# Honing Skepticism

**Remember President Ronald Reagan's foreign policy mantra, "Trust, but verify"? That idea is at the heart of a collaboration by leading business organizations, including NACD, to prevent fraud by honing the skill of skepticism in the financial reporting chain, which leads right through the boardroom.**

*Editor's note: This article is based on webinars and related research conducted as part of an ongoing Anti-Fraud Collaboration initiative (antifraudcollaboration.org). As such, it reflects contributions from Anti-Fraud Collaboration members. Responsibility for the content of this article, however, lies solely with NACD.*

Must directors be skeptics?

It's a challenge worth examining. The term "skepticism" is often associated with doubt, but it actually describes a search for the truth. The word comes from the Greek *skeptikos*, used some 2,300 years ago by disciples of the philosopher Pyrrhus. The verb *skeptesthai* means "to reflect, look, view."

The earliest self-declared skeptics emphasized the importance of the senses in confirming reality. Over time, the word's meaning expanded to include the notion of reasonable doubt. Today, the "skeptic" is perceived as a doubter, someone who may trust but must always verify. As such, embracing skepticism carries unique role-related challenges for each member of the financial reporting chain, including directors. Everyone involved in a company's financial reporting effort can benefit from skepticism. After all, they need every possible weapon at hand to hack away at the legendary fraud triangle, the three factors—as explained in the Center for Audit Quality's 2010 report *Deterring and Detecting Financial Reporting Fraud: A Platform for Action*—that when combined often lead individuals to commit fraud: pressure (or an incentive or motive) to engage in fraud; a perceived opportunity; and the ability to rationalize fraudulent behavior. A passage from that report reveals the magnifying power that skepticism can have: "Skepticism throughout the financial reporting supply chain increases not only the likelihood that fraud will be detected, but also the perception that fraud will be detected, which reduces the risk that fraud will be attempted."

The CAQ report notes that management exercises skepticism by periodically testing assumptions about financial reporting processes and controls, and recommends that boards and audit committees take a skeptical approach in their

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—*Kenneth Daly*

work. The report also states that for both internal and external auditors, skepticism is integral to the conduct of their professional duties, pointing out that those auditors can "provide insight into the company's ethical culture and the effectiveness of its internal controls to assist board and audit committee members in exercising skepticism."

### Sharpening Independence

Although no professional standard requires directors to exercise skepticism, this attitude is clearly implied by the concept of director independence, required in the United States under a number of existing standards set by Congress, the Securities and Exchange Commission and the stock exchanges *(see related sidebar, "Director Independence Requirements," opposite page)*. Director independence—as interpreted today by leading organizations including the NACD—requires an independent mind-set; this in turn makes skepticism possible, as the two traits are closely related.

NACD has long recognized independence and skepticism as valuable traits for audit committee chairs. The 1999 *Report of the NACD Blue Ribbon Commission on the Audit Committee: A Practical Guide* linked audit committee effectiveness to the "independence, competence, dedication and leadership skills of the audit committee chair." The commission, led by the late A. A. Sommer Jr., a former commissioner of the SEC, noted that the chair "will ideally be a highly respected, highly experienced director who demonstrably possesses the attributes of intellectual curiosity, *a skeptical eye and ear*, tenacity and courage."

A subsequent commission—co-chaired in 2010 by Dennis Beresford, former chair of the Financial Accounting Standards Board; and Michele Hooper, audit chair at PPG Industries, director of UnitedHealth Group and NACD, and co-chair of the Anti-Fraud Collaboration, an initiative supported by the CAQ, Financial Executives International, the Institute of Internal Auditors and NACD—reinforced these same themes.

Business Roundtable also cites skepticism as a desirable director trait. BRT's 2012 *Principles of Corporate Governance* notes that "effective directors maintain an attitude of constructive skepticism; they ask incisive, probing questions and require accurate, honest answers."

