness, and actions of the board of directors, management, owners, and others concerning the importance of control [2].
According to the COSO Internal Control Framework [6], the control environment component is composed of five principles, among which we can find tone at the top as one of the attributes that characterize the first principle, i.e. "The organization Demonstrates a Commitment to Integrity and Ethical Values". Within the Framework [6], this attribute is referred to as "Tone at the top and throughout the organization". In essence, the main message that this principle encompasses is that management and the board of directors are expected to lead by example in developing values, a philosophy and an operating style in the pursuit of the entity's objectives. In this respect, management and the board may seek to set the tone in terms of moral, social, environmental, or other forms of responsible conduct [6].

The resulting expectations are expressed to varying degrees of formality in the form of, for example: mission and value statements; standards or codes of conduct; policies and practices; operating principles; actions and decisions of management at various levels and the board of directors; attitudes and responses to deviations from expected standards of conduct. The degree to which these expectations are not only communicated but also applied by senior management and the board as well as other levels of leadership within the organization characterizes the tone at the top and throughout the organization [6].

Tone is impacted by the personal conduct of management and the board of directors, even when the behaviour does not directly affect the achievement of the organization's objectives; employees are likely to develop the same attitudes about right and wrong – and about risks and controls – as those shown by management.

The tone must be consistent from senior management through to operating unit management levels, to ensure that the values, business drivers, and resulting behaviour are shared among all employees and partners of the organization. Clear guidance and direction from the top, and congruence across different levels of management are fundamental to the achievement of entity's objectives. Therefore tone can be either a driver or a barrier to internal controls.

If we now refer to the Components of COSO ERM Framework [27], then tone at the top is seen as part of the Internal environment (first of eight interrelated components). According to COSO ERM [27], the internal environment encompasses the tone of an organization, and sets the basis for how risk is viewed and addressed by an entity's people, including risk management philosophy and risk appetite, integrity and ethical values, and the environment in which they operate. Risk management is the process by which a company evaluates and reduces its risk exposure. This includes actions, policies, and procedures that management implements to reduce the likelihood and severity of adverse outcomes and to increase the likelihood and benefits of positive outcomes [28].

COSO ERM Framework [27] encompasses internal control, forming a more robust conceptualization and tool for management. However, the emphasis is now on the concepts of risk, risk appetite, and risk tolerance; these concepts form the basis for the general risk culture that is set in the organization. A risk culture involves setting the tone for risk tolerance in the organization and ensuring that risk consideration is a key part of all decisions. Survey data suggests that strong leadership, clear parameters surrounding corporate risk taking, and access to information about potential risks are necessary for this to occur [28]

Under this framework [27], it is management's responsibility to support the entity's risk management philosophy, promote compliance with its risk appetite, and manage risks within their spheres of responsibility consistent with risk tolerances. The board of directors provides important oversight to enterprise risk management, and is aware of and concurs with the entity's risk appetite [27].

Tone at the Top and the Commitment to Integrity and Ethical Values

Integrity seems to have become a significant and fascinating topic in business, especially in relation to leadership [29] [23]. Prior literature has assigned different meanings to the word integrity. However, in most of the cases, integrity is often related to specific moral and ethical behaviours [29].

Khoen [23] considers integrity a business asset with an intrinsic value, because it enables us to be the finite, vulnerable, interdependent human beings that we are. People of integrity care for the larger community, act with a view to both the short-term and the long-term, are open and honest, trustworthy, and act with care and prudence; integrity is the precondition for being truly human [23].

Becker [10] on the other hand defines integrity as the nature of human values and the identification of a code of values to guide human choices and actions. Thereby, integrity is acting according to a code, a set of principles and values and not just with any code, but a code of morally justifiable principles [10].

