

Internal Auditing's Role in Organizational Governance



Presented by:

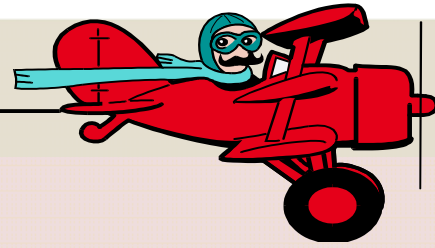
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AGENDA



1. What is Governance?

2. What might an organizational governance framework look like?

3. What are the components and principles of governance?

4. What is the role of Internal Auditing

Governance Definition Per IIA Standards

- ***The combination of processes and structures implemented by the board in order to inform, direct, manage and monitor the activities of the organization toward the achievement of its objectives.***

Governance represents the means by which **direction and control** are applied to **stewardship** of an organisation's assets – tangible and intangible, financial and non-financial – in the pursuit and delivery of the **primary objective of sustainable value creation**. It is essentially a function of **leadership and direction** within the organisation; appropriate **risk management and control** over its activities; and the manner in which meaningful **disclosure** relating to its activities is made to shareowners and other stakeholders.

King II Report, 2002
South Africa

What is Governance?

Governance is...

A way of life that drives an organization forward and establishes a **leadership** where success and results are valued and **personal behavior** is seen as a primary driver to helping concepts become reality.

“Three Little Words” of Governance

- Expectations
- Communications
- Accountability

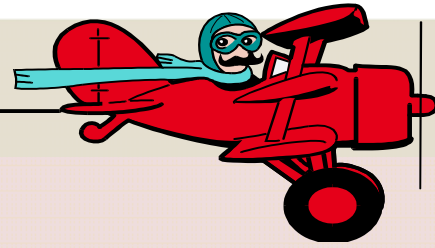
Governance – Key Words

- Expectations
 - What is needed for success:
 - Policies, procedures, guidance, organization, assignment of responsibilities
- Communications
 - Informing & training
- Accountability
 - Holding people accountable for meeting expectations

Why Good Governance?

- Right vision
- Right tone
- Right involvement
- Consistent with organization's mission
- Consistent with expectations of constituents

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The IIA Corporate Governance Model



Governance

- Defining roles
 - Leadership - tone
 - Employees – carry out mission
 - Constituents – interest in success
- IA role
- Governance model
- Governance principles

Governance Framework

Governance Structure

How we are organized to:
Assign responsibility
Hold people accountable

Governance Practices/Culture

How we use governance components:
risk, control, strategy, ethics, etc.

Governance Principles

Underlying statements of expectations

Corporate Stakeholders

Board of Directors

Board Committees

**Staffing
Independence
Committees
Charters
Assessment
Gov. Prin.**

**Governance
Committee**

**Audit
Committee**

**Internal Audit
External Audit
Ethics
Risk
Control
FS Accuracy**

Senior Management

**Ethics
Officer**

**Compliance
Officer**

CRO

CIO

**Disclosure
Committee**

Ethics
Program

Compliance
Program

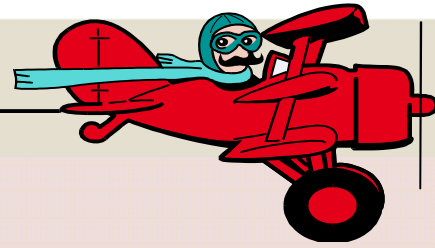
EWRM
Program

Information
Security
Program

FS disclosure
& I/C Assess.



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Components of Good Governance

- Strategy and planning
- Risk management
- Tone at the top
- Measuring and monitoring
- Transformational transactions
- Management evaluation, compensation, & succession planning
- External communications
- Board dynamics



Governance Principles

- Statements of what is important
- Visualization of governance in action
- Measurable
- Specific
- Enable assignment to key leaders
- Overarching statements of how things should be



King II Governance Characteristics

- Discipline = Commitment to standards of behavior
- Transparency = Disclosure of information
- Independence = Conflicts of Interest avoided
- Accountability = To shareowners
- Responsibility = Acceptance of consequences
- Fairness = Balance between stakeholders
- Social Responsibility = ethical, environmental and economic impacts

King II Guiding Principles

- Constitution & operation of board and its committees
- Performance evaluation & reward
- Risk management and internal control
- Internal audit
- Sustainability
- Business ethics & organizational integrity
- Accounting and auditing
- Disclosure practices