"If we take a look at the widely reported failures that have recently occurred, many times it's a lack of adequate skepticism that is the common denominator. But skepticism is very different from playing devil's advocate, asking uninformed questions or being argumentative," says NACD President and CEO Kenneth Daly. "It's about understanding the industry and the business, applying your business acumen to the subject matter, and requiring logical responses to relevant, well-formed questions."

### A More Effective Audit Committee Chair

The audit committee chair plays an important role in the exercise of skepticism needed for independence. An effective chair does a lot of pre-work with the CFO, the chief internal audit executive and the external auditor. As the chair facilitates the meeting, it is important for him or her to know when to go deep and when it is time to come back up to the real issues.

"I know from my experience sitting on audit committees for multinational companies that there is a lot of complex information behind each 'number' for a financial statement," says Hooper.

An effective chair solicits input from all audit committee members, not just the designated financial expert. Indeed, sometimes the best questions come from people with nonfinancial backgrounds.

Audit committee oversight and support of internal audit are essential for assuring an independent, objective and skeptical internal audit function. Audit committees have primary responsibility for hiring the external auditor, as mandated under the Sarbanes-Oxley Act of 2002. Clearly, audit committees should assess skepticism when selecting auditors or evaluating their performance. But this is not the only role they play.

The NACD Blue Ribbon Commission report warns, "Effective audit committees are not and cannot be auditors." Rather, audit committee members should focus on reviewing financial risks and overseeing risk management. "While they should exercise constructive skepticism as they question management and auditors about the quality of management's financial reporting and the quality of controls, they must rely for the most part on the financial and reporting judgments of the full-time managers and professionals, and the advice and reports of the auditors," the report states.

"Deviance from revenue recognition policy is frequently the most common example of financial statement fraud in a company," explains Martin M. Coyne II, lead director and audit committee member at Akamai Technologies. "An audit committee can start by looking at a policy, then move to what adjustments have been suggested by the external auditor, then move to items like the number and size of credits issued and the trends in bad debt reserves and revenue reserves. If you connect the dots from all of these independent data points, this may point very early to…a potential problem."

Directors can benefit from the advice offered in *Enhancing Board Oversight: Avoiding Judgment Traps and Biases*, a March 2012 publication produced by the Committee of Sponsoring Organizations. Authors Steven M. Glover and Douglas F. Prawitt note that "…in a world of high-stake decisions, deadlines, and limited capacity, the judgments of even highly educated, capable people are vulnerable to common, systematic traps and predictable biases."

Using an example from the audit realm, Glover and Prawitt note that in collecting and assessing audit evidence, auditors often are confronted with issues that need to be addressed. Therefore, they need to identify the problem (for example, sales revenue is inconsistent with customer counts) and then begin to consider alternatives (why might sales revenue be higher in this period when the number of customers has decreased?).

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## Director Independence Requirements

The Sarbanes-Oxley Act of 2002 requires independence for public company audit committee members, and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 requires independence for compensation committee members. These requirements apply to all public companies, regardless of stock exchange, with few exemptions. Furthermore, stock exchanges have specific independence requirements.

The New York Stock Exchange requires that a *majority of directors* of its listed companies be independent. An "independent director" under NYSE rules is one who the board has affirmatively determined has no "material relationship" with the listed company. This definition applies for all purposes throughout the NYSE listing standards, except that additional restrictions, consistent with Section 301 of Sarbanes-Oxley, apply to membership on the audit committee. In addition, all members of the audit, compensation and nominating/governance committees must be independent—thus extending beyond SOX and Dodd-Frank when it comes to the nominating/governance committee.

Nasdaq also states that a *majority of directors* on the boards of listed companies must be independent, defining an independent director as one who is not an executive officer or employee of the listed company, and who, in the opinion of the board of directors, has no relationship that would interfere with the exercise of "independent judgment" in carrying out the responsibilities of a director. Nasdaq also requires that all members of the audit committee be independent. The compensation committee requirements must conform to Dodd-Frank as described above. As for the nominating/governance committee, director nominees are selected or recommended for the board's selection by an independent nominating committee or by a majority of the independent directors.

