

Technical Newsletter

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Corporate Governance

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Corporate Governance – CAE’s Role Redefined

Internal Audit (IA) has a major role to play in good corporate governance (CG). It is one of the cornerstones of CG, the other legs being the executive, the board and the shareholders. GIAS 2024 encapsulates the primary function of internal auditing reflecting on its role in strengthening corporate governance, risk management and control processes and its consequential role in contributing to the organisation’s ‘overall stability and sustainability...’ (ref GIAS Internal Auditing and Public Interest, pg 7).

This is a momentous task reflective of the importance of the IA function. The CAE and IA team should be on point to deliver. This is achieved by not only having core IA skills but also being ‘business savvy’, especially on governance issues.

The regulators recognise the role of IA and Practice 11.1 / 11.2 for Internal Audit enumerates in detail the expectations placed on the Board. In this context, it is imperative for the CAE, to have a healthy working relationship and be on the same page as the AC of being a ‘trusted advisor’, as to the level of governance in relation to ethics, integrity, accountability and compliance.



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Governance Elements



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Organisational Culture and Governance

GIAS – Standard 1.2 Organisation's Ethical Expectations.

"Auditors must encourage and promote an ethics-based culture. If internal auditors identify behaviour within the organisation which is inconsistent with the organisation's ethical culture expectations, they must report the concern..."

An organisation's culture drives how it conducts business and executes its strategies. All organisations have a culture, whether intentionally created or not. Various facets make up culture which in essence is the 'tone at the top'.

The culture defines its values related namely, amongst others, to trust and integrity which is translated to the expectations on the workforce and what is the benchmark against which they are evaluated. It could include, for example, a zero-tolerance level policy to bribery and corruption.

Healthy organisations

These organisations have several common cultural characteristics including:

-  Positive tone from the top – The board and senior management work together to define the organisation's values and proactively emphasise and model those values, ensuring strategies are consistent with the values.
-  Clear communication – Management reinforces the values and culture through clear communication of expectations across the organisation. Methods include formal communications, day-to-day interactions, and meetings with employees, customers, and third parties.
-  Open dialogue – Management actively gathers and listens to feedback from all levels and is open to constructive criticism, joint problem-solving and objective setting.

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TOXIC CULTURE

Poor organisational culture has been identified as the root cause of many serious issues across the board in relation to good governance. In response, key business stakeholders, including boards and regulators are responsible for overseeing the internal control environment which may be adversely affected by negative cultures.

A toxic organisational culture, at its worst, erodes the effectiveness of all other control layers. A common factor cited when discussing an organisation's culture is "tone at the top."

Governance in Audit Life Cycle

- Culture and conduct are elements of the control environment. A toxic culture can undermine other controls and expose the company to unnecessary risk.
- Because it is so multifaceted, culture can be hard to define, but The IIA practice guide, Auditing Culture, offers this definition: "Culture represents the invisible belief systems, values, norms, and preferences of the individuals that form an organisation."

KEY ELEMENTS IN A GOVERNANCE FRAMEWORK



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Governance Red Flags

Governance red flags refer to warning signs which may indicate an employee and/ or an external party is/are engaged in activities, which may be prompted as a consequence of an unhealthy operating environment.

These include situations which may pose risks to the organisation's culture:

- Board and Senior Management does not share information on governance and expectations on culture or does not take the lead.
- Inflexible hierarchy impedes the flow of information up, down, and across the organisation.
- Employees lack knowledge of key risk management activities and potential risk.
- The environment is characterised by blind trust towards colleagues, including a lack of understanding of the role of control processes in achieving business objectives.
- An attitude of misplaced trust and complacency – 'e.g., it cannot happen here' or 'never happened here' e.g. fraud, maker/checker roles etc.
- Employees, especially those at senior management levels, lack accountability.
- The organisation fails to enforce codes of conduct and related policies and procedures.

The above could be used as part of a governance and culture risk assessment exercise to assist IA in the audit planning and execution stage

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Governance Red Flag Categories



GIAS 2024

One of the internal audit function's responsibilities, as the third line in the organisation's governance structure, is to assess the adequacy and effectiveness of the internal control environment directly impacted by culture and the conduct that arises from the staff that compromises these controls.

Standard 9.1 - Understanding Governance, Risk Management and Control Processes

IAD has to understand the risks associated with an organisation's culture, how effectively managing those risks supports a successful control environment, and how to approach an assessment of culture.

Supervisors set the cultural tone for their team and contribute by operating within the culture of the broader organisation. Many C- Suite members, unfortunately, are unaware of the importance of their role in setting and modelling an appropriate culture.

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Internal Audit Plan

The internal audit plan must be dynamic and updated in response to changes in the organisation's business, risks, operations, programs, systems, controls, and ultimately, the organisation's culture.

Risk Assessment

To audit culture-related subjects, internal auditors should start with the risk assessment on which the internal audit plan is based, where they can identify risks to the organisation's culture.

As internal auditors conduct their engagement-level risk assessments, they should review past workpapers and consider any past engagements that may contain information relevant for an organisational culture audit.

Work Program – Performing the Engagement

(Reference can be made to IIA Global's guidance notes, where applicable)

There are three main approaches to auditing an organization's culture.

- The integrated approach considers culture risk factors in all engagements.
- The targeted approach involves selecting a set of key processes and controls related to culture and developing an engagement work program that tests them across the board.
- The top-down approach is a comprehensive audit of all culture-related activities.



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CHALLENGES TO CAE

The challenge often facing the CAE is how to 'upskill' the AC and other directors on legitimate concerns, given that not all possess a mature governance mindset.

Whilst IAD can be construed as overstepping its function in highlighting the limitations of specific directors, this could be overcome by an audit of corporate services department as part of a holistic governance audit.

The audit coverage should include Corporate Services role in ensuring that directors are sent for relevant training, including whether a Board Evaluation Assessment (BEA) has been conducted. BEAs conducted by an external party, will be an eye opener on culture.

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Reference:

1. Global Internal Audit Standard (GIAS)
2. Google