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

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Good Governance Key to Managing Speed of Change

One of the “great” philosophers of late 20th century America – Ferris Bueller – famously said, “Life moves pretty fast. If you don’t stop and look around once in a while, you might miss it.”

Sure, Bueller is a fictional character who uttered those words in the Paramount comedy “Ferris Bueller’s Day Off.” But corporate boards should appreciate Bueller’s fundamental point about observing the larger picture. Indeed, three decades after the movie’s release, the need to look around has gone from “once in a while” to constantly, if boards know what’s good for them.

Pop culture references aside, Bueller’s words do evoke what corporate executives worry about. In January, Protiviti published its annual survey of top enterprise risks among board directors and senior executives. Consider these three among the top 10:

- Organization’s culture may not sufficiently encourage timely identification and escalation of emerging risks (No. 9);
- Rapid speed of disruptive innovations and new technologies (No. 6);
- Existing operations’ ability to meet performance expectations, especially against “born digital” competitors (No. 1).



These concerns show just how relevant Bueller’s words are for modern organizations. The speed of change is accelerating, so boards must now be far more sensitive to it and demand risk management processes that can anticipate significant disruption and help the company respond.

“The conversations are constant and ongoing,” says Gerald Whitburn, chair of the audit committee for the University of Wisconsin System Board of Regents.

From Whitburn’s perch, the biggest threats are mostly related to technology, and particularly IT security. Encouraging an awareness of those potential disruptions is no easy task, especially for an organization as large as UW, with more than 170,000 students spread across 26 campuses, plus 39,000 faculty and staff, and an annual budget of \$6 billion.

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That translates into challenges around recruiting the right personnel, training them to watch for disruptions, and “empowering them to act,” Whitburn says. That is particularly challenging for large organizations such as UW, which have brisk employee turnover from one year to the next.

“They need to stay current, and be more forward-leaning,” he says.

Sensible observations. So how does an organization build that awareness at scale, and exactly what is the board's role in overseeing that effort?

Defining the Landscape of Change

“Speed of change” is such a maddening risk because it can manifest in so many ways. Whitburn, for example, rightly notes that technology drives plenty of disruption. Then again, change can come from regulators, consumers, business rivals, and elsewhere.

Plus, that's just the “change” part of “speed of change.” The bigger governance challenge is coping with the accelerated speed of those changes, regardless of where they come from.

In truth, change can bring disruption at any speed, if the board and senior leaders are unaware of the disruption heading toward them. That's how change disrupts a company – by catching the business unprepared and unable to respond in a timely manner (See enterprise risk No. 6 above).

As simple as that point sounds, it underlines how companies should cope with the accelerating speed of change. Organizations whose sensitivity to change is properly calibrated are far more likely to detect potential disruptions promptly.

And that leads us to the board's role in this murky morass of risk management. The board's role is to assure that management has a reasonable plan to achieve that sensitivity, given all the potential changes swirling around out there.

“The board's concern is the speed at which it comes, in the sense of how the industry is changing, and figuring out, ‘Where's the fairway on this?; ‘When do we respond?’” says Edward Carey Joullian, IV, chair of the audit committee at BOK Financial Corp. and also CEO of Mustang Fuel Corp. “Obviously we want to be aware of things, but what are the expectations of management to have plans in place, versus [moving] too slow?”

Joullian's metaphor of a fairway is a good one. The board wants to understand the business landscape confronting the organization. Which courses of action might be uphill climbs but get you to the putting green sooner, or which ones might veer into misconduct or mistakes, and leave the organization lost in the woods?



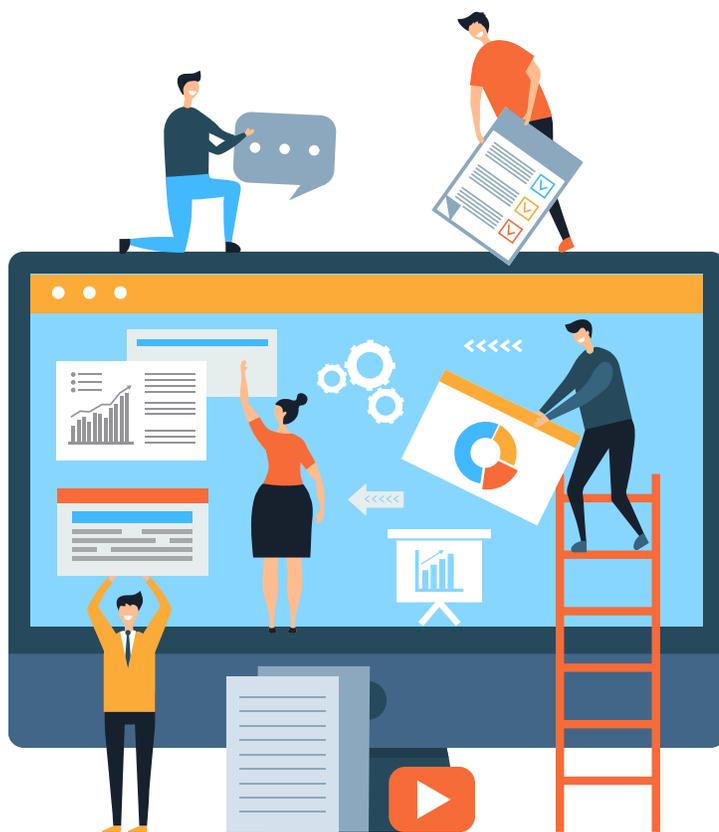
The board also wants to know when course layout might change, and how senior executives will navigate a new path forward rather than fall into a sand trap.