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—Mary Mitchell

Glover and Prawitt, both professors at Brigham Young University, propose the following COSO-endorsed model as a process for avoiding bias:

1. Define the problem and identify fundamental objectives.
2. Consider alternatives.
3. Gather and evaluate information.
4. Reach a conclusion.
5. Articulate and document the rationale.

### The Audit Committee's Role

The topic of director independence, and in particular the skill of skepticism, has received new attention in light of the Concept Release on Auditor Independence and Audit Firm Rotation, issued by the Public Company Accounting Oversight Board in August 2011. Directors serving on some audit committees may need to be more skeptical—not only of the financial executives who work for their firms, but also of the internal auditors and the external auditors.

Audit committee members can help promote professional skepticism by all the other participants in the financial reporting chain—including external auditors. That is, directors have a role in ensuring auditor skepticism. As stated in the *2009 SEC Handbook* (Section 603.07): "SEC registrants may, of course, change auditors at their discretion. It is imperative, however, that when a new auditor is engaged that [the] auditor possesses the integrity, objectivity and independence required by professional and Commission standards. The auditor must, at all times, maintain a 'healthy skepticism' to ensure that a review of a client's accounting treatment is fair and impartial."

Judging from the comment letters received by the PCAOB on the subject of mandatory auditor rotation, there are serious drawbacks to this practice, which can be expensive, unwieldy and risky. But this does not mean that audit committees and auditors should be complacent. The better they do their work, the less need for mandatory auditor rotation.

Professional skepticism is essential to the performance of effective audits under PCAOB standards. As the PCAOB notes in a December 2012 Staff Audit Practice Alert, those standards require that each individual auditor on the engagement team apply professional skepticism throughout the audit. Here are some highlights closely paraphrased from the executive summary of that document:

- PCAOB standards (AU 230.07) define professional skepticism as an attitude that includes a questioning mind and a critical assessment of audit evidence. The standards also state that professional skepticism should be exercised throughout the audit process, particularly in areas that involve significant management judgments or transactions outside the normal course of business.

### Tips for Audit Committees

- **Empower your audit committee, whether or not you belong to it.** These committee members, selected for their expertise and/or independence, are in an ideal position to ask the right questions of management, the internal auditor and the external auditor.
- **Even if you are not an auditor, see what you can learn from them.** In addition to their professional skepticism skills, auditors assess fraud risk and develop audit procedures and tests to respond to those risks. If you understand the potential risks of fraud in your company, you can determine how to mitigate those risks.
- **Support the internal audit function.** An independent and objective internal audit function contributes to a strong control environment and can be invaluable in deterring and detecting fraud.
- **Encourage vigilance by financial executives.** Questions aren't just for auditors and the audit committee; financial executives can pose them early on in the financial reporting process, preventing that infamous fraud triangle from taking hold.
- **Adopt a positive approach, with proper etiquette and good ethics.** Civility and integrity can help you ask tough questions effectively.

■ Certain circumstances can impede the appropriate application of professional skepticism and allow unconscious bias to prevail, including incentives and pressures resulting from certain conditions inherent in the audit environment, scheduling and workload demands, or an inappropriate level of confidence or trust in management.

■ Firms' quality control systems can help engagement teams improve the application of professional skepticism in a number of ways, including setting a proper tone at the top that emphasizes the need for professional skepticism.

■ The engagement partner is responsible for, among other things, setting an appropriate tone that emphasizes the need to maintain a questioning mind throughout the audit, and to exercise professional skepticism in gathering and evaluating evidence, so that, for example, engagement team members have the confidence to challenge management representations.

■ It is the responsibility of each individual auditor to appropriately apply professional skepticism throughout the audit, including in identifying and assessing the risks of material misstatement, performing tests of controls and substantive procedures to respond to the risks, and evaluating the results of the audit.

At a March 2012 public meeting in Washington, D.C., hosted by the PCAOB, Cynthia M. Fornelli, executive director of the Center for Audit Quality, expressed her views on the role of the audit committee in promoting and maintaining audit quality. "Audit quality has improved, but we must not let down our guard," she said. "The CAQ believes that audit committees should be further strengthened and empowered to take on more."