Governance Principles

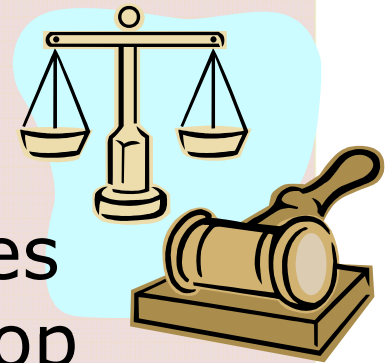
1. Organization & functioning board
2. Qualifications of board members
3. Board authority, funding, & resources
4. Transparency
5. Articulate Strategy
6. Organizational structure
7. Establish policies
8. Clear lines of responsibility & accountability



Per IIA position paper April 2006

Governance Principles

9. Interactions (board, mgt, EA, IA)
10. Strong internal controls
11. Compensation policies & practices
12. Ethical culture, values, tone at top
13. Use of internal auditors
14. Define & implement risk mgt policies
15. Effectively use EA
16. Appropriate disclosures of key info.
17. Governance process disclosure
18. Related party transaction oversight



Governance Principles - Portugal

- I. Disclosure of information
- II. The exercising of voting and representation rights by shareholders
- III. Corporate rules
- IV. Composition of board of directors
- V. Institutional investors

The CMVM (Comissão do Mercado de Valores Mobiliários) Nov 2003

Governance Principles - Portugal

The companies issuing securities admitted to trading on a regulated market situated or functioning in Portugal are obliged to ensure the disclosure of a set of information on the corporate governance structure and practices either as a chapter in the annual management report specially drawn up for the purpose or as an annex to same ... the companies subject to Portuguese Law are also subject to the CMVM's Corporate Governance Code and to the duty to disclose information on the corporate governance structure and practices in accordance with the provided for in the CMVM's Regulation 1/2007

Per **CORPORATE GOVERNANCE CODE AND LEGAL FRAMEWORK CONSOLIDATION CMVM April 2007**

OECD Governance Principles

I. Ensuring the Basis for an Effective Corporate Governance Framework

- **The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.**

OECD Governance Principles

II. The Rights of Shareholders and Key Ownership Functions

- ***The corporate governance framework should protect and facilitate the exercise of shareholders' rights.***

OECD Governance Principles

III. The Equitable Treatment of Shareholders

- ***The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.***

OECD Governance Principles

IV. The Role of Stakeholders in Corporate Governance

- ***The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.***

OECD Governance Principles

V. Disclosure and Transparency

- ***The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.***

OECD Governance Principles

VI. The Responsibilities of the Board

- ***The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders***

Kennesaw State Governance Principles

1. **Interaction** – Sound governance requires effective interaction among the board, management, the external auditor, and the internal auditor.
2. **Board Purpose** – The board of directors should understand that its purpose is to protect the interests of the corporation's stockholders, while considering the interests of other stakeholders (e.g., creditors, employees, etc.).
3. **Board Responsibilities** – The board's major areas of responsibility should be monitoring the CEO, overseeing the corporation's strategy, and monitoring risks and the corporation's control system. Directors should employ healthy skepticism in meeting these responsibilities.

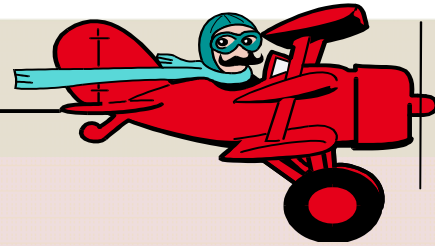
Kennesaw State Governance Principles (cont.)

4. **Independence** – The major stock exchanges should define an “independent” director as one who has no professional or personal ties (either current or former) to the corporation or its management other than service as a director. The vast majority of the directors should be independent in both fact and appearance so as to promote arms-length oversight.
5. **Expertise** – The directors should possess relevant industry, company, functional area, and governance expertise. The directors should reflect a mix of backgrounds and perspectives. All directors should receive detailed orientation and continuing education to assure they achieve and maintain the necessary level of expertise.

Kennesaw State Governance Principles (cont.)

- 6. Meetings and Information** – The board should meet frequently for extended periods of time and should have access to the information and personnel it needs to perform its duties.
- 7. Leadership** – The roles of Board Chair and CEO should be separate.
- 8. Disclosure** – Proxy statements and other board communications should reflect board activities and transactions (e.g., insider trades) in a transparent and timely manner.
- 9. Committees** – The nominating, compensation, and audit committees of the board should be composed only of independent directors.
- 10. Internal Audit** – All public companies should maintain an effective, full-time internal audit function that reports directly to the audit committee.