What senior management should not do, and what boards shouldn't allow, is undisciplined change. That would be the equivalent of a CEO lurching from one hill or dale on the fairway to another, with scant logic behind it. Or, as Joulilian puts it, "You don't want to go so fast that you're chasing your own tail – that you're pivoting all the time and you don't have continuity in what you're trying to do."

What to Build, and Audit

So what risk management processes and controls should a company have in place to endure rapid change? How does an organization attuned to the "speed of change" behave?

First, the board (and the audit committee in particular) should have strong, effective communication channels with regulators, external audit firms, senior management, and the chief audit executive. These players help the board frame its thinking about any business issue, including disruptions percolating in the wider world that may visit the organization someday.



ACTION ITEMS

So what can boards direct their audit functions to do or study within an enterprise to assess its ability to handle change? Here are several suggestions.

Audit the company's internal reporting systems.

The company's best early warning system is its own staff, so the more comfortable that employees feel in speaking up, the better. Assess their familiarity with internal reporting systems, comfort level in bringing concerns to managers, and confidence that confidential reports will be kept confidential. Internal audit also should assess the company's ability to aggregate and analyze information coming from employees.

Audit regulatory change management systems.

Especially in highly regulated industries such as financial services or healthcare, new regulations emerge every day. A company's ability to identify relevant regulatory changes, and then connect those changes back to the company's operations, is crucial. Assess what your organization's processes are for those tasks, including whether automated monitoring might be warranted.

Audit market research and reputation

management capabilities. Customers' wants and habits can change quickly, as can their perception of an organization's reputation for customer service, innovation, or ethical conduct. Assess how your organization gathers information about customer tastes, including external validation of any internal surveys or analytics the company does. Moreover, are those processes keeping pace with fast-moving social media trends?

Talk with the audit committee and external

auditors. A productive relationship between internal audit and the audit committee is a two-way street, so it is wise to encourage open, honest dialogue with audit committee members – including the concerns audit committee members bring from their work at other organizations or in chatting with board directors at other firms. Likewise, external auditors do see other clients and hear about many emerging risks. They know things you don't, so talk to them.

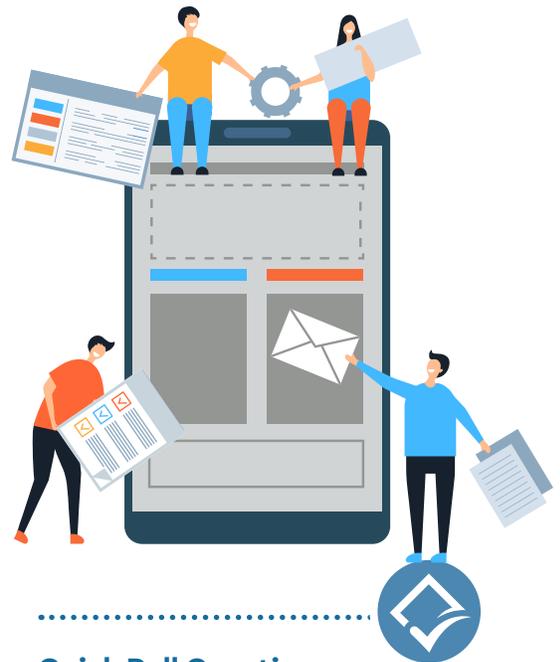
For example, at BOK, the bank’s regulators ask the board how it might handle market changes, Joulilian says. Its external auditors might bring a concern to the audit committee that their auditors have seen elsewhere and want to know how the issue might be handled at BOK.

At the same time, boards also need to assure that escalation channels work within the company, so that concerns about potentially disruptive change can rise through the ranks.

That implies a few things. First, employees need mechanisms to absorb information about change happening within or around the organization: market research, customer service centers, regulatory update systems, and so forth. (See a few examples in our Action Items sidebar.) Second, employees need clear direction on what management wants them to do, which – let’s be honest – can sometimes be lacking. Third, they need to feel comfortable bringing concerns about possible risk to supervisors; so yet again, corporate culture plays a strong role in building the company’s preparedness for rapid, disruptive change.

Audit functions can play a valuable role in working with those first and second lines of defense, by helping employees do their jobs in a risk-aware manner.

“Deliver the message that these are the priorities, and this is important, and we need to manage through this every day, and we’re here to help you, rather than the old days of ‘gotcha,’” Joulilian says.



Quick Poll Question

How capable is your organization to deal with rapid and disruptive change?

- Very capable
- Moderately capable
- Not very capable
- Not sure

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



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