TONE at the TOP®

POWERED BY The Institute of Internal Auditors | AUDIT EXECUTIVE CENTER®

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Providing senior management, boards of directors, and audit committees with concise information on governance-related topics.

Internal Audit's Role in Assuring Accurate Board Information

Boards of directors have a massive amount of responsibility placed upon them as they act on behalf of shareholders to ensure the organization achieves its objectives. This involves approving strategy, monitoring finances, remaining aware of marketplace and competitor developments, and keeping an eye on risks. They must make dozens, even hundreds, of critical decisions each year, and they cannot make them effectively without a basis of good, reliable information.

Indeed, knowing they have complete and accurate material on which to base their deliberations provides many directors some comfort that their liability is reduced and their exposure to allegations of failure to discharge their duties is limited. It is for this reason that alarm bells were sounded by statistics reported in the 2016–2017 NACD Public Company Governance Survey that indicated that board members are dissatisfied with the transparency of the management-developed information they are provided.

Survey Results

The National Association of Corporate Directors' survey was the focus of an article in the December 2016 issue of *CGMA Magazine*, which included two statistics taken from the data that signaled the board's lack of confidence in the material they were given to inform their decisions:

- About one-third (32 percent) believe the performance metrics they have been provided are inadequate to assess progress. Management may present the board a "polished" or high-level version of the organization's status, rather than an honest and adequately detailed report of successes and challenges.
- Roughly the same number (30 percent) consider the information they have been given about strategy to be insufficient. Board members need past results and lag indicators to make their best contribution to strategy discussions, but they cannot use that information alone. Trends and lead indicators, which focus the board's attention forward, are necessary as well.

Those responses indicate that boards are not afraid of making bold decisions on strategy nor averse to hearing bad news, but they struggle to do so without transparency from management.

About The IIA

The Institute of Internal Auditors Inc. (IIA) is a global professional association with more than 190,000 members in more than 170 countries and territories. The IIA serves as the internal audit profession's chief advocate, international standard-setter, and principal researcher and educator.

The IIA

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Board's Role in Getting What They Need

To Leslie Murphy, who sits on a number of boards and is CEO of Murphy Consulting, boards' responsibility relative to securing the material they need to perform their duties is straightforward: "It is the responsibility of the board to make it clear what information is requested of management. If we believe there is not sufficient transparency with challenges, we need to ask specific questions and make detailed requests to satisfy our needs."

This casts board members in a proactive posture, specifying the information they expect rather than passively accepting whatever is handed to them. To that end, the board may find candid discussions with the CEO necessary in conveying its expectations.

Those expectations undoubtedly apply to nonfinancial as well as financial information. As evidenced by the formation of the International Integrated Reporting Council (IIRC), which has developed a framework for integrated reporting, there is, in IIRC's words, a need to "bring about integrated thinking, enabling a better understanding of the factors that materially affect an organization's ability to create value over time."

IIRC reports that businesses that use integrated reporting experience enhanced understanding of value creation, greater team collaboration, more informed decision making, and improved stakeholder relations. Boards need information that enables them to take a qualitative perspective on organizational performance outside the balance sheet. If that material is not provided, boards should request it.

When management is prepared to provide whatever the board needs to perform its responsibilities, board effectiveness will improve and shareholders stand to benefit in the long run.

Role of Internal Audit

Internal audit's role relative to the quality of board information tends to come after the fact — assessing whether activities and decisions were implemented as planned. And, of course, this is a valuable contribution to organizational success. But surely internal audit can contribute at the front end of the board process as well, by assessing the risk of the board failing to understand business issues or making inadequate decisions based on the quality of the information available. Traditionally, however, this does not occur.

This could be a missed opportunity. Trained in systems thinking and control processes, internal auditors may be able to help with identifying risks and challenges up front, as well as designing processes and controls and reporting formats that accommodate the balance needed.

The board is provided a regular stream of information — financial, operational, performance, compliance, sustainability, sales, human capital, IT/cybersecurity, etc. — that it uses to make strategic, financial, and other decisions. Does the board have assurance that the information is accurate and complete? And what about bias? Executives and management are incentivized on certain achievements; they want to accomplish certain goals. Is it possible they could be slanting the information provided to the board to support a favorable perspective? Considering these questions clearly makes some board members a bit uneasy, as evidenced by the NACD statistics.

Financial reports tend to get a lot of attention from various departments within the company and from without, through the external auditors. Depending on the industry in which the company operates, this attention may be amplified by regulatory compliance requirements. There is generally a greater feeling of comfort about that material because of the extra level of scrutiny it receives, but the other reports, which may uncover looming pitfalls or unaddressed opportunities, are equally important.