One way to strengthen the independence of the audit committee and auditor relations—suggested as an alternative to mandatory audit firm rotation—is to allow the audit committee to select the lead engagement partner on an audit, Fornelli said. Audit committees would also need to be satisfied that their members have the necessary technical competence and experience, which would set the tone for the relationship with the external auditor.

Fornelli also suggested implementing an annual assessment of the auditing firm and the lead audit partner. Best practices for such an assessment might include a review of compliance with the various independence requirements, along with the application of objectivity and professional skepticism, followed by an audit committee disclosure on the results of the evaluation. (On this last point, NACD has helped to develop a tool, which is available at NACDonline.org, for directors that assists in the evaluation of the external auditor.)

### The External Auditor

As mentioned, external auditors define skepticism as "an attitude that includes a questioning mind and a critical assessment of audit evidence."

According to the audit standard *Due Professional Care in the Performance of Work* (AU 230), "The auditor uses the knowledge, skill and ability called for by the profession of public accounting to diligently perform in good faith and with integrity, the gathering and objective evaluation of evidence.… The auditor neither assumes that management is dishonest nor assumes unquestioned honesty." Back in 2000, the *Report and Recommendations of the Panel on Audit Effectiveness* noted that this definition is often characterized as the "neutral" view of skepticism.

The auditing standards that focus on fraud talk about auditors having to presume some level of dishonesty in the preparation of the financial statements unless the audit evidence indicates otherwise. This is referred to in academic literature as "presumptive doubt": "The auditor should conduct the engagement with a mindset that recognizes the possibility that a material misstatement due to fraud could be present, regardless of any past experience with the entity and regardless of the auditor's belief about management's honesty and integrity.

"Furthermore, professional skepticism requires an ongoing questioning of whether the information and evidence obtained suggests that a material misstatement due to fraud has oc-

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curred. In exercising professional skepticism in gathering and evaluating evidence, the auditor should not be satisfied with less-than-persuasive evidence because of a belief that management is honest" (AU 316, *Consideration of Fraud in a Financial Statement Audit*).

Today, auditors face a much more complex financial world. As Michele Hooper points out, there was a time when financial reporting was much simpler—companies used historical costs, and the volume of transactions was smaller.

"The volume of transactions has increased exponentially, the majority of the transactions are automated, and many issuers have collateralized debt obligations, as well as complex assets for which it is difficult to obtain reliable estimates because they are not widely traded," she says.

### Training Auditors

Few people are "born skeptics," but everyone can learn how to apply skepticism. Today it is embedded in auditor training. Given the ever-growing complexity of the transactions they are looking at, auditors are obliged to be even more skeptical than in the past. "What's really important is experience…the way you really learn as an auditor," says Gregory G. Weaver, chairman and CEO of Deloitte & Touche LLP.

For auditors to be able to exercise professional skepticism in response to a given set of evidence, they must be on high alert for patterns and anomalies. As Mark W. Nelson, a professor of accounting at Cornell, writes in *Model and Literature Review of Professional Skepticism in Auditing*, published in the November 2009 issue of the academic journal *Auditing*, auditors "must understand the directional implications of evidence of audit risk, and also must be able to apply their knowledge of evidential patterns and error/nonerror frequencies to determine whether a given set of evidence suggests a heightened risk."

Being able to understand evidential patterns is a skill developed through experience, and that experience is often gained through the supervisory review of work throughout the audit. The nature of the audit requires auditors to continually make judgments, so it is beneficial to understand the process used in making judgments.

Auditors typically develop multiple alternatives and test them by gathering evidence and evaluating the information. For example, if financial reports indicate that a company has higher sales revenue but fewer customers (a scenario mentioned earlier in the COSO model), there are several alternatives to consider: fewer customers are purchasing more items, the current customers are purchasing higher-priced inventory resulting in higher revenue, the company has adopted a strategy of focusing only on high-volume customers, or perhaps the company is booking sales for the next period in the current period to meet sales goals. In the course of working through an audit issue, the auditor will weigh evidence that supports his or her alternative theories with that which disconfirms the alternatives under consideration. Once he or she reaches a conclusion, the next step in the judgment process is to articulate the findings and document the rationale for that conclusion.

