



EXECUTIVE WHITE PAPER

Leadership as the Hidden Control Environment

How leadership behavior shapes decisions, strengthens control execution, and reduces risk



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This paper expands on the Rehumanizing Risk session delivered at the 2026 IIA Financial Services Exchange in New York City.

Executive summary

Every policy, process, and control eventually passes through a human decision. The quality of that decision depends on more than technical competence or written procedure. It also reflects the environment leaders create through the priorities they reinforce, the pressure they apply, the questions they welcome, and the way they respond when someone raises a concern.

This paper calls that environment the hidden control environment. It sits alongside the visible control environment of policies, processes, controls, and governance. The visible layer defines what should happen. The hidden layer influences what people actually do when expectations compete, information is incomplete, or speaking up carries social or career risk.

The idea aligns with established control and risk frameworks. COSO places integrity, accountability, competence, and board oversight within the control environment.¹ The Institute of Internal Auditors links culture risk to a successful control environment.² The Financial Stability Board identifies tone from the top, accountability, effective communication and challenge, and incentives as indicators of sound risk culture.³ Federal Reserve leaders have similarly emphasized that even excellent measurement and limits cannot protect a firm when decision-makers ignore risk or risk professionals lack influence.⁴

Four conclusions

- Leadership behavior functions as a control amplifier. It can strengthen a sound system or quietly weaken it.
- Many findings have two root-cause stories: the visible control failure and the environment that influenced the decision behind it.
- Culture and management quality require judgment, but they can still be assessed through observable signals, patterns, and evidence.
- Organizations reduce risk earlier when they equip leaders to create clarity, responsible challenge, learning, and accountability in daily work.

The practical question. For audit, risk, compliance, and business leaders, the practical implication is straightforward: continue testing the control, then examine what the environment taught people to do before the control failed.

The control environment has two layers

Organizations invest heavily in policies, governance structures, monitoring, technology, and assurance. Those investments matter. Yet well-designed controls still fail because design effectiveness and operating effectiveness meet at the point of human judgment.

Layer	What it includes	The question it answers
Visible control environment	Policies, processes, controls, governance, roles, systems, monitoring	What should happen
Hidden control environment	Trust, pressure, clarity, incentives, expectations, integrity, accountability	What people believe will happen when they act

The hidden layer becomes most consequential when employees face a trade-off. A leader may say quality comes first while praising speed, rewarding volume, tolerating workarounds, or reacting defensively to bad news. Employees learn from the repeated signal. The practical standard becomes the behavior that earns approval or avoids friction, even when the written standard says something else.

The decision point

A control becomes real only when someone decides to follow it, verify the information, question an assumption, stop a process, document an exception, or escalate a concern. By the time an audit identifies the outcome, many small decisions may already have accumulated. Each decision can look reasonable inside the environment the employee experienced.



Figure 1. Leadership influences risk through the environment in which people interpret priorities and make decisions.

The idea is already embedded in risk governance

Leadership as a hidden control environment does not replace established frameworks. It makes their behavioral assumptions explicit and connects them to day-to-day management practice. The IIA's Global Internal Audit Standards reinforce the expectation that internal audit evaluate and contribute to the improvement of governance, risk management, and control processes.¹¹

Source	What the framework emphasizes	Implication
COSO	The control environment includes integrity and ethical values, oversight, accountability, competence, and structures that support responsibility.	Leader behavior gives these principles credibility in daily decisions.
The IIA	The 2024 practice guide on auditing culture states that managing culture risk supports a successful control environment.	Culture belongs within assurance and advisory conversations, not outside them.
Financial Stability Board	Sound risk culture rests on tone from the top, accountability, effective communication and challenge, and incentives.	These are observable leadership and management practices.
Federal Reserve and New York Fed	Governance, risk culture, speaking up, psychological safety, management example, and the influence of risk functions affect risk outcomes.	Formal limits work only when decision-makers respect and act on them.

The FSB is especially direct: it describes risk culture as the norms, attitudes, and behaviors that shape risk awareness, risk-taking, and risk management. It warns that supervisors should not treat cultural indicators as a checklist or rely on one isolated result. Instead, they should combine evidence across activities, assess recurring themes, and exercise experienced judgment.³

That approach fits the realities of internal audit. Leadership quality rarely appears as one clean data point. It appears as a pattern across escalation delays, repeat findings, survey differences, exception behavior, incentive design, meeting dynamics, remediation discipline, and the treatment of dissenting views.

