The governance imperative

Decisions made in boardrooms have far reaching consequence. As such the value of good governance, the process of making and implementing decisions, cannot be overstated. Is there anything more important than that which determines an organisations ethics, strategy and how it operates?

Back in 2017 there should have been a reason to celebrate for all those connected with governance; the 25th anniversary of Cadbury's famous phrase '*corporate governance is the system by which companies are directed and controlled*'. Yet whilst progress has been good, there are still too many events occurring which present a picture of inappropriate organisational culture and the slow pace of change:

- Collapse of public sector partner and construction giant Carillion
- Tesco's financial misstatement debacle
- Deepwater Horizon oil disaster rooted in governance failings
- banks fined >£800m for issues such as the Libor rigging scandal and PPI claims mismanagement
- delayed reporting by Equifax of a data breach affecting 145 million people
- Sport Direct systemic cultural issues likened to a Victorian workhouse by MPs
- Oxfam workers exploiting vulnerable communities in Haiti
- Wells Fargo announces profit drop after CEO exits in fake accounts scandal

Social distancing measures introduced to stem the coronavirus pandemic was one of the new governance challenges in 2020 with audit committees postponed and activities subsumed back into the main board rather than engaging through virtual meeting.

- What are the governance arrangements in your organisation?
- Is there a risk temporary changes due to the COVID-19 crisis become permanent or where positive are not embedded?
- When did you last advise the board on what good corporate governance looks like?
- In times of crisis should the time allocated for governance be protected or is it acceptable to 'explain' more often than 'comply' to stakeholders?

Other examples may come to mind, there have been too many over the years to include them all. Aside from reading about each debacle and being grateful that you were not the chief audit executive (CAE) in the headlines, what have you actually done? How many boxes can you tick on the list below?

Talked to the Audit Committee Chair ☐	Agenda item to discuss with Board/AC ☐	Reviewed risk assessments ☐
Quick desktop review of governance ☐	Added/escalated governance on audit plan ☐	Organised a breakfast debate ☐

Notwithstanding that auditing governance can be challenging; inaction is no longer an acceptable course of action for CAEs. This is not futile rhetoric but fact. Chartered professions and those working in them, regardless of their personal views, have a duty to act in the public interest; it is time for internal audit to banish poor governance practices.

Butterfly effect

The butterfly effect is a scientific theory that small changes in one place can have a massive impact elsewhere. It is a useful way to think about governance as the decisions made in the boardroom have ramifications across not only your organisation but also wider society. All sectors have experienced issues:

- the outcome when Sir Philip Green agreed to sell BHS for £1 was felt across 11,000 families and numerous suppliers;
- global consequences were felt within days of the Haiti Oxfam scandal as 3.5% of direct debit donors cancelled donations, ministers postponed funding, corporates such as John Lewis reviewed project funding and overseas aid was suspended coupled with the halo effect on other charities due to the erosion of trust;
- inadequate risk management by multiple parties contributed to the Grenfell Tower disaster; and
- surgeon carried out hundreds of unnecessary breast surgeries, continuing to operate for eight years after alarms were first raised.

And the butterfly effect has never been more evident than in the 2020 pandemic, when decision-making by governments and key organisations affected all global citizens.

Internal audit has an enterprise-wide remit, the processes and decision making behind all of these matters are auditable. When audit concerns are raised, what governance shortcomings prevented them from being heard? Often these failings are rooted in culture and human failings; fear, apathy, greed. How well do you as CAEs try to influence small occurrences before they become endemic? The turn of the head, the evaded question, the inaccurate or incomplete minutes approved by the Board/Audit Committee, the CEO banging the table, the overturned decision, the lack of debate.

Headlines

Our introduction mentioned CAEs in the headlines, which is not strictly true; internal audit is infrequently mentioned in the media. The profession escaped public scrutiny in the wake of the financial crisis; will it do so again as the media dissects governance, despite its clear linkages with the board, non-executives, external audit, regulators etc.? Is this simply because internal audit is beneath the radar of journalists or because of the perception of the profession?

When internal audit was challenged during the parliamentary inquiry into Carillion's collapse, the Deloitte partner asserted that they had called out control issues but in line with chartered guidance it was not within their remit to take strategic decisions. Depending on perspective - a factual statement or hiding behind the fact. How defensible are your audit opinions?

View a session transcript of the parliamentary inquiry; all CAEs are urged to read Q796-818 and Q849-862. Imagine yourself in that position, what would your defence be in the event that your organisation failed?

Early in 2018, Oxfam admitted that former employees had exploited sex workers whilst active on a project in Haiti. Governance yet again hit the UK headlines for all the wrong reasons, also in the headlines was Oxfam's former head of safeguarding (2012-15) stating that she had raised concerns internally and to the regulator, the charity commission, about misconduct by staff saying '*if we don't have resource to safeguard those we are meant to help from harm caused by our own representatives, then how can we justify the work we do*'. The public information about the issue suggests that there were multiple governance failings within the charity and a lack of scrutiny by the regulator. Were the lessons of the financial crisis not meant to be heeded across all sectors?

