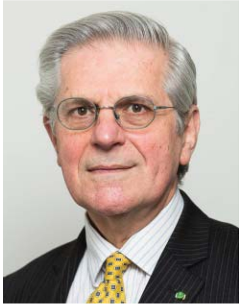

Allies of the Board, Obstacles and Internal Control

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For many independent directors, the desire to provide strategic direction while not interfering in operational matters results in the challenge of finding out what is really going on within a corporate organisation in relation to their roles and responsibilities. Are issues and concerns being hidden? Is the information received so detailed as to conceal what is important, or so fragmented as to make it difficult to form an overview on the adequacy and integrity of corporate systems and processes?

Penetrating the Fog

From the perspective of the boardroom some companies seem to have hard shells, with a CEO and executive directors acting as gatekeepers. One can ask questions, probe and call for briefings and reports. One could specify the format of reports and request trend lines, root causes and suggested actions, but what if the papers submitted to the board are sanitised or so complex and voluminous as to conceal rather than illuminate?

Executive directors may also find it difficult to find out what is happening in other departments and/or divisions where barriers exist and colleagues are protective of their turf and interpret questions as a challenge to their authority and competence. Induction arrangements, visits and briefings can be used to expose directors to certain people and opinions, while keeping them away from those with contrary views.

Obtaining independent and objective input on problems, deficiencies and weaknesses can be difficult when vested interests are at stake. Consultants with an eye on future assignments may produce reports that support the views of management and avoid any criticism of them. Professions that were once focused upon independence, grasping nettles and protecting the public now sometimes seem to be more concerned with limiting the liability of their members.

Despite challenges, directors usually have powers they can use to penetrate the fog, which can include the right to independent advice. Sometimes using certain powers might harm relationships with a CEO and executives and be regarded as a last resort. On other occasions help may be at hand from people whose remit and powers of investigation range across a corporate organisation. Board committees such an audit or risk committee may periodically meet them, agree their work programmes and receive inputs from them without other executives being present.

Effective Internal Control

Boards need to ensure that an effective system of governance and internal control is in place across organisations for which they are responsible, to reduce the possibilities of fraud and abuse and to help ensure the integrity of accounts and other financial information. In this and other aspects of a board's work there are hopefully others who share their objectives and concerns. Actual and potential allies should be identified and supported and obstacles to their work addressed.

Directors should be alert to those who can help them to discharge their responsibilities and to who or what might get in the way. Within a corporate organisation their concern for good governance and ethical conduct should be shared by a range of people, including a company secretary and a chief legal officer and their teams. An effective system of internal control should be of particular interest to a chief financial officer and team and to internal and external auditors.

In public sector organisations in many jurisdictions a responsible accounting officer, often the CEO, is required to prepare and submit an annual statement of internal control. Its contents are likely to depend upon investigations and reports of internal and external auditors, relationships with whom may be managed on behalf of the board by an audit committee. Effective boards take steps to ensure the integrity and independence of such people and their processes.

Inputs and Reports to the Board

Many directors find it difficult to form a view on the integrity of corporate processes and related risks because so many of the people reporting concerns do so from a departmental point of view. Corporate organisations consist of people with defined roles who may look at issues from a particular perspective and whose reports may be distorted as they pass upwards through layers of management. In contrast, directors should have a more holistic and objective perspective.

Boards need information that is significant and current. Those who assemble it should adopt an organisation wide perspective and have a sense of what is material. The concern of some boards is that while they may be inundated with separate reports from a chief risk officer, internal auditor and others, their consolidation into a single report might result in the loss of something important. Excessive departmentalism can prevent officers from seeing the bigger picture and identifying the wider implications of certain developments.

Directors should consider how a board might secure more integrated advice and how the activities of potential allies could be mutually supportive. For example, is there a good working relationship between the internal and external auditors? Do both adopt a risk based approach and coordinate their tests and investigations with audit committee support? Do they trust and make use of each other's findings? How engaged are they with a chief risk officer and other senior professionals?

Independence and Professional Integrity

Particular attention should be paid to certain roles and responsibilities, to ensure that they and reporting relationships to not inhibit independence and objectivity. Do certain members of the executive team, which could include a company secretary, an internal auditor, a chief compliance, financial, legal and/or risk officer, exercise independent judgement and act objectively and with integrity? Are there personal loyalties, commitments or interests that might cloud their judgements?

The independence of an internal auditor and his or her rights in areas such as access to information should be set out in an internal audit charter. Does the internal auditor have a reporting line to an independent or non-executive chair of an audit committee? Thought should also be given to the rights that should be agreed for the holders of other roles such as a chief compliance, legal or risk officer. Does a chief risk officer have a reporting line to the independent chair of a risk committee?

While welcoming allies and their support, directors need to be realistic and even sceptical in assessing their competence, contribution and independence. Does their perspective embrace a company's network of relationships and supply and value chain? Are they all viable, trusted, adding value and needed? Are they open, innovative and flexible? Are they providing relevant, holistic and objective assurance, advice and insight? Are there boundary issues? Do they inhibit integrated understanding and complicate decision making?

Auditor Independence

Steps to assess auditor independence should not become quick tick box rituals. One needs to ensure that conflicts of interest do not occur in audit activities. Directors should check that external auditors are not overly financially dependent upon their income from particular audits to such an extent as to cloud their judgement. Are they engaged in consulting work and/or other assignments of a nature and/or significance that might compromise their objectivity and independence?

An audit committee and board should keep a careful watch upon non-audit work undertaken by a company's external auditors to ensure it does not create a conflict of interest and that where Chinese walls are required or desirable they apply. Auditors should not be expressing an opinion on processes and practices that they themselves have been responsible for.