Besides integrity, business ethics has currently become a popular topic for worldwide business executives, employees, shareholders, consumers, and academics, with ethics being the topic of religious, cultural, and philosophical beliefs [30]. Business ethics has been defined by Lewis [30] as "the rules, standards, codes or principles which provide guidelines for morally right behaviour and trustfulness in specific situations". This definition places emphasis on the most common themes mentioned by business writers and professionals – moral rules, standards, codes, and principles governing individual behaviour. Business ethics then has to do with a person's behaviour measured up to such standards as the law, organizational policies, expectations regarding fairness and what is right, plus one's own internalized moral standards [31]. Paine [32] argues that ethics is not only a personal issue, but also an organizational one, reflecting the values, beliefs, language, and behavioural patterns that define the organization's operating culture.

Crane and Matten [33] have defined ethical theories (ethics) as a set of rules and principles being concerned with the study of morality and the application of reason to elucidate specific rules and principles that determine right and wrong for any given situation. This definition is representative for a larger set of definitions of the term business ethics that refers to the rightness or wrongness of behaviour. Despite this large number of definitions, there seems to be however confusion on what is morally right or wrong, good or bad, ethical or unethical [30].

In the business organizations, ethics, as a highly contested subject, it concerned with the moral reasoning of what is right and wrong. Ultimately, under ethical dilemmas, the decision of what is right and wrong rests with the individual concerned. A framework that can be applied in order to interpret the whole afore-mentioned process is Kohlberg model of moral development. This model is concerned with the levels of human moral development to explain the reasoning process behind moral judgements [34].

Kohlberg's theory of cognitive moral development [34] is concerned with the ethical development of individuals through three levels of moral development, i.e. pre-conventional, conventional and post-conventional, with two stages at each level, giving six levels in total. Individuals at level one are concerned about external rewards, punishment and self-interest. The individual is likely to define what is right or wrong in relation to the anticipated rewards or punishment. Level two is known as the conventional one, individuals having their moral reasoning at this level generally learn to live up to the expectations of others. Individuals at the highest level, according to Kohlberg [34], make their own ethical decisions based on the belief of what is morally right or wrong.

Kohlberg's theory attempts to show the reasoning processes used by individuals, and how those processes changed as the individual matured from a child to an adult.

For business situations, the cognitive moral development theory relates to the different levels of reasoning that an individual can apply when confronted with ethical dilemas.

According to Paine [32] it is a manager's responsibility to shape organizational ethics. Failure to do so implies that managers share the same responsibility with those who conceive, execute, and knowingly benefit from corporate misdeeds [32]. It is the responsibility of executives to create ethical behaviour and define it clearly into a firm's value system and to pursue it relentlessly as a top-priority goal [12]. Therefore, the vision, values and strategy established by the organisation will be undermined completely if they are not supported by top management. And the stage of moral development of the people forming the top determines the overall level of ethics within the organization.

In all the above mentioned facts resides the high importance of top's level of integrity, ethical values and stage of moral development. Tone at the top describes and influences the general business climate within an organization via ethical or non-ethical decision making performed by the top, and determines to some extent, in turn, the ethical behaviour of all the people forming that organization.

Tone at the Top and Organizational Behaviour

As already mentioned in the introduction, a lot is being written about tone at the top because people realise that role models play an important role in internal control. (source) However, if we are to zoom in into the correlation between internal controls, previously discussed, and organizational behaviour, then an appropriate way to do this is to first look at tone at the top from a management control perspective. Management control involves managers taking steps to help ensure that the employees do what is best for the organization [35]. This is an important function because it is the human capital in the organization that make things happen.

Merchant and Van der Stede [28] classify tone at the top as a form of cultural controls. Cultural controls stimulate employees to monitor and stimulate each other's behaviour [28]. Among the various methods of cultural controls (namely code of conduct, group rewards, transfers, physical and social controls, and tone at the top), tone at the top serves mainly to address the lack of direction problem, i.e. to inform and guide employees on how they can maximize their contributions to the fulfillment of organizational objectives. Hence, the emphasis on the behavioural focus of controls should be noted to make the link between tone at the top and management control.

Further, it is important to note that organizational behaviour flows from an organization's culture. Cultures are built on shared traditions, norms, beliefs, values, ideologies, attitudes, and ways of behaving [3]. And the person who can set the tone for values and beliefs that is appropriate or inappropriate behaviour is the leader of that organization.