As an auditor or other professional goes through the judgment process, it is important to recognize the traps that might lead people to the wrong conclusion. It is human nature to develop alternatives that will support the original solution to a problem that has been identified. This is often referred to as "confirmation bias"—you want to gather as many facts as possible to support what you believe will be the ultimate conclusion (e.g., that the company has shed low-volume clients and has succeeded in increasing sales to its higher-volume customers). Auditors are trained to expand the enumeration of possible alternatives to include those that will make one question the validity of the evidence that they are considering. Contradictory evidence is not something to be dismissed in the conduct of the audit.

Training reinforces the need to carefully examine all disconfirming evidence and to continue to ask questions—is this consistent with historical trends, and if not, why not?

What can other participants in the financial reporting supply chain learn from external auditors with regard to skepticism? Financial statements are composed of a series of estimates, and there is a great deal of information that goes into those estimates. Business has become more complex, and accounting and auditing standards have increased in complexity. Auditors must continually reassess the risk of a material misstatement in the financial statements.

### Internal Auditors

According to the Institute of Internal Auditors' *Practice Guide: Internal Auditing and Fraud*, "Internal auditors often play a critical role in the success or failure of organizational fraud risk management. With their intimate knowledge of the workings of an entity, internal auditors are in a unique position to identify many of the indicators of fraud. When internal auditors act with skepticism and they focus on the effectiveness of internal controls, the likelihood that they will notice the common characteristics of fraud is increased, and they might uncover possible fraudulent activity if and where it exists."

As Richard Chambers, president and CEO of the IIA, points out, "Skepticism can have a much broader definition for internal auditors because our mission includes addressing a broad variety of risks—not just financial risks, but also operational risks, compliance risks, and business and strategic risks that organizations deal with every day."

A focus on skepticism can also add to and improve the skills on a team and ensure balance and perspective in internal auditing.

Paul Sobel, vice president and chief audit executive of Georgia-Pacific, suggests directors think about control as a "segregation of duties," since sometimes it is necessary to have more than one person performing parts of a job, rather than relying on an individual to perform the entire task.

"Without professional skepticism, an auditor might trust that the control works, based on discussions with the individuals, but there's always a possibility that two or more employees could work together to override the control," Sobel explains. "So a professionally skeptical auditor would investigate or verify the control, rather than just trusting what they are told. In other words, a skeptical auditor is not one who automatically doubts the control is working, but one who investigates and verifies before jumping to a conclusion."

### Financial Executives

As a professional group, financial executives have long been aware of the need for skepticism, although, like directors, they have no professional requirement to be skeptical. However, some people may naturally have honed these skills. "Many of our top accountants had years in the major accounting firms, where professional skepticism is endemic. For our financial analysts, many of them came from top MBA programs, where effective analytical and communication skills are taught," says Gary Kabureck, vice president and chief accounting officer of Xerox and chairman of the FASB Subcommittee at Financial Executives International. "While we certainly have a lot of technical training, a large part of being financially skeptical comes from a pervasive ethical culture with required ethics training for everyone annually, including our CEO."

Even before financial executives field questions from others—such as the internal auditor, the audit committee and the external auditor—they must ask these skeptical questions of their data sources. For example, if a CFO receives questionable data points from a division president or from his or her own staff, the CFO should not accept them at face value and wait for the internal auditor, audit committee or auditor to question the results. Rather, he or she should take a proactive position to investigate the situation.

Mandates aimed at financial statements have increased in recent years. Under Sarbanes-Oxley, CFOs are required to vouch for internal controls (Sections 302 and 404) and for financial statements (Section 906). Under the Dodd-Frank Act, executives face clawbacks of incentive pay awarded under financial statements that are subsequently restated (Section 954). It is more important than ever for chief financial officers to make sure that others are also honest. The skills of skepticism can help them not only do their own honest work, but also avoid negative consequences stemming from the possibly dishonest work of others.