Asking the Right Questions

Since board materials are intended to support the board in making productive decisions, they should not only provide the right information, they should also inspire the board to ask the right questions. Some examples include:

- Where did this data come from? Is it current? Is it trustworthy?
- Does this report reflect the risks involved in the organization's plans? Does it describe the appropriate mitigating actions put in place to address the risks?
- Does this report balance the historical information with discussion of emerging trends and opportunities?
- Are there supplemental reports that should be provided to further illustrate pertinent points? Or, does it describe where such additional detail can be accessed?
- Does the information in this report represent the entire organization/department? Is performance consistent across all units, or are some far outperforming others? If so, does the report define what separates the successful units from those that are less productive?
- Does the report describe how the activities support achievement of organizational objectives outlined in the overarching strategy?
- To what degree are marketplace developments and/or competitor activities reflected in this report?
- To what degree did different departments/units collaborate on the preparation of this report, to reflect the required interaction of a variety of activities involved in achieving an objective?

Source: Adapted from CIMA's "Performance Reporting to Boards: A Guide to Good Practice"

The solution is not to have internal auditors review every report before it goes to the board. That would be short-term and superficial. The solution is more systemic: building a better, more open relationship between the board and internal audit. When board members feel uncertain about their understanding of an aspect of the business or concerned that they lack the information they need to make an informed decision, they should be able to leverage their relationship with internal audit to convey that concern to the CAE, perhaps through the audit committee, who can place it on the audit plan.

But communication is a two-way street. The CAE needs to speak up as well, requesting regular meetings with the board and the audit committee to hear what they perceive to be the company's biggest risks. This information will improve risk assessment activities and make the annual audit plan reflective of a broader set of concerns.

Organizational success often depends on the decisions and guidance provided by the board. No company would hire, say, an accountant and then deny him or her access to the software, procedures, and information needed to perform the job. Failure to give the board members the information they need to lead the company is equally counterproductive.

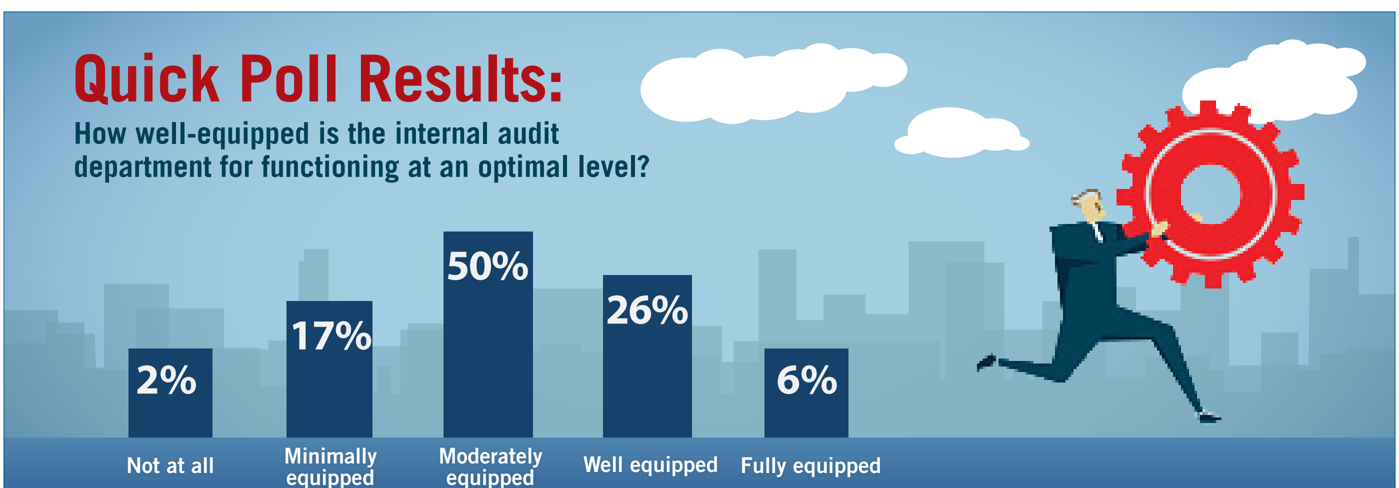
Internal audit is an independent, objective resource that has a solid grasp of the company's activities. It has the unique ability to take a proactive, enterprisewide, risk-based view of issues of most importance to the board and the business. Indeed, if the board has concerns about being able to do its job, based on the accuracy, completeness, and transparency of the information it is provided, it would be difficult to find a more useful partner than internal audit.

Quick Poll Question

How involved is internal audit in assuring accurate and complete information flows to the board?

- ❏ Not at all involved
- ❏ Slightly involved
- ❏ Moderately involved
- ❏ Very involved
- ❏ Extremely involved

Visit **www.theiia.org/tone** to answer the question and learn how others are responding.



Source: *Tone at the Top* August 2017 survey. Results do not equal 100 due to rounding.