



UNITED, CONNECTED AND ALIGNED

*How the Distinct Roles of Internal Audit and
the Finance Function Drive Good Governance*



United, Connected and Aligned: How the Distinct Roles of Internal Audit and the Finance Function Drive Good Governance was developed jointly by the International Federation of Accountants (IFAC) and The Institute of Internal Audit (IIA).

IFAC is the global organization for the accountancy profession dedicated to serving the public interest by strengthening the profession and contributing to the development of strong international economies. IFAC is comprised of more than 175 members and associates in more than 130 countries and jurisdictions, representing almost 3 million accountants in public practice, education, government service, industry, and commerce. More information is here: <http://www.ifac.org/>

The Institute of Internal Auditors (IIA) is the internal audit profession's most widely recognized advocate, educator, and provider of standards, guidance, and certifications. Established in 1941, The IIA today serves more than 190,000 members from more than 170 countries and territories. More information is here: <https://na.theiia.org>

IFAC and The IIA wish to thank the 11 governance experts who provided their experience and insights to this project, and Margaret Christ, CIA, associate professor of accounting at the University of Georgia's Terry College of Business, for her research and writing talents.

Copyright © 2018 by the International Federation of Accountants (IFAC) and the Institute of Internal Auditors (IIA). All rights reserved. Written permission from IFAC is required to reproduce, store or transmit, or to make other similar uses of this document, save for where the document is being used for individual, non-commercial use only. Contact permissions@ifac.org.

ISBN: 978-1-60815-370-1

Published by:



Table of Contents

DRIVING GOOD GOVERNANCE	5
Keys to Achieving Good Governance	5
Key Roles: Finance Function and Internal Audit	6
Checks and Balances	7
The Internal Audit Function: Independent Assurance	7
Coordination Between the Functions: Working Apart Together	8
Best Practices for Effective Coordination	8
Advocating for Governance	9
Conclusion	9
INTERVIEW INSIGHTS	10
Culture Counts	10
Internal Audit Needs to be its Own Champion	11
It's a Balancing Act	12
Encouraging Performance and Conformance	13
Respected Governance	14
Communication and Emotional Intelligence	15
It's the Tone at the Top	16
Collaboration and Communication	17
Integrated Audit to Improve Communication and Coordination	18
Providing Accurate and Reliable Information to the Board	19
Everyone Has a Role in Governance	20

Driving Good Governance

How the Distinct Roles of Internal Audit and the Finance Function Drive Good Governance

Effective governance involves many individuals and departments throughout an organization, including the Board of Directors, executive management, finance, and internal audit, among others. Yet each of these groups has a different set of skills and responsibilities. To successfully identify and manage risk, they must come together to create and maintain a sound system of corporate governance.

The insights shared here by 11 governance experts offer important perspective as to how finance and internal audit collaborate to support corporate governance, despite their distinct and separate missions.

Interviewees provided perceptions and experiences and shared best practices, as well as challenges, that they have encountered on their quest to achieve effective governance.¹ These contributors come from organizations around the world that differ in size, industry, and management configurations. Several experienced governance from within both the finance function and internal audit.

A few shared perceptions include:

- The Board of Directors is responsible for setting the proper tone for the organization;
- It is critical to purposefully develop a consistent culture throughout the organization, driven by the CEO and senior management; and
- Communication and coordination across complementary functions is vital.

KEYS TO ACHIEVING GOOD GOVERNANCE

There are many different definitions of governance. According to The Institute of Internal Auditors (hereafter The IIA), governance is “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.”²

The International Federation of Accountants (hereafter IFAC) [uses](#) a slightly different definition which focuses more on the creation of strategic objectives and stakeholder value, “Governance is to create and optimize sustainable organizational success and stakeholder value, balancing the interests of the various stakeholders. It comprises arrangements put in place to ensure that organizations define and achieve intended outcomes.”³

Both definitions suggest that good governance and the achievement of organizational success are not the responsibility of the Board alone, but rather the outcome of a mosaic of organizational policies, processes, and cross-functional interactions.

When asked to provide the key objectives of governance, interviewees shared a number of different perspectives. Most frequently, good governance was defined as representing the interests of stakeholders by setting appropriate objectives and driving a culture that supports them.