According to Schein [36], leadership is originally the source of the beliefs and values that get a group moving in dealing with its internal and external problems. Thoms [14] claim that leadership practices shape the organizational culture. In a more recent study, Weinberger [37] argues that leadership makes a difference. Weinberger's study draws on a range of recent corporate scandals, such as Royal Dutch Shell misreporting its oil reserves in 2004, Hewlett Packard spying on fellow board members in 2006, and most recently Bernard L. Madoff Investment Securities fraud in 2009, to perform the research and to base its findings. It is the character of the organization's leader in interaction with its culture that creates an environment and social situations conducive to ethics failure or success [24]

In most of the cases, the leader is the CEO. CEOs can model the behaviours that are expected of employees to change the culture because these behaviours will trickle-down to lower-level employees. Schein [35] identifies five primary mechanisms by which leaders can change cultures. These include: leader's consistency in what they pay attention to, reactions to crises, role modelling, allocation of rewards and status, and defining clear criteria for selection and dismissal. With particular relevance to our paper is a leader's position as a role model. Role modelling is the process by which employees modify their own beliefs and behaviours to reflect those of the leader [38].

Taking them combined, management can shape culture and behaviour in the organization by setting the proper tone at the top. Managers serve as role models and are often cited as a determining factor in creating a culture of integrity in their organizations. The key determinants of "success" in this respect are management's statements, that should be consistent with the type of culture they are trying to create and, most importantly, their behaviours should be consistent with their statements.

Linking Tone at the Top with Internal Controls, Ethical Values and Organizational behaviour via Case Studies

Barings Bank - Breakdown in Internal Control Systems

Barings Bank collapsed in 1995, after one of the bank's employees, Nick Leeson, the General Manager of Barings Futures in Singapore (BFS), lost £827 million due to speculative investing, primarily in futures contracts, at the bank's office located in Singapore. In a case study on the bank's failure, Edwards [39] asks a series of questions that are relevant for the perspective we look at the case in this paper: "how is it possible that one man was able to cripple a financial giant? What was the role of senior management in this situation and did they contribute to the demise? How effective were the internal control systems and was the Singapore operations managed effectively?"

Numerous reports were issued at the time the collapse occured, with the objective to identify the causes of the collapse; lots have presented that certain deficiencies in internal controls and risk management system have impacted the bank, and ultimately lead to its collapse. Also, some reports tried to identify what was the role that the top management played in this case, and whether it has appropriately fulfilled its responsibilities. Among these reports, a Report worth mentioning is the one based on a thorough investigation, conducted by the Bank of England, into the collapse of the Barings Bank [3], trying to answer two key questions: 1) how were the massive losses incurred, and 2) why was the true position not notice earlier? In short, the Report concluded that the losses were incurred by reason of unauthorised and concealed trading activities within BFS, and the true position was not noticed earlier by reason of a serious failure of controls and managerial confusion within Barings; this is what we will expand upon in the next paragraphs. Nick Leeson engaged from the very beginning in dubious trading, accounting, and reporting practices designed to conceal losses he was incurring. To cover his tracks over the years he used an "error account" (account £88888) to hide the true nature of his contracts in addition to reporting erroneous profits to senior management in London (Barings head office). This was possible in the first place given the fact that top management failed to ensure that there was adequate segregation of duties between various functions of the Singapore operations, thereby undermining the effectiveness of any controls that would have been put in place [38]. Leeson was in charge of the dealing desk and also had control over the back office operations. The fact that Leeson was permitted throughout to remain in charge of both front office and back office at BFS was a most serious failing [40]. Together with being in charge of the two offices, Leeson had cheque signing authority, authority to sign off on trading reconciliations and was responsible for vetting bank reconciliations.

Furthermore, it was reported that Barings internal audit team told senior management that the control of both the front and back offices was an excessive concentration of power, citing that there is a significant risk for override of controls. Management, however, failed to implement remedial measures, and this fact only served to further exacerbate the identified weaknesses.

