TONE at the TOP®

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

**Issue 92 | April 2019**

# Generating and Bringing Accurate Information to the Board

Every executive strives to make the best decisions possible. Still, even the most thoughtful decisions in the world are only as good as the information people rely upon to make them.

Board directors know this; that's why they spend so much time seeking assurance about corporate operations before a decision is made. The very word "assurance" raises the question board directors implicitly ask when working toward a decision: Are we confident that what we've been told is in fact accurate and reliable?

The answer is uncertain right now. In the latest corporate governance survey from the National Association of Corporate Directors, 53 percent of respondents said they want improvement in the quality of information supplied by management. That figure is on par with The IIA's own 2019 Pulse of Internal Audit survey of audit executives, in which 36 percent of respondents only somewhat agreed with the statement that "management provides the Board with all pertinent risk information," and another 15 percent somewhat or strongly disagree.

This is an issue neither boards nor chief audit executives (CAEs) can ignore.

"It's a struggle," says Carolyn Dittmeier, a former audit executive who now serves on the boards of several European companies: Generali in Italy, Alpha Bank in Greece, and Ferrero in Luxembourg.

Like corporate directors everywhere, Dittmeier relies on whatever board packet lands on her desk from management. "It's all handed to you," she says. Yes, committees and directors can then push management for more specific information, "but it's still whatever is handed to you."

The problem isn't deliberate deception. That happens, but it's relatively rare. More accurate is to say that the governance duties of boards and the risk landscapes of organizations are shifting so rapidly that traditional channels of gathering and conveying information to the board might no longer be fit for purpose.

# Understanding the Board's Challenges

The shift that challenges boards so much is an inexorable increase in the importance of risk monitoring — especially emerging or atypical risks the organization has never before encountered.

Such risks are now more likely to pose a greater threat to the organization's ability to generate value for its stakeholders. For example, a new competitor with a digital-only platform that undercuts your business model, or a supplier that uses slave labor and whose misconduct is suddenly telegraphed across Twitter, tarnishing your brand and reputation along with it.

What's more, regulators around the world have also stepped up their attention to corporate governance — or more accurately, the lack thereof — which can lead to misconduct. For an organization to avoid criminal charges, monetary penalties, and other punishment, it must be able to show it understood the compliance risks in its operations and took appropriate steps to mitigate those risks.

Those pressures now drive the audit committee to focus more on "anticipatory" risk and internal control systems that quantify how well the organization is preventing adverse events from happening. Which, in turn, increases the importance of getting high-quality information into the audit committee's hands so it can understand where its priorities should be.

"It is highly important, and we do feel the pressure" to be responsive, says Jeff Austin, chair of the audit subcommittee for the Texas Transportation Commission. Austin always wants his committee to have the opportunity to intervene on burgeoning risks within the Texas Department of Transportation rather than have outsiders surprise everyone with unexpected information.

That sounds sensible enough, but are organizations succeeding at monitoring anticipatory risks in a competent, disciplined manner?

Again, the answer is not clear. In the 2019 Pulse of Internal Audit survey, more than 90 percent of CAEs were very or moderately confident in their ability to identify and assess emerging risks. Further, 80 percent of CAEs were very or moderately confident in their ability to identify and assess atypical risks. At the same time, 47 percent also strongly or somewhat agreed that it was fairly common for an emerging or atypical risk to surprise management.

That suggests a disconnect between the ability to detect and monitor a risk and the ability to relay that information to the highest echelons of the organization in a timely manner.




## The IIA

1035 Greenwood Blvd.
Suite 401
Lake Mary, FL 32746 USA

## Systems and Channels

To be clear, it is management's job to bring information to the board. That won't change. The questions here are whether the board is getting the right information in a timely manner and whether the systems for relaying information work well. Both are questions that audits could address.

In her time as an auditor, Dittmeier says she routinely warned boards that completeness, accuracy, and reliability of information was "an uncovered area" of risk. She divides the potential trouble into two categories.