A 2024 Federal Reserve speech on counterparty credit risk made the same point in operational terms: sophisticated reporting and calibrated limits provide little protection when leaders ignore risk or risk professionals lack standing in business decisions.⁴

Engagement and psychological safety affect control execution

Employee engagement often gets discussed as a retention or productivity topic. Its risk relevance deserves equal attention. Engaged employees tend to have clearer expectations, stronger connections to purpose, better support, and more frequent developmental feedback. Those conditions influence whether employees notice, question, and act on risk signals.

Gallup's 2024 global report summarized a meta-analysis covering more than 183,000 business units across 53 industries and 90 countries. Compared with bottom-quartile units, top-quartile engagement units reported 63 percent fewer safety incidents and 32 percent fewer quality defects. Gallup also reported that managers account for 70 percent of the variance in team engagement.⁵

These figures do not prove that engagement alone causes every difference, and they should not be transferred mechanically to a specific bank. They do establish a strong and widely observed relationship between workplace conditions and outcomes that matter to risk leaders.

Speaking up is a leadership outcome

Research on employee voice finds that managerial openness influences whether employees offer improvement-oriented concerns and ideas, partly through psychological safety.⁶ Research on leader inclusiveness similarly shows that words and actions inviting contributions can strengthen psychological safety and improvement efforts.⁷

The New York Fed has translated this evidence into a practical risk message: creating channels for speaking up is necessary but insufficient. Employees must feel comfortable using them, and managers who create the immediate culture must normalize risk conversations in daily work.^{8, 12}

The audit implication

A hotline, escalation protocol, or open-door policy shows design intent. Operating effectiveness requires evidence that people use the mechanism, leaders receive challenge without retaliation, concerns move at the right speed, and employees see that raising risk leads to thoughtful action.

Five leadership signals shape risk decisions

Employees continuously interpret leadership behavior. The signals below influence whether written controls retain their intended force under pressure.

Signal	What employees observe	The inference employees make	Evidence to examine
Attention	What leaders repeatedly ask about and review	This is what truly matters here	Agenda time, dashboard focus, follow-up questions
Trade-offs	How leaders balance speed, revenue, service, quality, and risk	This priority wins when goals compete	Exceptions, deadlines, resource choices
Response	How leaders react to mistakes, bad news, and dissent	Speaking up is safe, useful, risky, or pointless	Meeting behavior, retaliation concerns, escalation timing
Recognition	What earns praise, promotion, compensation, or status	This behavior advances careers	Performance criteria, awards, promotion patterns
Follow-through	Whether leaders address issues consistently and learn from them	Accountability is real or negotiable	Repeat findings, action-plan aging, lesson sharing

None of these signals operates alone. A leader can invite challenge but undermine the invitation by rewarding only speed. A firm can publish strong values while allowing high performers to bypass expectations. A manager can encourage escalation but teach silence by becoming defensive whenever someone brings unwelcome information.

This explains why tone at the middle matters as much as tone at the top. The FSB describes middle managers as the channel through which risk culture reaches business lines. Senior leaders set expectations. Frontline and midlevel leaders convert them into the lived operating environment.³

Three operating stories reveal the hidden environment

The following anonymized stories come from my operations leadership experience. They illustrate how attribution, metrics, and performance pressure can shape decisions long before a formal finding appears.

1. The error reports nobody reviewed

Early in my hospitality career, I worked as a night auditor reviewing transactions from restaurants, golf operations, retail, and guest services. I documented errors and sent reports to department leaders so employees could learn from the mistakes. When the same names and errors appeared repeatedly, I began labeling the employees: lazy, careless, or incompetent. I even created a remedial Saturday class for repeat offenders.

I eventually discovered that the root cause was different. Some department leaders had not reviewed the error reports with their employees. The people had never received the information needed to correct their work. The repeated error looked like an individual performance problem, but the stronger explanation was a management and feedback failure.

Audit lesson. Labels can stop inquiry. Before concluding that an employee lacks care or capability, test whether expectations were clear, feedback reached the person, coaching occurred, and leaders removed barriers to correct execution.

2. The 18-minute room

At another organization where I worked, a senior leader focused intensely on a benchmark showing that one property could clean a guest hotel room in about 18 minutes. The benchmark came from a smaller property with different operating conditions, yet it became a broad expectation. As the number gained visibility, employees learned that speed carried more weight than the contextual differences leaders acknowledged in conversation.

Housekeepers rushed. Supervisors felt pressure. Local leaders searched for shortcuts that protected the metric. No one needed to instruct employees to lower quality. The environment communicated the trade-off.