On the other hand, the Barings incident clearly provides an insight into the importance of effectively managing the risk posed by the operations of a bank. It was noted that senior management's response to the recommendation of placing a suitable experience person to run the back office was that there was not sufficient work for a fulltime treasury and risk manager even if compliance duties were incorporated in the function."Barings' management seems that just did not understand the concept of to the allocation of resources commensurate with the risk posed by the business activities being undertaken" [38]. Senior management should have been guided to some extent by the fact that very high profits (as shown by the Singapore office) are generally generated by risky activities, thus management's approach should have been guided by the principle of implementing controls sufficient to mitigate and manage the risk consistent with the bank's risk appetite, which they totally failed to do.

Edwards [38] concludes his paper by emphasising that "the popular perception that one person was responsible for Barings demise may be a fallacy and a rather myopic view", as one person should not be able to take down an institution. And here comes into place a discussion about the factors that made possible bank's collapse, discussion which is of particular relevance for our study. Beacuse, what actually happened at Barings was a breakdown in fundamental systems which should have protected the bank. These are ineffective compliance; weak internal controls; no proactive risk management; delayed remedial actions; and, by extension, poor corporate governance. Hence, Barings Bank is not called for no reason „the model of all control bloopers". All the above mentioned causal factors provide evidence that failure to implement effective internal control and risk management systems can and does have catastrophic implications for an organization.

Having the afore-mentioned characteristics properly embedded in the organizational culture allows influencing the manner in which business is done. In the end, this aspect is very important to the long term viability of an entity. Moreover, it is not enough to have implemented an internal control system, but it is necessary to have mechanisms in place for monitoring its effectiveness.

And it is top management or the board of directors who are responsible for oversight of the business and the control environment according to the Center for Audit Quality [41]. The board of directors is seen as an oversight mechanism of senior management on behalf of the shareholders to protect and enhance their investment and following on as a consultant to management as in providing insight and authority on major enterprise decisions and providing wisdom in developing corporate policy [25].

Barings-Leeson catastrophe occurred in the first place because the bank's senior management (be it Leeson's direct supervisors, the bank's management committee, and the board of directors) did not appropriately played their role and did not fulfill their responsibilities. Top management's errors were thus one of omission, rather than commission. In other words, it is the top management who has the responsibility not only to ensure that these systems are appropriately designed and effectively working in the organisation, but also to set the tone for how other people in the organisation work in the same direction, in a collective effort towards achieving organisation's goals and objectives.

Toyota - Recall of Corolla - Promoting integrity and Ethical Values by Means of Moral Reasoning

Due to the many scandals that have lead many businesses to close their doors as a result of the bad decisions made by their top management, one would then question the morality of tone at the top encountered in these organizations, and if the major global organizations are being managed by individuals of moral integrity or not.

In the management literature, integrity has been classified by Palanski and Yammarion [29] according to four behavioural aspects into: integrity as consistency of words and actions, integrity as consistency in adversity, integrity as being true to oneself, and integrity as moral/ethical behaviour. The first and last of the four categories are more important in the context of our paper, with the last being of particular importance for the example provided by Toyota case study in case of its recall of Corolla model cars from the market, when technical problems have been signalled.

It is expected that senior management or CEOs would have high moral reasoning, possibly between stages five and six in the Kohlberg's model. The study by Weber (2010), deals with assessing CEOs moral reasoning in the automobile industry based on the annual social responsibility or sustainability report, which includes a letter from the CEO. The assessment of the CEOs moral reasoning is based on the moral language used in the CEOs letter to stakeholders that introduces the annual company's report. Surprisingly, most CEOs moral reasoning lies between stages two and three, indicating that these CEOs do not exhibit a higher level of moral reasoning. In this study, Toyota CEOs' moral reasoning was between the levels three and four.