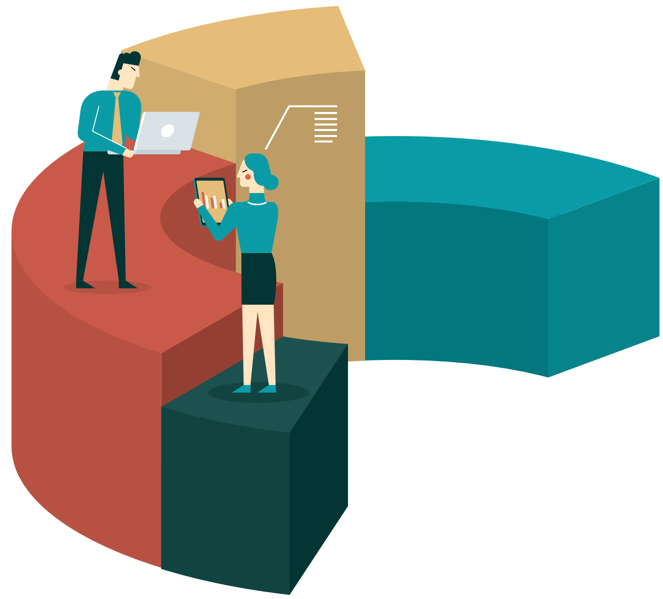
First are problems of people: either the corporate culture overall, or specific senior executives, don't have any disciplined process to gather and convey risk information. You might have a good, risk-aware culture, but the escalation processes are unstructured. Dittmeier describes this as "risk management without method."

Second are problems of process: the systems that organizations use to relay information might not work efficiently enough to deliver news in a timely manner, or may not be versatile enough to capture all the data the board needs.

That brings up the question of key performance indicators (KPIs), and whether they should be built into dashboards that board members can use to monitor risks. "Absolutely yes," Dittmeier says. "Big time."

Audit executives can work with their audit committees to design KPIs that give board members more objective, reliable information. First comes a conversation about what the organization's objectives are, and what the risks to achieving those objectives might be. Then the audit team can design more data-driven KPIs to monitor those risks and feed that data directly to the board.

Clarence Davis, former chief operating officer at the American Institute of Certified Public Accountants (AICPA) and board member at GAMCO Investors Inc. and Telephone and Data Systems (TDS), gives the example of management estimates. If management, internal audit,



and the audit committee could better define the business process in question — if the process could be "machined" with data, he says — then the audit committee might be able to rely more on data-driven KPIs and less on the subjective judgment of management about an important line item.

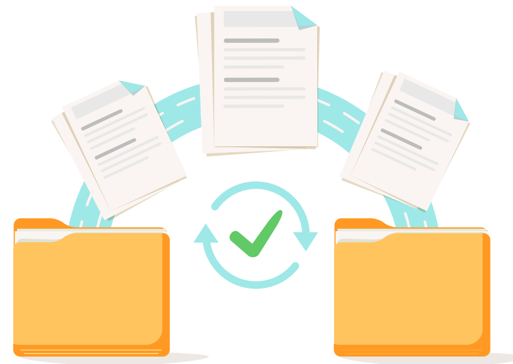
It's worth noting that when the Securities and Exchange Commission fined Hertz Corp. $16 million in late 2018 for poor accounting practices that led to a restatement in 2015, abuse of management estimates was the culprit. The Public Company Accounting Oversight Board has also made better auditing of estimates a priority. So the more a company can move away from reliance on estimates in favor of data-driven KPIs, the better.

"That's in its infancy now and needs to be fleshed out more, because it's critically getting down to the nuts and bolts of the process," Davis says. He adds that, when creating a KPI, you need to understand why it is important and what the data are that make it up.

The transition from ad hoc discussions of risk that are reliant upon management's subjective judgment toward more disciplined, data-driven, up-to-the-moment snapshots of risk has the potential to be difficult, but it's a move boards need to make. That's one piece of information board members can rely upon.

## Action Items

- Assess the organization's systems to escalate information about risk. Are the systems themselves effective at relaying complete, accurate information in a timely manner? Does senior management accept that information and bring it to the board properly?
- Consider corporate culture and its influence on generating accurate information. For example, conduct an employee survey asking whether employees feel confident that concerns they bring to management are heard and addressed properly.
- Review accounts that are material to the financial statements to determine which ones rely on management estimates. Work with management and the audit committee to see whether those business processes could be redesigned to rely more on KPIs and less on estimates.
- Hone your own audit function's abilities with data analytics. This can apply to all sorts of risk and audit issues, but remember that KPIs and risk monitoring can't happen in any disciplined way without strong capabilities in this area.



### 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.