Corporate Governance Health in a Post-COVID-19 Environment

A speaker at the most recent National Association of Corporate Directors annual conference touched off a firestorm of complaints from virtual attendees by delivering a blistering critique of board members that alleged their complicity with social injustice.

Anand Giridharadas, editor-at-large at TIME and author of Winners Take All: The Elite Charade of Changing the World, questioned whether directors do enough to counter what he described as “widening inequality over the last four decades.” Giridharadas contends board directors are, “preserving the business status quo, which includes creating monopolies that strangle competition, paying workers precarious incomes, and finding tax dodges for their companies and themselves that deprive the country of needed funding,” according to an Agenda article published in November.

The affront challenges common beliefs that corporate boards are increasingly aware of and sympathetic to diversity and sustainability issues, particularly with growing momentum for fundamentally changing economic models that prioritize returns to investors over societal needs.

Beyond debates over whether Giridharadas’ comments were justified, the reproach raises important questions about the evolving role of boards and whether their views about corporate behavior reflect clear-eyed realism or a rose-colored never-never land. Data from two new signature reports from The Institute of Internal Auditors paint a decidedly mixed picture.

Observations from OnRisk 2021: A Guide to Understanding, Aligning, and Optimizing Risk suggest improving alignment on risk management among boards, executive management, and internal audit, particularly in light of the challenges posed by the COVID-19 pandemic. However, data from the soon-to-be-published American Corporate Governance Index (ACGI) reflect continued reluctance among some directors to push back on what they are hearing from the C-suite.

Granted, relationships among risk management players are complex and vary from organization to organization. However, it is helpful for boards to have a clear understanding of the forces that influence those relationships, and data from both reports provide important perspectives and insights that can strengthen that understanding. What’s more, such insights can be applied to help corporate boards effect positive change in their organizations and society overall.
OnRisk 2021

The IIA’s annual risk report, now in its second year, provides a unique perspective on risk and risk management by bringing together the views of the three key players into a single report — the board, which sets the risk appetite and provides strategic oversight for long-term value creation; executive management, which sets and executes risk management strategy; and internal audit, a resource for the board and management, which provides assurance and insights independent from management.

This year’s report includes five key observations gleaned from qualitative interviews and quantitative surveys. Three of the observations provide insights into how board and management views on risk can diverge, which can lead to communications breakdowns and misunderstandings.

Perceptions on capability to manage risks.
This year, responses from OnRisk participants were more tightly clustered in ranking organizational ability to manage risk. The inaugural OnRisk report noted a critical misalignment between executive management views in this area and what is communicated to the board. This resulted in board members consistently viewing organizational capability to manage risks higher than executive management.

However, the board overconfidence noted in last year’s report appears to have eased in 2020. Responses to COVID-19, which focused in part on renewed risk assessments and more frequent communication and collaboration among risk management players, likely drove stronger alignment on organizational strengths and weaknesses.

Perceptions on risk relevance.
Board members and internal audit were largely aligned on their perception of the relevance of the 11 risks included in OnRisk 2021. However, management relevance rankings were lower overall, with an especially large gap in perceived relevance of risks related to governance and economic and political volatility. Indeed, the C-suite assigned higher relevance to operational risks such as talent management, culture, and business continuity.

Relevance of organizational governance.
The disparity in relevance rankings for organizational governance as a risk is significant and telling. Management’s lower relevance ranking on this risk, combined with its higher rankings on personal knowledge and organizational capability, signal management overconfidence in this area and a disconnect from boards and chief audit executives.
ACGI

In January, The IIA will publish the ACGI, which rates corporate governance among publicly traded companies. While the index scoring for 2020 reflects slight improvements over the previous year across several measures of corporate governance health, boards remain reticent to challenge management and are loath to evaluate overall corporate governance.

The ACGI survey of CAEs finds that more than one-third believe their boards are not willing to offer contrary opinions or push back against the CEO. While improvements were noted in board performance in several areas — technical expertise, diversity of perspectives, pushing for sufficient details, time to properly execute its role — reluctance to challenge management remains uncomfortably high.

Evaluating corporate governance also remained the lowest rated of eight key governance principles examined by the survey. While modest improvement was noted in this area over 2019, the gains come primarily from improved ratings of board discussions on governance and seeking feedback on corporate governance efficacy. What remains virtually unchanged is formal evaluation of the full system of corporate governance on a regular basis.