Toyota is one of the world's largest manufacturers of automobiles in unit sales and in net sales. Surprisingly, during the year 2009 Toyota recalls 1.3 million vehicles worldwide because of seatbelt and exhaust system problems. Later, they would recall 4 million cars in the United States alone due to seatbelt and accelerator pedals. Toyota's unintended acceleration problem became a crisis after a tragic accident forced the company to begin to address the issue publicly. Toyota's quality issues transcended the universe of their customers and exploded onto front pages of newspapers around the world for a prolonged period [42].

Toyota has done a number of things to correct the problem and deal with the bigger picture of quality, however, the role of its leaders in helping rebuild trust and reputation was also critically important. Reputation is a valuable asset and can easily be lost [41], and corporations must take a long view in doing business in order to ensure survival. During the recovery from the recall crisis, Toyota was considered to be positioned relatively well, mainly due to the reputation for quality products and corporate responsibility it has developed over the decades [41].

Leaders in the company in different locations around the world have set the tone for the culture promoted within the organization, but also for the customers or other external stakeholders, in order for them to understand what the company stands for [41]. Even though mistakes were made, they were subsequently corrected, in the process of gaining, maintainig, and rebuilding trust.

Enron-Lead by Example into Creating a Culture of Unethical Values

The values, actions and leadership style shown by Jeffrey Skilling, Enron's former CEO, can be placed at the negative end of a behavioural continuum, based on the results of the study by Free *et al.* [43].

Having set as a broad focus Enron's failure, the study of Free *et al.* [42] shed light into how a sophisticated and comprehensive set of management controls can fail to prevent and detect widespread and continued corporate-wide fraud, information manipulation and dishonesty. The specific focus of the study was on the cultural environment surrounding Enron's management control systems, and the influence of a powerful-risk taking culture on the company's controls.

Enron's case is an example which demonstrates that employees at high levels in the organization have the power to bring their vision and change an organization's culture, and its behaviour as a consequence.

The Enron scandal, revealed in October 2001, eventually led to the bankruptcy of the Enron Corporation, an American energy company based in Houston, Texas. Enron's failure was considered to be the largest bankruptcy reorganization in American history at that time [44]. And, as seen in the introduction section, tone at the top is a significant factor in the incidence of fraudulent reporting. Enron's management initiated aggressive targets and putted pressure on employees to engage in unethical activities [36].

CEO's leadership style was representative for a recognized number of characteristics and traits that exemplified Enron's culture [42]. In Skilling's leadership style, earnings was of great importance. Earnings management was accomplished largely by using special purpose vehicles, pseudo-partnerships, which allowed the company to keep debt off its balance sheet. Another critical trait of Skilling's leadership style was the importance of rewards and status. Compensation plans, a powerful shaper and emblem of Enron culture, had one purpose in mind – to enrich the executives, not to enhance profits or increase shareholder value. Further, rewards were given to originators possessing the ability to analyze any deal with respect to forward costs, revenues, and earnings that could be marked to market and close money-making deals quickly which triggered the fraudulent behaviour of the employees [45]. The final characteristic of Skilling's leadership style was also reflected in the way Enron recruited, selected and promoted employees. Skilling hired only the best and the brightest graduates of prestigious universities, promotions came quickly, and employees were allowed to change their current positions with new ones where they could add more value and generate as much revenues as possible [44] [42]. Those who did not produce deals were quickly redeployed and soon after, often, terminated [42]. Although he was named the number one CEO in the United States of America for several years in a row, his leadership style pervaded and degraded Enron's management control systems, creating a culture of pushing the limits which was considered a surviving skill [46].

Drawing on a vast database of public records, testimonies at the various Enron-related trials, and insider accounts concerning Enron's rise and fall, the study by Free *et al.* [42] concludes that it was the leadership of the CEO that lead to Enron's demise. This finding is very relevant for the purpose of our research. More precisely, it shows that a corporate failure flowing from a leadership style is possible, thus a leader's position should not be underemphasised. In Enron's case, this fact was possible even though the company had a proper management control system and the usual governance mechanisms which included a formal code of ethics, an elaborate performance review and bonus regime, a risk assessment and control group, a Big-5 auditor, a well-credentialed board of directors, an audit and compliance committee, and regular SEC oversight. Thus, we can see that a supplemental, rather than a complementary relationship exists between different mechanisms that entities have to benefit from tone at the top.