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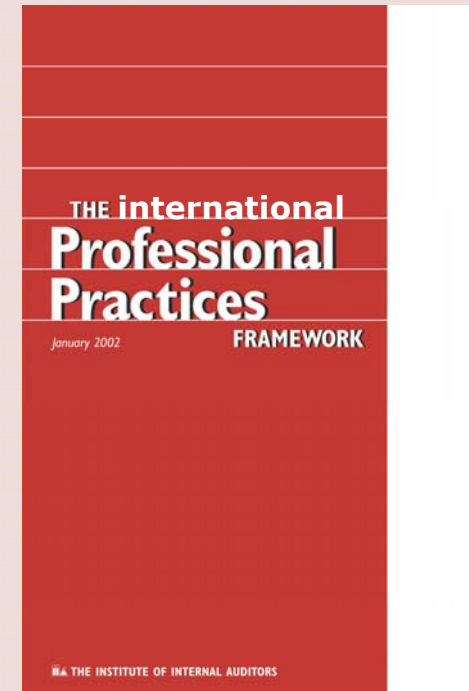
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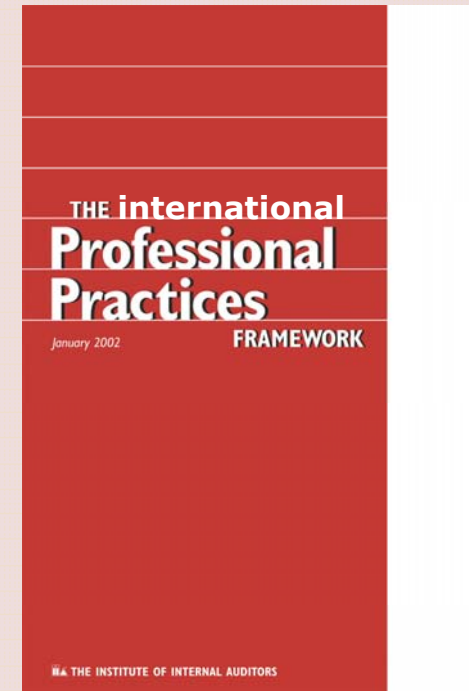
IIA Standards-Governance

- **2110-Governance**
- **The internal audit activity MUST contribute to the organization's governance process by evaluating and improving the process through which (1) values and goals are established and communicated, (2) the accomplishment of goals is monitored and accountability is ensured, (3) risk and control information is communicated to appropriate areas of the organization; and (4) activities of the board, external and internal auditors, and management are coordinated.**



IIA Standards-Governance

- **2110.A2 – The internal audit activity must assess whether the information technology governance of the organization sustains and supports the organization’s strategies and objectives.**



