THE QUALITY OF BOARD INFORMATION

Understanding the responsibility of CAEs
# Table of Contents

- Introduction ................................................................................................................................ ................... 1
- Defining board information .......................................................................................................................... 2
- Understanding the gap ................................................................................................................................ . 4
- Getting heard ................................................................................................................................ ................. 5
- Conclusion ................................................................................................................................ .................... 8

---

## About the Expert

**Gregory Jordan, CIA, CRMA, CPA**

Gregory Jordan began his career at Nationwide in 2001 and has served in several business and finance leadership roles. As chief audit executive and senior vice president for Nationwide’s Office of Internal Audit, Jordan is responsible for overseeing, reviewing, and communicating the results of internal audit work.

Jordan’s background prior to joining Nationwide includes six years at Midland Life Insurance Company/Swiss Re, where he was the vice president of operations and controller. The Ohio State University graduate began his career with EY, where he spent 11 years, and was a senior manager in the Insurance and Financial Services practice. He is a fellow in the Life Management Institute, serves on The Institute of Internal Auditors (IIA) Central Ohio Board of Trustees, and on The IIA’s International Exam Development Committee. He is a community member on the Columbus City Schools Audit and Accountability Committee, and serves on the board of Lutheran Social Services, a non-profit organization.
INTRODUCTION

Understanding the value of information

Sound information is essential to organizational success. Whether addressing customer satisfaction, business trends, or risk management, leaders must base strategic decisions on the best available data. The challenge for board members is to make sure the information on which they base those decisions is complete, accurate, timely, and relevant.

Boards have recently come under scrutiny from regulators and shareholders regarding their oversight over nonfinancial reporting areas such as sustainability and cybersecurity. This intensifies the pressure for boards to have the right information at the right time.

Survey data from the National Association of Corporate Directors (NACD) suggest boards are generally satisfied with the information they receive, but they also want better — not more — information.1 Unfortunately, a number of high-profile governance failures, such as Wells Fargo’s fake account scandal, suggests boards are sometimes in the dark about key risks. Boards typically rely heavily on executive management for information. Multiple surveys confirm this, including the 2019 Pulse of Internal Audit and the 2019-2020 NACD Public Company Governance Survey.2 Conversely, those same surveys show boards rarely use internal audit as a source of information, while internal audit seldom provides routine assurance on information provided to the board. What’s more, OnRisk, A Guide to Understanding, Aligning, and Optimizing Risk found that chief audit executives (CAEs) are significantly less confident than either boards or executive management in their organizations’ ability to manage risk associated with the quality of information going to the board.3

This data paints a disheartening picture for internal audit, but it is one that can and must change as all players in the risk management process are pressed to improve their efficiency and effectiveness. This is achievable; indeed, the pace of modern business demands nothing less. There are numerous examples of organizations that effectively address board information risk.

This knowledge brief focuses on the value of complete, accurate, timely, and relevant information going to the board. Additionally, it explores how CAEs can position themselves and their audit functions to provide assurance on that information.

DEFINING BOARD INFORMATION

The high risk of poor or incomplete information

An increasing focus

As regulators, investors, and the public demand stronger board oversight, boards will focus more on the quality of information they are provided for decision-making. The danger of poor or incomplete information getting to the board cannot be overstated. Indeed, boards not having a full picture of risks or risk management practices contributed to a number of recent high-profile governance failures.

Danger to the organization

Boards that are uninformed or only partially informed cannot operate at full efficiency. Yet peak efficiency should be the goal for any decision on strategy, operations, budgets, and other vital judgements made at the board level. Two recent high-profile scandals offer stark examples of the dangers organizations face when boards are hampered by poor-quality information.

The former head of the Community Bank at Wells Fargo effectively shielded much of the organization, including the board, from understanding the extent of its fake account problems until it exploded in controversy. In the aftermath of the scandal, which cost the bank more than $3 billion in fines and settlements, investigations exposed profound culture problems at the venerable lending institution. Despite repeated efforts from front-line workers to blow the whistle on unrealistic sale goals and high-pressure management tactics to meet them, the board remained largely oblivious.

The board at Blue Bell Creameries was equally in the dark to significant and prolonged food-safety problems at its manufacturing plants. Those problems led to a 2015 listeria outbreak, three related deaths, and the company’s eventual bankruptcy. Today its board members are battling lawsuits that aim to hold them personally liable for breach of duty.

Not all instances of uninformed or poorly-informed boards will lead to scandal, fines, or bankruptcies. However, it is logical to conclude that decisions driven by poor data analysis, overly optimistic projections, or a host of other scenarios where incomplete, inaccurate, or irrelevant information is shared, do not benefit the organization. In today’s fast-paced business environment, any misstep based on faulty information can have significant impacts on an organization’s competitiveness and bottom line.

