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When rampant organizational fraud occurs, where was the board?

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The importance of corporate governance and a resilient board of directors is not a new concept. It has long been held that effective board oversight can do much to reduce the risk of management misconduct. In fact, this concept was reinforced many years ago in the October 1987 *Report of the National Commission on Fraudulent Financial Reporting.* The *Report* opined on the increased prevalence of fraud with "the absence of a board of directors or audit committee that vigilantly oversees the financial reporting process."[1] Unfortunately, that premise has not been universally embraced, and fraud and other misconduct persist.

Whether it is the headline-grabbing corporate fraud cases of Enron, WorldCom, Adelphia, and a host of others from 20 years ago or the more recent ones at Volkswagen, Theranos, Luckin Coffee, and Wirecard, we are compelled to ask the provocative questions: Where was the board; what did they know; and when did they know it? Or did they not even know? While we have seen very few cases where the board was complicit in management fraud, in such cases we must ask, why did they not do more in their governance and oversight role to detect and prevent rampant misconduct? Why have the gatekeepers and the guardians of governance let us down in so many instances? At times, boards have failed miserably but faced few consequences.

To reinforce the failure of board governance, I will discuss three organizations from the public, private, and nonprofit sectors that made headlines, and not in a good way, for their misconduct. The common denominator in these case examples is the action, or rather the inaction, of the boards of directors involved. I will then discuss the questions that boards need to ask themselves to ensure they are fulfilling their roles effectively.

Red flags missed at Wells Fargo

Wells Fargo's reputation was damaged by a sales practices scandal where management pressured employees to meet unrealistic sales targets that resulted in the opening of unauthorized customer accounts. Initially 2.1 million phony accounts were disclosed, but subsequently the number increased to 3.5 million.[2] The practice may have started as early as 1998. More than 5,300 employees were fired for these phony accounts between 2011 and 2016.[3] The former CEOs were forced out, executives linked to the inappropriate sales practices were fired, there were multiple government investigations, and billions were paid in fines and class-action settlements. So, where was the board?

The Wells Fargo board missed the numerous red flags that screamed misconduct. There were the aggressive and unrealistic sales goals for bank employees, the focus on cross-selling, and the decentralized business model that siloed interactions and limited transparency. Then there was the prior reporting by employees of the sales practices; the greatest number of internal ethics complaints going back more than 15 years related to "sales integrity" issues.[4] There was no follow-up and more unheeded red flags. An employee filed a whistleblower lawsuit in 2011 that should have put the board on notice. In one of the related depositions, a lead teller stated, “Everyone at the branch...was aware of the unethical conduct of bankers.”[5] We do not know if the board was ever specifically told about these issues back then, but if they were told and did nothing, their severe lack of oversight would be an even worse failure.

The one red flag that should have caused the board to respond sooner was the aggressive sales culture that former CEO Richard Kovacevich brought to Wells Fargo and was later promulgated by his successor, John Stumpf. “Kovacevich had initiated the ‘GR-8’ program to pursue cross-sell at Norwest and brought that focus to Wells Fargo” after Norwest’s 1998 purchase of Wells Fargo.[6] Kovacevich coined the term “Go for GR-Eight” that meant each Wells Fargo customer should have eight products, such as checking accounts, savings accounts, auto loans, mortgages, credit cards, and the like. Kovacevich left the CEO role and became chairman in 2007, leaving Stumpf to take over the CEO role. Stumpf continued this aggressive sales culture with his own mantra of “eight is great.”[7] In 2013, the *Los Angeles Times* reported that “Wells Fargo said it averages 6.15 financial products per household—nearly four times the industry average.”[8] This disparity alone should have indicated to the board that something was amiss and needed immediate inquiry.

When Wells Fargo whistleblowers reported sales practices violations to the Wells Fargo helpline and nothing changed, the whistleblowers apparently went to the newspapers.[9] The sales practices were not deep, dark secrets at the bank, so where was the board in its oversight role? It was not until the *Los Angeles Times* published its 2013 article that the board got involved. The board did not even consider sales practices as a business risk until 2014.[10] Did they not consider the implications of the “eight is great” mantra and its pressure on employees?

It was not until 2016 that the board finally learned of the prior terminations of the 5,300 employees for sales practices violations.[11] Even if the board was misled by management, the board had the governance requirement to conduct its own independent investigation years earlier. It was not until the scandal became even more public through a multitude of media reports that the independent directors of the board retained counsel to investigate the sales practices. The subsequent independent investigation report was released in April 2017.

There is no doubt that the Wells Fargo board has taken significant steps to reform the company’s practices and culture, but the damage was done. Today, Wells Fargo is still recovering from its past, and it will take many years to fully gain back customer, investor, and regulator trust. While many in management and across employee ranks were responsible, the question of “Where was the board?” persists.