Internal auditors are sometimes requested to undertake consultancy type activities and projects to improve processes and practices rather than just comment upon them and make recommendations for their improvement. This can also create conflicts of interest if an internal auditor is then expected to express a view on his or her work.

It is good practice for both internal and external auditors to periodically meet with the independent members of an audit committee without the executives being present. Both should have access to the audit committee chair and, if need be, a board chair if they feel it necessary to use this route to raise an issue or concern. The periodic rotation of auditors and refreshing of the members of an audit team is desirable to ensure they do not become complacent and fail to sufficiently question and probe areas that have not caused concern in previous years. One should never assume compliance just because this has been the case in the past.

Raising Sensitive Questions

Competent directors have the courage to raise issues that boardroom colleagues may be reluctant to bring to the table, choose to ignore or sweep under the carpet. Until they speak up, concerns that others may have may remain unaddressed and the negative aspects of a situation might continue. On occasion, people, including potential allies, may be inhibited from bringing up certain topics by perceived social conventions about loyalty and a desire not to be impolite or to rock the boat. Some people are risk averse and do not like being in a minority or sticking their neck out.

On some boards there seem to be "no go" areas such as overt criticism of a colleague around the boardroom table. Experienced directors try to avoid charges of rudeness and the triggering of defensive reactions by being

diplomatic. Rather than saying a proposal is stupid or wrong, they might ask whether certain aspects have been considered or particular risks have been taken into account. What if circumstances change or costs continue to rise?

Executives can also be sensitive to perceived encroachments upon their territory. The authority of some can depend upon their specialist expertise, while that of others may largely reflect powers delegated by a board. Can one be too diplomatic when dealing with certain colleagues and/or executives? What if hints are not taken and warnings are ignored?

Whistleblowing

Internal and external auditors cannot be everywhere or investigate all transactions. They have to take a risk-based approach and rely upon sampling and testing. Like an internal financial team, they might use algorithms to monitor a wide range of transactions and other activities to flag up unusual items. Those that lie beyond normal control units may be subject to further investigation.

In other areas, a whistleblowing policy that encourages staff to speak up when they have concerns and offers certain protection to those who do can be helpful, but its implementation needs to be undertaken with care. The reality is that many whistleblowers pay a personal price for raising concerns that can range from a blighted career to securing a reputation as a trouble maker.

In some situations, a high proportion of cases raised may be trivial or motivated by personal enmity. A system of triage and the exercise of judgement about which cases to pursue may be advisable. Care needs to be taken to ensure that those occupying such a role do not act to protect themselves and/or their friends, and thought needs to be given to how to handle a case that involves someone to whom an incident would normally be reported.

Support of Whistleblowing

A corporate environment that resembles a police state with surveillance cameras in offices, staff carrying personal trackers and individuals reporting each other's every move is hardly conducive of the freedom of expression and enquiry that can spur creativity, innovation and entrepreneurship. However, vigilance and the right whistleblowing policy can massively increase the number of people who can act as the eyes and ears of the board.

There are questions directors can ask to determine whether there is a positive environment for whistleblowing. Is top management committed and supportive? Is the whistleblowing policy accompanied by helpful and reassuring guidance? Do they make clear that employees who report concerns that turn out to be unfounded will not be punished if they had reasonable grounds for raising an issue? Is confidentiality and anonymity provided and protected?

Are alternative reporting paths provided that can avoid line management? Does the whistleblowing policy address the question of how to handle a complaint against an executive director or CEO? For example, is there a reporting route to an internal or external auditor, a company secretary or corporate lawyer, the chair of an audit committee or a board chair? What if the person complained of is a CEO who is also chair of the board? How should such an individual be investigated?

Is a whistleblowing policy fair and balanced? Does it make it clear that penalising someone for raising a genuine complaint will be dealt with as a serious matter, as will groundless complaints and the making of false accusations? In certain cases, can whistleblowers have recourse to external parties such as a regulator or sources of independent advice?

Coordination across Specialisms

Returning to a board's requirement for integrated inputs and whether internal functions are mutually supportive, directors should consider the extent to which activities of various specialists with an enterprise wide perspective are aligned. For example, do internal auditors, chief risk officers and others share their findings? Do they coordinate investigations and their follow up where there is limited assurance?

The internal audit and risk management communities may have similar views on enterprise risk management. In many companies they may also use the same or similar standards and guidance frameworks. Directors could probe whether any potential for collaboration is being realised. Do different functions behave as allies or rivals for funding and attention? Is there open and regular communication between them? Are their work plans based upon the same or consistent risk assessments? Do outputs contribute to each other's plans and activities? Are resources being shared across functions or hoarded, protected and withheld?

Are both internal audit and risk management contributing to the assessment, monitoring and mitigation of the strategic risks facing an organisation? Does the board receive coordinated inputs from across functions that embrace different perspectives? Do different departments consider themselves to be complementary or rivals? Is the most relevant resource allocated to addressing significant issues as they arise, irrespective of which department it is located in?

Monitoring Activities and Management Responses

Trends should be monitored to determine if limited or substantial assurance assessments are increasing or falling. The number and nature of adjusted or unadjusted misstatements in an external auditors report can be an indicator of the state of accounting. Particular attention should be paid to management responses to audit, compliance and risk reports and recommendations. Rejections and disputed reactions could indicate defensiveness and a reluctance to accept criticism, help and support. Acceptance of recommendations could be a measure of the value being added by allies.

As well as identifying and supporting potential allies, directors and boards should ensure they operate at a sufficiently high level to have impact, secure respect and for their recommendations to carry weight. Assurance activities need to be adequately resourced, Sometimes directors find their most valuable allies and advisers are those who are not inhibited and who speak their minds. ■

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