Risk lesson. Metrics become cultural signals. When leaders elevate one measure without balancing indicators, local context, or safe challenge, employees may optimize the number while weakening the process it was meant to improve.

Performance pressure can make unsafe choices feel normal

3. When speed displaced care

In one resort operation where I worked, a guest died in an incident involving electrical wiring. The experience forced me to confront a difficult question: What happens when the environment rewards speed so consistently that stopping, questioning, or escalating begins to feel like failure? The written standards did not endorse unsafe work. Yet the working environment still influenced what people believed they needed to prioritize.

This story carries a different weight from a missed target or repeat exception. It shows why leadership behavior cannot be treated as a soft issue. The signals leaders send influence whether people pause, verify, ask for help, challenge urgency, and protect one another when the stakes are high.

Risk lesson. The purpose of examining the environment is not to remove individual accountability. It is to understand the full system that made a decision more likely. Responsible analysis can hold people accountable while also asking whether leaders created clear priorities, adequate resources, credible stop-work authority, and a safe path for escalation.

The pattern across all three stories

Observed outcome	Easy explanation	Deeper environmental question	Control response
Repeated errors	People are careless	Feedback never reached them	Verify the learning and coaching loop
18-minute target	Employees chose shortcuts	Leadership emphasis made speed dominant	Test conflicting goals and incentive signals
Fatal incident	Someone failed to follow the standard	Performance pressure shaped the operating context	Examine workload, authority, escalation, and leader response

These examples point to a broader root-cause discipline: ask what happened, then ask what the environment made reasonable, rewarded, or difficult at the moment of decision.

The CAMELS debate sharpens the measurement question

As of October 2026, the revisions remain proposed. In May 2026, the FFIEC proposed revisions to the Uniform Financial Institutions Rating System, commonly known as CAMELS. The proposal would retain the framework while removing the special consideration historically given to the **M**anagement component when assigning a composite rating. It would also update the Management definition and evaluation factors, emphasize material financial risk, and seek greater consistency and transparency.⁹

The OCC supported the direction of the proposal while arguing that the Management component must provide distinct value rather than repeat deficiencies captured elsewhere. The Comptroller called for Management to function as a standalone assessment.¹⁰

What the debate means

The debate does not establish that management is irrelevant. It highlights a legitimate measurement problem: how should supervisors distinguish management quality from the financial and control outcomes management influences? How should they reduce inconsistency without waiting for losses to make weak governance obvious?

The answer should combine outcome data with behavioral evidence. Capital, liquidity, asset quality, earnings, and sensitivity provide essential evidence of condition. Management assessment can add forward-looking value when it focuses on observable practices that influence how risk is identified, debated, escalated, and addressed.

From subjective impression to disciplined judgment

- Define the leadership behaviors linked to risk outcomes before assessing them.
- Use multiple evidence sources rather than a single culture survey or anecdote.
- Test consistency between stated expectations, incentives, decisions, and consequences.
- Differentiate a local manager issue from a recurring enterprise pattern.
- Connect behavioral observations to material risks, control execution, and remediation results.

Subjectivity becomes less problematic when organizations make the judgment criteria explicit, triangulate evidence, document reasoning, and monitor trends over time.

Every audit finding tells two stories

Story	Evidence
Visible story	Policy, process, control, exception, ownership, frequency, financial or regulatory effect
Hidden story	Decision context, leader signals, pressure, clarity, confidence to challenge, incentives, response to prior concerns

The second story should not replace traditional root cause analysis. It should deepen it. A finding may require a control redesign, system change, or clearer procedure. If the organization leaves the environmental cause untouched, however, the same pressure may produce a different workaround later.

Questions to add to interviews and walkthroughs

- What did employees believe mattered most when the decision was made?
- Which leader behaviors reinforced that belief?
- What happened the last time someone slowed the work, challenged the target, or escalated bad news?
- Were responsibilities clear, and did employees receive timely feedback on errors?
- Did goals, staffing, incentives, or deadlines create a conflict with the control?
- Could control functions influence the decision before the exposure grew?
- Were repeat issues treated as learning signals or isolated performance failures?
- What evidence would show that the environment has changed after remediation?

A strong finding describes the broken control and the conditions that weakened it. A strong action plan repairs both.

A practical Hidden Control Environment Review

Organizations can assess leadership and culture without pretending they are perfectly objective. The review below combines observable behavior, employee experience, and operating evidence.