For example, Rachel Grimes, Chief Financial Officer, Group Technology Finance of Westpac Group, and President of IFAC, describes the objectives of governance as:

“Encouraging performance and conformance. [This means] bringing out the best in the vision

² Institute of Internal Auditors. 2009. International Professional Practices Framework. Altamonte Springs, FL: The Institute of Internal Auditors. p.18.

³ From the International Federation of Accountants: <https://www.ifac.org/global-knowledge-gateway/governance?overview>

¹ [Individual profiles of each interviewee are provided separately and highlight some of the key insights gained from each interview.](#)

and the mission of the company in terms of the goods, services, while conforming with laws and regulations. [But also conforming with] the community or public expectations as well, [which] really aligns with the ethics of the accounting profession. We're built on a code of ethics and that's what sets our profession apart from many others."

Melvyn Neate, former Director of Internal Audit for Her Majesty's Revenue and Customs, the UK's tax authority, focused his comments on the importance of developing an appropriate culture:

"Governance depends critically [on] the ethics, values, and tone at the top from the board. [The Board provides direction] as to what they want the organization to do and the behavior and values that they want the organization to follow. In organizations where governance has been good it is very clear that the tone at the top has been clear and has been effectively communicated. Where governance has slipped it is caused by poor communication and/or the tone at the top is not clear."

Several interviewees broadly defined their stakeholders to include not only shareholders, customers, and employees, but also the community at large. For example, Greg Grocholski, Vice President of Internal Audit at SABIC, a global chemical products company headquartered in Saudi Arabia, sees that the role of governance is:

"To align the various factions of investors, stakeholders, community, employees, board, management, and the broader public wherein this alignment and good governance allows the culture that instills the proper vetting of discussion to ensure decisions are made in the proper light of the context, content, transparency, risk and return."

Mr. Grocholski continues,

"If you are a public company, you have a concrete relationship with investors, stakeholders, the public, etc., because you are operating in the community. It brings with it greater responsibility and, therefore, greater accountability."

Because the effects of governance are far-reaching, it is imperative to establish the right culture and to empower effective leaders

throughout the organization to carry out good governance processes.

KEY ROLES: FINANCE FUNCTION AND INTERNAL AUDIT

All interviewees indicated that the Board is responsible for setting the objectives and strategy, propagating a consistent culture, and providing oversight as the strategy is executed. However, the rest of the organization executes on the strategy, and each part plays an important role in governance.

According to Laurie Tugman, a corporate director in Canada and chairman of the Strategy, Management Accounting and Finance Advisory Board for CPA Canada:

"Everybody has a role in governance. If you are in a leadership role, you have a responsibility for governance because every manager who is responsible for achieving certain objectives is automatically also responsible for managing the related risk."

Interviewees also described the importance of the finance and the internal audit functions to support and advance the Board's objectives. Charles Tilley, Chair of the IFAC Professional Accountants in Business Committee, opines:

"The ability for the Board to understand how value is created and then to make decisions about sustaining that value over time requires the best information possible. The accounting and finance function produces that information. It is the owner of management's information."

Internal audit complements finance by providing a critical assurance function over the accuracy and reliability of data:

"If you don't have internal audit providing assurance over the information, you have a weakness in control," Mr. Tilley says.

Other interviewees focused on the importance of internal audit as an independent assurance function that provides an objective assessment of organizational performance. For example, Mr. Neate, who also is a former president of IIA-UK and Ireland, says:

"[Internal audit provides] assurance and advice. They are the conscience of the organization. They can say, 'Stop,' if *anything* is incorrect. A good internal auditor will tell it as it is and speak-up."

To summarize, all interviewees emphasize the importance of both the finance function and internal audit with respect to good governance. It is essential, therefore, that these two areas have the proper skills and organizational support to be effective.

CHECKS AND BALANCES

The finance function is close to the business, providing the support, information, and control the organization needs to effectively set and achieve its objectives. In that sense, finance and accounting is integral to good decision making and proper execution.

"If they do their job properly they should be the financial conscience of the organization," Mr. Neate says.

Not surprisingly, the primary skills mentioned for the finance function were technical knowledge and expertise on financial matters and related financial reporting standards. However, several interviewees made it clear that financial knowledge is just one part of the skillset required for finance to be an effective part of good governance. Finance and accounting personnel also need a clear understanding of the business and its operations, as well as the external environment that could affect the business.