WHY ALIGNMENT MATTERS

In 2020, the social justice movement, economic and political volatility, and once-in-a-century risk challenges created by a global health pandemic have made preserving the business status quo an untenable option. Moving forward, fundamental changes to how organizations navigate digital transformation, manage talent, address sustainability, and respond to disruption place greater emphasis on the need for sound governance.

As noted earlier, responses to the pandemic drove stronger alignment among key risk managers on risk assessments, alignment on responsibilities and priorities, and identification of weaknesses in crisis response and business continuity planning. However, the persistent reluctance by organizations to step back and assess overall governance does not bode well for success in a post-pandemic environment.

There are already signs of significant shifts in thinking about economic models after COVID-19. For example, a 2019 survey by global research firm Gartner found 55% of organizational redesigns focused on increasing efficiency by streamlining roles, supply chains, and workflows.

LEVERAGING THE ONRISK METHODOLOGY

The OnRisk approach uses an innovative methodology that uniquely brings together the perspectives of major contributors to organizational risk management — boards, executive management, and internal audit. Alignment of these players’ views on risk knowledge, capability, and relevance is a significant step toward achieving strong risk management in support of effective governance.

The methodology for the report employed qualitative interviews of 30 board members, 30 C-suite executives, and 30 CAEs from 90 different organizations. Further support came from a quantitative survey of CAEs, which drew 348 responses. The combination of qualitative and quantitative research provides robust data sets to examine top risks facing organizations and allows for both objective data analysis and subjective insights based on responses from risk management leaders.

Readers of OnRisk 2021 should review and analyze the data for each of the 11 key risks addressed in the report and are encouraged to conduct a similar analysis among their own organizations’ boards, management, and internal audit functions.

OnRisk 2021 offers a glimpse into not just what board members, the C-suite, and CAEs think of each risk, but also how they think about them. While their comments provide some insights, it is vital for every organization to have similar discussions about how each player in the risk management process understands risk, the organization’s capability to manage risk, and the relevance of individual risks to the organization’s efforts to set and achieve goals.

A critical step in such an analysis is to undertake a clear-eyed examination of how those charged with risk management understand and execute their roles. The IIA’s recently published Three Lines Model provides additional guidance for understanding the essentials of governance and the roles that support those essentials:

» Accountability — by the governing body (board) to stakeholders for oversight.
» Actions (including managing risk) — by management to achieve organizational objectives.
» Assurance and advice — by an independent internal audit function to provide insight, confidence, and encouragement for continuous improvement.

The COVID-19 pandemic has impelled organizations toward improved communications, ongoing risk assessments, and closer alignment on key risks. When combined with a strong understanding of roles, this new collaboration and communication create ideal conditions for successful risk management and sound governance.
However, the pandemic has shown that models that focus on efficiency often offer little flexibility to respond to disruption. Just a year later, business leaders are gravitating to business models that avoid rigid structures, embrace agility, and provide employees with varied, adaptive, and flexible roles that also promote cross-functional knowledge and training.

Such rapid and profound changes in economic approaches will undoubtedly strain corporate governance health, which could lead to unanticipated problems and risks. Board directors should be mindful of this potential upheaval and take actions to assure communications with and information from executive management are timely, accurate, and relevant.

FIVE QUESTIONS FOR THE C-SUITE IN A POST-COVID-19 ENVIRONMENT

1. Has the pandemic changed our fundamental approach to business? If so, how?
2. Has the pandemic accelerated our use or adoption of new technology? If so, how will that change how we do business?
3. How will the work-from-home phenomenon change our short- and long-term approach to talent management?
4. What actions are planned to provide objective assurance on the efficacy of processes and controls created because of the pandemic?
5. In our current risk assessment, how relevant is our organization’s overall governance?

Quick Poll Question

Does your organization formally evaluate the full system of corporate governance on a regular basis?

- Yes
- No
- I don’t know

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

QUICK POLL RESULTS

How has the COVID-19 pandemic changed your organization for the better?

- We have become better aligned in how we manage risk. 23%
- We have accelerated our use of technology. 75%
- We have become more agile in handling disruptive change. 55%
- We are still trying to figure it out. 22%

Source: Tone at the Top October 2020 survey.