Danger to the board members

Beyond the obvious dangers poor board information poses to the organization and its shareholders, rulings in two 2019 court cases provide additional examples of how significant the fallout can be. In Marchand v. Barnhill, the Delaware Supreme Court affirmed that ignorance about poor risk management is not a defense against board liability. This case was filed against the board of Blue Bell Creameries.6

The Marchand ruling affirmed that where there is no board-level reporting process for essential compliance matters, the board director can be held liable. Although directors and officers generally are immune from liability, board members cannot be “absent from the fundamental matters” of the corporation, according to the court ruling. Directors also are negligent in their duty of oversight if they consciously fail to “monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.”

While the decision in Marchand focused on the board’s failure to oversee “mission critical” risks involving food safety, the takeaway for boards, regardless of industry, is when it comes to risk management, what you don’t know can hurt you.

The second case involves a publicly-traded pharmaceutical company developing a lung cancer treatment. In Clovis Oncology, Inc., Derivative Litigation, shareholders successfully argued that the company’s board ignored or failed to call out faulty drug trial information for its premier lung cancer treatment. Among other key arguments, the plaintiff claimed that the board was aware management incorrectly reported drug trial response rates but did nothing to address it.7

Both court rulings are part of cases that continue to work through the courts. In neither case has there been a final resolution to the question of board liability. However, both rulings are important to the evolution of case law stemming from the landmark 1996 Caremark decision — the seminal case in the United States for determining board liability.

The Caremark ruling set up a two-pronged test to determine board oversight liability: “(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.”8 The Marchand ruling is based on the first prong, while Clovis Oncology is based on the second.

---

UNDERSTANDING THE GAP

Misalignment between CAEs, C-suite, and the board

CAEs express concern

CAEs are significantly less confident than executive management and board members when it comes to the organization’s ability to manage this risk. According to the findings illustrated in OnRisk 2020, all players believe they are knowledgeable about risks related to the information that goes to the board. However, CAEs rate capability much lower than their counterparts do.9

As seen in Figure 1, 43% of CAEs rate their organization’s capability to manage board information risk at 6 or 7 on a 7-point scale, with 7 being “extremely capable” and 1 being “extremely incapable.” This is 16 percentage points lower than executive management and a whopping 26 percentage points lower than the board.10 This may be attributable to CAEs believing that executive management is less than transparent, or due to CAEs lacking knowledge about information provided to the board.

Data from the 2019 North American Pulse of Internal Audit would seem to support the latter. The Pulse survey reflects that 60% of audit functions rarely or never provide assurance on the quality of information given to the board. What’s more, 57% report internal audit rarely or never formally discusses with the board and management the completeness, accuracy, timeliness or relevance of information going to the board.11

Whether CAE concerns are valid is in some ways beside the point. The danger for organizations is that there appears to be little or no assurance in this area.

10. Ibid.
GETTING HEARD
Conveying the importance of independent assurance

Communication is a virtue

Effective communication between CAEs and their boards is fundamental to addressing board information risk. As recommended in OnRisk 2020, CAEs should, “Make inquiries of board members regarding their comfort level that information they are provided is complete, accurate, and timely. Further, with board support, CAEs should consider reviewing certain board materials, particularly those involving mission-critical risks, and communicate if any information is incomplete or inaccurate.”

However, CAEs also should establish collaborative relationships at the management level to facilitate and ensure the board is getting the information it needs. Greg Jordan, Nationwide Insurance senior vice president and CAE, works closely with department heads and executive management at his organization to coordinate what information his audit committee receives. This communication and coordination is vital to ensure getting board members exactly what they need, Jordan said.

This includes looking to eliminate duplicative information that may be presented to different committees of the board. Jordan said he works with the CFO, legal counsel, and other department heads to compare information and reduce redundancies between committees. Indeed, it is not about getting the board more information, it is about getting it the right information.

“We’re going in the direction of communicating information that is essential for proper governance and risk management and eliminating redundancies between committees. By providing material as read-only prior to meetings, we can pare down the volume of information sent to committee members,” Jordan said. “We’re trying to keep the actual meeting materials themselves to be what we need to talk about and items requiring committee action. We’re continuing to post additional committee materials and internal audit reports several weeks in advance of our meetings on the board site. The committee members therefore have additional time to review the material. I mean, there’s no point having numerous pages of material if those pages will not be discussed in the meeting.”

Getting the best information to the board

Jordan recommends getting leaner on material to board members before the meeting, and reducing the number of last-minute changes. Similarly, plan meeting agendas with the audit committee chair well in advance. One best committee-governance practice is to have a designated meeting planner who identifies topics for each meeting in advance. The meeting planer should be updated continually.
As for questioning whether the board is getting all the information it needs, Jordan said he is in a position to read board material, although in some cases after the meeting. He also participates with senior leaders on board and committee agendas.