Glossary - Definition

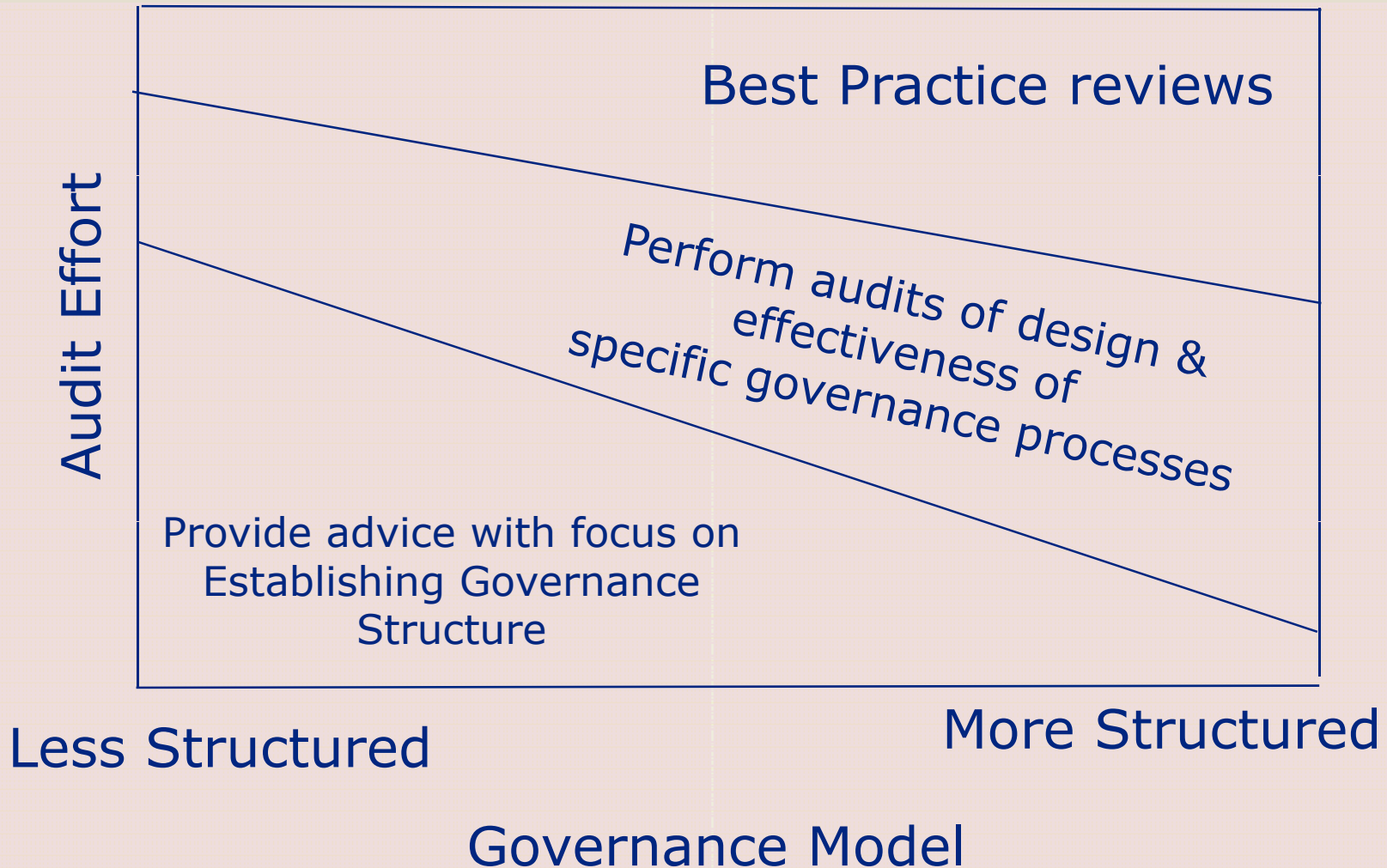
Information Technology Governance

- Consists of the leadership, organizational structures, and processes that ensure that the enterprise's information technology sustains and supports the organization's strategies and objectives.

Governance Performance Standard 2110.A1

- The internal audit activity should evaluate the design, implementation, and effectiveness of the organization's ethics-related programs and activities.

Allocation of IA Effort



What Should IA Do?

Setting Expectations:

IA should:

- Help drafting of policies, procedures, processes, guidance to utilize their
 - knowledge
 - expertise
- Ensuring Controls are build into processes not added on

What Should IA Do?

Communicate:

IA should:

- Assist in training programs on
 - Ethics
 - Risk identification
 - Control options
 - Fraud awareness
- Design programs
- Participation in training sessions

What Should IA Do?

Accountability:

IA should:

- Perform objective assessments using systematic, disciplined approach that incorporates an evaluation of evidence
- Ensure compliance to management directives by comparison of actual to criteria
- Assist in evaluation of processes to ensure efficient operations and effective accomplishment of objectives

Types of assignments

- Expectations:
 - Board structure, objectives, dynamics
 - Board Manual reviews
 - Board committee assessments
 - Process for remaining aware of requirements
 - Proper assignment of organizational responsibilities & establishment of Performance measurement systems
 - Recruitment procedures

Types of assignments

- Communication:
 - Education of board members
 - Ethics policies and code of conduct
 - Employee training
 - Internal controls
 - Ethics policies
 - Disclosures & compliance requirements
 - Board policies

Types of assignments

- Accountability:
 - Ethics investigation
 - Management evaluation & compensation
 - Board self-assessment
 - External communications
 - External auditor oversight

Good Governance is evident in:

- The way we provide information
- How we value the problem identifier & solver
- How people in the organization commit their “personal power” to perform beyond expectations
- The “vision” of what is important
- Expectations communicated
- Holds people accountable
- Walk the TALK (do vs. say)



Internal Auditors' Role in
organizational governance
is new and
often an area where
expertise and
credibility is lacking

THUS: **The Real Challenge!!!**