Conclusion

This paper aimed to provide insights into the meaning, relevance and current academic debate around the concept of "tone at the top". We have started by providing an overview of the relevant literature on the topic and highlighted most important findings. Tone at the top was analysed from three different, but highly interrelated perspectives in an organizational context– internal controls, ethical values and behaviour. Second, we have looked into whether academic findings find support or contradiction in real case situations, and we have done that by means of analysis of some relevant case studies.

At its very beginnings, tone from the top was seen as the attitude of the firm's management toward regulatory compliance [46-48]. The concept in itself evolved while gaining more and more importance in the same time. Nowadays, tone at the top is seen as the most important component of the control environment. Control environment is the foundation of an effective internal control system [9] and begins with the tone at the top, the words and actions of the entity's leadership. Under an effective control environment, employees should view internal control as essential and integral to doing their day-to-day job duties. Hence, it is important for organizations to place greater importance on tone at the top, be it a part of or included in the control environment, by focusing more on the behavioral orientation of internal controls.

An appropriate tone at the top should be reflected by the board of directors, senior executives, and top managers, sustaining an ethical corporate culture within a firm. Once an ethical corporate culture is developed and sustained, the assumption is that the extent of crime, corruption, and unethical activity within organizations or on their behalf will be minimized. Of course, developing an ethical corporate culture is only the first step, as multiple challenges must continually be overcome. Further, it is not important "the tone" but more important is to have the "right tone". Also, it may not be just the tone "at" the top, but it may be also the tone "from" the top, since management's tone has a trickle-down effect on employees. Studies have shown that if top managers uphold ethics and integrity, so will employees. But if upper management appears unconcerned with ethics and focuses solely on the bottom line, employees will be more prone to commit fraud and feel that ethical conduct is not a priority. In short, employees will follow the examples of their leaders. Unfortunately, it is often difficult to measure the success of an ethical corporate culture in terms of outcomes, as one cannot always identify scandals that were avoided as a result of ethical work environments.

Organisations are created by people and it is the task of management to motivate them to realise the objectives of the organisation. In fact, tone at the top is about leadership. Employees throughout the organisation must be able to understand the norms and values of the organisation and must want to respect and apply them because they represent the organisation's preferred culture and these norms and values can be reinforced by the role model behaviour of respected and trusted top managers.

The case studies of accounting scandals have shown that there is a link between leadership style and creating an ethical climate in the organization. This shows that ethical leadership is linked to the organization's moral culture which could lead to a successful business or fraud prevention. Nonetheless, it is also important for leaders not only to talk about the values of the company, but also to live up to those values.

In conclusion, the concept of tone at the top may not be so important in itself – as a theoretical construct – but its great added value and importance come from the practical implications which derive from the way the top propagates within an organization the right tone. In other words, the top creates strategy but the question is "how does this strategy come down to the front line employees?" Thus, tone at the top becomes one of the most important elements that contribute to a company's long term success. As professor Sumantra Ghoshal highlighted by means of analogy in his speech at the Economic World Forum, in practical terms, tone at the top is related to the context ("smell of the place") and the change in that particular context that top management creates around their people. Thus, the context that the top creates flows as a result of constraints ("stretch"), compliance ("discipline"), control ("support") and contract ("trust"). If we look into more depth at these concepts, we can observe that they are strongly connected to the controls that a company chooses to implement, the ethics exhibited within the organization and the overall organizational behaviour. In fact, we can see that this connection only reinforces once again what we have already highlighted via the analysed case studies. The final conclusion we can draw is that the real test or challenge for the top and the management is not only to create the right "smell" that shapes the behaviours of people within the organization through the process of creating the "stretch", "trust" and "support", but also to maintain and protect it over long periods of time. The top of the companies portrayed as negative examples has failed to achieve this protection, and this has lead to huge scandals and even demise of the whole organization.

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