“Obviously we’ve got full access to all the books and records and are not being held back from review,” he said. “If I didn’t feel that they’re getting the right information or if I felt there were things being withheld from whatever committee of the board, I would be comfortable speaking up. In our operational audits, we are consistently reviewing key reports and operational data and metrics for accuracy. This is critical since a great deal of the information is provided to the board.”

**Internal audit must step up**

It also is important that internal audit be considered a fundamental part of risk management. CAEs should push to be included in strategic discussions.

“If I we were not aware of what information is being communicated to the board or included in strategic planning discussions to understand what’s going on at the company, I couldn’t do my job,” Jordan said. “Because it all starts with what are the strategic goals of the organization, and what are the risks to achieving those objectives.”

The relationships Jordan and his team have built with executive management make it easier for him to speak out should information be incomplete or need a different perspective. This is particularly true with information going to the audit committee. He noted that the success of his relationships requires a solid tone at top, great corporate culture, and independence of the internal audit function. Jordan reports directly to the audit committee and has a dotted reporting line to his CEO, with whom he meets with on a regular basis.

Boards can help themselves by being professionally skeptical and by asking internal audit to look at the quality of information being provided. They also should hold management accountable when there appears to be information that is not accurate or provided in a timely way.
Key points CAEs should discuss with board members

- What types of risk information are presented to you, by whom, and at what level of detail?
- Is a clear risk-appetite statement communicated throughout the organization at all levels? What is the board’s role in developing the risk-appetite statement?
- Do you participate in a strategic risk assessment? If so, is it repeated at regular intervals? Are the results analyzed? If so, who sees the results, and how are the results used to make decisions?
- Do you receive information on emerging or atypical risks to the organization? If so, how is that information presented and discussed?
- Are you comfortable with the accuracy and timeliness of the data in reports given to you for review?
- Does the information you receive reflect the risks involved in the organization’s plans? Does it describe the appropriate mitigating actions put in place to address the risks?
- Does the information you receive balance historical information with discussions of emerging trends and opportunities?
- Does the information presented to you 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? Have you discussed these key performance indicators with management?
- Does the information you receive describe how the organization’s activities support achievement of organizational objectives outlined in the overarching strategy?
- To what degree are marketplace developments and/or competitor activities reflected in the information you receive?
- Do different departments/units collaborate on the preparation of board materials to reflect the required interaction of a variety of activities involved in achieving an objective? If not, why not? Also, if so, do you feel you receive enough information to understand the interdependencies?

Source: Adapted from CIMA’s “Performance Reporting to Boards: A Guide to Good Practice” as shown in The IIA’s *Tone at the Top*, Oct. 2017.
Relationship building is key

Board information risk will increase in relevance as shareholder and regulator demands for stronger board oversight grow. Internal audit must be well-positioned to provide independent oversight on the information boards receive or to alert boards when information is not complete, accurate, relevant, and timely. To do so, internal audit must build resilient and respectful relationships with the board and senior management to assure it has access and influence on what information the board receives.

Audit functions that are not fully immersed in the risk management process, such as those whose scope is limited to financial reporting assurance and compliance, are ill-equipped to provide assurance in this area. CAEs should push to be included in discussions on strategic risk assessment, risk appetite, and strategic goals in order to better understand the spectrum of risks the organization faces and gauge the information needs of the board.
ABOUT THE AUDIT EXECUTIVE CENTER

The IIA’s Audit Executive Center® (AEC®) is the essential resource to empower CAEs to be more successful. The Center’s suite of information, products, and services enables CAEs to respond to the unique challenges and emerging risks of the profession. This report is reserved for your exclusive use as a member of the Audit Executive Center. For more information on the Center, visit www.theiia.org/AEC.

ABOUT THE IIA

The Institute of Internal Auditors (IIA) is the internal audit profession’s most widely recognized advocate, educator, and provider of standards, guidance, and certifications. Established in 1941, The IIA today serves more than 200,000 members from more than 170 countries and territories. The association’s global headquarters is in Lake Mary, Fla. For more information, visit www.theiia.org.

DISCLAIMER

The AEC and The IIA publish this document for informational and educational purposes. This material is not intended to provide definitive answers to specific individual circumstances and as such is only intended to be used as a guide. The AEC and The IIA recommend seeking independent expert advice relating directly to any specific situation. The AEC and The IIA accept no responsibility for anyone placing sole reliance on this material.

COPYRIGHT

Copyright © 2020 The Institute of Internal Auditors, Inc. All rights reserved. For permission to reproduce, please contact copyright@theiia.org.

May 2020