Dimension	Core question	Illustrative evidence
Clarity	Do people understand priorities, risk appetite, decision rights, and escalation paths?	Interviews, role documents, decision logs, survey items
Pressure and trade-offs	What happens when speed, revenue, service, quality, and control expectations compete?	Targets, staffing, exception patterns, overtime, deadline changes
Voice and challenge	Can people question assumptions and raise concerns without interpersonal or career penalty?	Escalation data, meeting observation, retaliation concerns, skip-level interviews
Learning	Do leaders use errors and near misses to improve systems and capability?	Repeat findings, coaching records, after-action reviews, lesson sharing
Accountability	Are expectations and consequences consistent across role, level, and performance status?	Performance criteria, promotion decisions, consequence management, overrides
Leader capability	Do managers know how to create engagement, clarity, feedback, and responsible challenge?	360 feedback, leader routines, team variation, development plans

How to conduct the review

- Select a material risk, process, or recurring finding rather than assessing culture in the abstract.
- Map the decisions that determine whether the control works in practice.
- Gather evidence from multiple organizational levels and compare subcultures.
- Identify the leadership signals that strengthen or weaken each decision.
- Link findings to measurable operating outcomes and assign leadership actions alongside control actions.
- Reassess the same evidence after remediation to test whether behavior changed.

The goal is not to produce a single culture score. The goal is to identify the few leadership conditions most likely to improve control execution in the selected risk area.

An action agenda for boards, executives, and audit leaders

For boards and executive teams

- Define the behaviors that demonstrate the desired risk culture, including how leaders handle challenge, trade-offs, and bad news.
- Review whether incentives and promotion decisions reinforce those behaviors when results are strong and when pressure rises.
- Ask for evidence of tone at the middle, including variation across teams, locations, and business lines.

For chief audit executives and internal audit teams

- Include leadership and decision context in root cause analysis where human judgment affects control execution.
- Develop a small set of behavioral indicators tied to material risks rather than launching a broad culture checklist.
- Use thematic analysis across findings to identify repeated signals involving pressure, voice, accountability, or learning.
- Frame observations in language that connects behavior to exposure, not personality or leadership style.

For business and people leaders

- Make priorities explicit when goals conflict. Employees should not have to infer which standard they may quietly ignore.
- Respond to concerns with curiosity, timely action, and visible follow-through.
- Coach from errors before assigning labels. Confirm that people received expectations, information, resources, and feedback.
- Recognize employees who protect the organization by pausing, verifying, challenging, and escalating responsibly.

How the National Academy of Leadership Development supports this work

The strongest control environment combines sound systems with leaders who make good decisions easier, responsible challenge safer, and accountability more credible.

The National Academy of Leadership Development helps organizations equip leaders to create people-first environments where individuals, teams, and organizations flourish. In risk-sensitive settings, that work strengthens the human conditions that controls depend on: clarity, trust, engagement, responsible challenge, learning, and accountability.

Stage	NALD support	Intended result
Discover	Assess leadership signals and employee experience around a selected risk, process, or recurring finding.	A shared view of the environmental factors influencing control execution
Equip	Develop leaders through keynotes, workshops, facilitated experiences, and customized learning.	Practical behaviors leaders can use in daily decisions and conversations
Apply	Connect leadership practices to real audit themes, risk scenarios, operating metrics, and team routines.	Transfer from a learning event into the working environment
Sustain	Support reinforcement through coaching, leader cohorts, measurement, and follow-up.	Visible progress and continued accountability

Ways to engage

- Rehumanizing Risk keynote or executive briefing
- Hidden Control Environment working session for audit, risk, compliance, HR, and business leaders
- Priceless Leadership workshops for managers and executives
- Customized leadership development, coaching, and organizational development consulting
- Facilitated review of leadership conditions connected to a material risk or repeat finding

About Scott Doggett

Scott Doggett is the Founder and Chief Servant Leader of the National Academy of Leadership Development and author of Priceless! See People Differently. Lead People Better. His career spans nearly 30 years in hospitality operations, resort general management, organizational learning, and leadership development. He helps leaders connect the way people are treated with the decisions they make and the results organizations achieve.

To discuss a keynote, executive briefing, or Hidden Control Environment working session, contact Scott Doggett at scott@nationalald.com.

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Research note

This paper synthesizes established frameworks, regulatory guidance, workplace research, and anonymized practitioner experience. It offers a practical leadership and audit lens, not legal, regulatory, or accounting advice. Organizations should adapt the questions and evidence to their risk profile, jurisdiction, and supervisory expectations.