It goes without saying that the institute does not want to see the profession in the headlines associated with poor governance; however, it is surely time for internal audit to step out of the safety of the shadows and fully engage with its role and its mission statement '*to enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight*'.

Advocacy

Within the profession, internal audit considers itself to be fundamental to good governance although its stakeholders have yet to truly embrace the powerful role that it can play. IIA Global recognise the challenge this presents to CAEs when conducting or proposing audits in this space and have produced a public document that can be adapted to build advocacy.

CAEs cannot rely on 'the profession' informing their stakeholders, the real power for change lies not solely with the institute lobbying but also with CAEs demonstrating value and leveraging relationships; sharing with colleagues both internally and externally the benefit internal audit brings to the governance, risk and trust agenda.

The quick win is to secure a governance agenda item at the next board/audit committee to encourage an open discussion including lessons learnt from public failures and either sharing the results of or gaining commitment for audit reviews. If you don't have the skills available, co-source, it is no longer acceptable for CAEs to accept an assurance gap for governance.

A longer-term goal is to influence the governance decision makers about the value of good governance and internal audit, if they are not already advocates use your passion, evidence, professional tools and convince them.

The vision for the profession is that internal audit is universally recognised as essential to the success of organisations, however, as a chartered body there is also an overriding imperative to act in the public interest. When organisational governance fails, if it isn't highlighted and discussed at a senior level/reported to regulators then doesn't internal audit also fail in its duty?

Trust

It is still true that the vast majority of people do not set out to do the wrong thing but this is not taken into account when governance goes wrong. The 2020 Edelman Trust Barometer continues to highlight the global decline of trust across all of the societal institutions measured by the study: government, business, NGOs and media. Calls on technical experts to deliver credible communications to rebuild confidence in facts reached new heights in May 2020 when Twitter warned users of the validity of tweets made by US president Donald Trump. Check out this video on the trust barometer. In Europe this is also manifested in the growing presence of populism, acutely felt in the UK following the Brexit vote.

There is a groundswell of activity recognising the erosion of trust and need to promote more effective governance which internal audit has the opportunity to leverage:

- UK corporate governance code 2018
- Wates corporate governance principles for large private companies 2018
- Guidance on board effectiveness 2018
- UK stewardship code 2020

This is a good time for CAEs to be promoting corporate governance. It is no longer about whether an organisation is required to comply, it is simply good business practice and social stewardship applicable to all organisations regardless of sector, size or structure.

An absence of trust impacts corporate investment; if reports and dialogues cannot be relied upon how can effective decisions be made? An increase in investor interest and activist pressure has already been seen and is likely to continue. Morrisons investors quashed plans to increase their CEO reward package and in the shipping sector investors have made significant governance demands to address known issues.

Application

The institute provides support and guide CAEs in rising to the challenge such as training sessions, offering guidance on technical audits and facilitating networking to share lessons learnt together with good practice.

There are activities that CAEs should be doing to promote good governance such as:

- auditing/advising on the recruitment of non-executives (trustees etc.)
- ensuring that NED's 'walk the floors' to understand the business and the workplace
- recommending the use of a skill matrix to ensure appropriate skill coverage
- validating board composition complies with good diversity practice
- building a relationship with all non-executives not just the chair of the audit committee
- meeting with all senior managers as part of their induction
- developing candid relationships with the company secretary/communications director
- reading information on good governance and sharing insights with the board and audit committee

There are also many governance related audits that should be part of the audit universe, including:

- decision making process
  - financial budgeting
  - business case process e.g. prioritisation and sign off investment/extraordinary spend/projects
  - strategy setting
  - risk appetite setting and communication
  - viability statement review
  - annual report review, particularly non-financial reporting e.g. modern slavery, gender pay

reporting, human rights

- organisational culture
    - non-executive/trustee recruitment process
    - risk management methods and practices
    - reputation audit, e.g. level of stakeholder trust, affiliates, global practices, communications
    - performance management
    - reward setting at all levels e.g. remuneration committee activity
    - attraction, recruitment and retention of staff
    - succession planning
    - sustainability/corporate social responsibility
    - communication, e.g. tone, media, shared values, ethics statement, code of conduct
    - incident reporting and escalation
    - compliance with policies, procedures, laws and regulation
    - reporting regime with regard to regulators
    - diversity/inclusion e.g. board, senior executives, employees, gender bias roles
    - whistleblowing

There will be resource challenges in the form of available time and suitable skills, risks may not be assessed as a high priority, governance related risks may not even be identified and audit findings may be challenged but these are standard issues for CAEs, it is just the subject matter that is emotive and the stakeholders more powerful than usual.

Closing thoughts

If not internal audit, who else has the authority and capability to improve the process of decision making and call out the consequences of decision failures. Internal audit also needs to challenge how key business critical decisions are implemented.

Chief audit executives, *you* personally *can* make a difference, by understanding the butterfly effect, that *every action matters*, not only to the governance of *your* organisation but to the extended enterprise that *you* are part of; thousands if not *millions* of people and the environment.

> *"Somewhere inside all of us is the power to change the world"*

- Roald Dahl