"You need to see management and how it is relating to employees. Where there is smoke there is fire. If you hear something, there is more. Ask, 'Do the words and the music go together?'"
*—William White*

## Mastering the Skill of Skepticism: A Six-Part Webinar Series

Everyone involved in financial reporting—including external auditors, directors, financial executives and internal auditors—can work more effectively if they can master the skill of professional skepticism. This does not mean a lack of trust. Rather, it means "I trust you, but my responsibilities require me to confirm what you and others tell me." This "trust, but verify" approach is explored in a video introduction and five 25-minute webinars posted (with full transcripts) on the NACD website at NACDonline.org/skepticism.

**1. Introduction by Michele Hooper, director, PPG Industries (audit committee chair), UnitedHealth Group (nominating and governance committee chair), NACD, Center for Audit Quality governing board, and co-chair of the Anti-Fraud Collaboration.**

**2. The Etiquette and Ethics of Skepticism, with Mary M. Mitchell, president, The Mitchell Organization; and William White, director, NACD and ContextMedia, and professor, Northwestern University.**

Asking "skeptical" questions can help directors and others get to the bottom of things. But this can involve asking tough questions about sensitive topics. How can an individual exercise skepticism without causing offense or weakening trust? The answer lies in proper etiquette as well as good manners and ethics.

**3. Skepticism and the External Auditor, with Cynthia M. Fornelli, executive director, Center for Audit Quality; and Gregory G. Weaver, chairman and CEO, Deloitte & Touche.**

Financial statements are built on a series of accounting estimates regarding transactions that can be extremely complex. So gathering audit evidence is a multistep process to get to the core of the estimate or transaction. As they exercise professional judgment—from defining the right problem to documenting their findings—external auditors approach their task with skepticism, a "questioning mind and a critical assessment of the audit evidence," along with "presumptive doubt." In exercising skepticism, external auditors and others need to overcome natural human judgment biases such as "confirmation," "overconfidence," "availability" and "anchoring."

**4. Skepticism and the Audit Committee, with Martin M. Coyne II, lead director and audit committee member, Akamai Technologies; and Ken Daly, president and CEO, NACD.**

Directorships are part time and subject to the inherent risk of asymmetric information, so directors need skepticism to ensure that the information they receive is valid. Skepticism doesn't mean being mistrustful, playing devil's advocate or asserting superior financial expertise. Rather, it means understanding the industry and business, and applying business acumen. It also means insisting on logical responses to relevant questions. Common sense is a critical variable; sometimes the best questions come from the non-expert. An effective board and audit committee can bring the best out in external auditors, internal auditors and financial executives, as all parties grapple with important issues of accounting judgment.

**5. Skepticism and the Financial Executive, with Marie Hollein, president and CEO, Financial Executives International; and Greg Kabureck, vice president and chief accounting officer, Xerox Corp.**

Financial executives find themselves on the receiving end of skepticism as they present financial reports and analysis to other management, the board, the external auditors and others. But these executives also need to exercise skepticism when it comes to the information flowing up to them through their organizations. Building a skepticism-ready team begins with hiring the right people, including executives with experience in conducting major audits. It is also important to alleviate time pressure, which is a major motive for fraud, through good time management. Certification and attestation requirements under Sections 302, 404 and 906 of Sarbanes-Oxley help promote skepticism, because professionals won't vouch for a report they don't trust. The Committee of Sponsoring Organizations' five key areas—control environment, risk assessment, control activities, information/communication and monitoring—can become part of a reliable reporting system.

**6. Skepticism and the Internal Auditor, with Richard Chambers, president and CEO, The Institute of Internal Auditors; and Paul Sobel, chief audit executive, Georgia-Pacific.**

Internal auditors are on the front lines of the fight against financial reporting fraud. With their daily presence inside a company and their constant focus on internal controls, internal auditors are in a uniquely strong position to contribute to the deterrence and detection of fraud. But to be effective, they must adopt an attitude of skepticism. For internal auditors, as for external auditors, skepticism means having a questioning mind, insisting on evidence and having a mind-set that recognizes the possibility of fraud. Only by having an independent as well as an appropriately and competently staffed internal audit capability can the true value of internal audit be fully unlocked.

Additionally, the C-suite can focus on setting a tone at the top that goes beyond the CEO giving a speech or emailing employees a code of ethics. "What we really need in practice is more tone from the top, from the C-suite down and across the organization, to permeate throughout the organization, to walk the talk by interfacing with staff, encouraging an open atmosphere where people can ask questions of their managers if they have concerns," says Marie Hollein, president and CEO of Financial Executives International.

### Etiquette and Ethics

What can participants in financial reporting—including board members—do to sharpen their skepticism? Asking tough questions can help directors and others get to the bottom of things, but doing so can also put people on the defensive. How should an individual exercise skepticism without causing offense or weakening trust? The answer lies, at least in part, in proper etiquette and ethics.

"You don't have to be mean to be tough," says Mary Mitchell, president of The Mitchell Organization and the author of nine books on manners, including *Class Act*.

"Etiquette is a customary code of polite behavior in society or among members of a particular profession or group—a set of rules one can learn," says Mitchell. It accords with good manners, an internal attitude based on respect and integrity. Etiquette and manners create good relationships, which create good business, Mitchell believes.

FEI's Hollein adds this wisdom: "When it comes to codes of ethics, the key is not just to sign a piece of paper, but to really walk the talk and exercise skepticism by challenging what you see and hear, not in a combative way, but a thoughtful way."

Studies by Harvard University, the Carnegie Foundation and the Stanford Research Institute have concluded that career advancement depends largely (85 percent) on interpersonal skills and less (15 percent) on technical knowledge. Similarly, a professional's ability to exercise skepticism effectively depends in part on interpersonal skills. Key elements in any personal interaction include a sense of setting, careful word choice, listening skills, appropriate facial expressions and body language, and exercising common courtesies.

The ethical tone of an organization will both drive and reflect how it deals with employees, suppliers, customers and host communities. Ethics and skepticism go hand in hand—both involve a search for the truth.

"Life is full of slippery slopes, and it is important to know when you are approaching one," says William White, former chairman and CEO of Bell & Howell, nonexecutive chair of ContextMedia, board member of NACD and a professor at Northwestern University. "Once you are on it, it is too late. You will fall. And to see one of these coming you need all your senses. You need to see management and how it is relating to employees. Where there is smoke there is fire. If you hear something, there is more. Ask, 'Do the words and the music go together?'

"The ethical tone of an organization is cumulative, resulting from many personalities and many actions, but a single individual can make a difference," White adds.

Everyone along the financial reporting chain can help both deter fraud and detect it. To do so, it is important to distinguish facts from opinions and values. Of the three, facts are likely the easiest to ascertain, White believes. One can agree to disagree when it comes to opinions, but values rise above situational ethics, he notes. Directors and others need to make their own judgments and pay attention not just to what people say but also to what they do.

To be sure, there may be unethical skeptics or naïve ethicists, but these are the exception, not the rule. White summarizes: "The skeptic is ethical—someone looking for the truth based on evidence. And conversely, the ethical person is skeptical—will be curious and looking for details. So it's hard to be effectively ethical without exercising skepticism." D

For more information about the Anti-Fraud Collaboration, visit antifraudcollaborationorg. For the webinar series, produced by Erin Essenmacher and Lia Temarantz of NACD Education and Alexandra R. Lajoux of NACD Research, see NACD online.org/skepticism.

## Ask the Right Questions

In judging the actions of people, to determine what is right, directors and professionals can ask a series of questions:

- Is it legal?
- If so, is it moral?
- If legal and moral, what about its long-term impact?

In all of these areas, ethics and skepticism may be closely aligned.