In today's multi-capitals environment, the finance function must "account for the whole business – not just the balance sheet," according to Mr. Tilley. Therefore, financial and non-financial information needs to be integrated to be able to account for the entire business.

The finance function also requires soft skills, including: sound business judgement, which includes both good intuition and strong analytical skills to support that intuition; strategic thinking; communication and leadership skills; and, critically, skepticism and objectivity.

As Khalilullah Shaikh, Head of Supply Chain at K-Electric in Pakistan, describes, often finance functions are required to partner with operations while also monitoring their performance:

"The business wants to fly through operations at warp speed, but the accounting and finance function must evaluate performance objectively and maintain a healthy skepticism throughout the process."

THE INTERNAL AUDIT FUNCTION: INDEPENDENT ASSURANCE

The internal audit function performs independent audits on governance, risk management, and control across the organization, which also includes how the finance function conducts its work. Internal audit reviews how the diverse components of governance are designed and determines whether

they are working effectively, thereby providing assurance, insight and advice.

Importantly, these reviews must include the organizational culture and the behavior of employees and management. As Patricia Cochran, retired Chief Financial Officer of Vision Service Plan, describes:

"The assurance function [provided by internal audit] is the report card that tells you whether you are truly doing what you [set out to achieve]. The best internal audit functions are those that are looked upon as collaborative partners with the management team, not as policemen – those who identify areas for improvement and help provide a methodology through the corrective action planning and reporting process to make sure that these changes have actually been achieved."

When describing the skills required by the internal audit function, interviewees indicate that, similar to finance, internal auditors require technical knowledge of the entire business, as well as leadership, communication, strong analytical and critical thinking skills, and healthy skepticism.

Notably, interviewees often described the importance of internal audit being sufficiently independent, qualified and confident to command respect as they conduct their audits. As internal auditors must interact with employees throughout the organization and report to the highest executives and Board, the internal audit function must have a high enough stature. It must be positioned well within the company and the mandate must be clear to allow the internal audit function to access any aspect of the organization necessary to provide an accurate assessment of the governance process.

Lesedi Lesetedi, Deputy Chief Executive Officer for the Botswana Open University and former founding Director of Internal Audit for the Botswana International University of Science and Technology, suggests:

"The internal auditor should be confident and the position should come with the stature that allows anyone [in the organization] to recognize their importance."

Ms. Lesetedi also emphasizes the importance of soft skills for internal auditors, including an emotional intelligence that allows them to understand how to best interact with their auditees and the executives to which they are reporting. This is fundamental to building trust with both groups and providing effective assurance.

COORDINATION BETWEEN THE FUNCTIONS: WORKING APART TOGETHER

Many interviewees subscribe to the importance of the Three Lines of Defense model for governance⁴ for its ability to describe distinct risk management roles and responsibilities. The model differentiates among the first line of defense – operational management who carries out the internal control procedures – from the second line – those who oversee controls carried out by the first line, which includes the finance function. The third line is internal audit, which reviews and provides assurance on the controls. All three lines have reporting responsibilities to senior management. The governing board (or audit committee) oversees it all with direct reporting from internal audit.

While the Three Lines of Defense model identifies the finance function as part of the second line and internal audit as the third, most interviewees felt the model does not reflect the vital need for effective coordination and collaboration among all three lines.

In particular, interviewees cautioned against developing a three-lines system in which each function operates in a silo, which can create inefficient redundancies and gaps in organizational processes. Christine Ong, Senior Group General Manager for Internal Audit at IGB Corporation, says:

“If everyone is committed to the success of the organization, then there shouldn’t be silos of responsibility. That will not work. From my experience as an internal auditor we must get departments to talk together. You have to be sure everyone understands that by working together they can achieve more.”

Similarly, John Bendermacher, Director of Group Audit for ABN AMRO Bank, elaborates:

“With the Three Lines of Defense model, we are all looking at the same processes, transactions, etc. But I like to see the Three Lines of Defense model without walls between each line. Instead, while each function should have its own duty, they should work together. If internal audit is performing an audit, it will try to rely on the results of the second

line of defense and the second line will try to rely on evidence from the first line. It makes the Three Lines of Defense model stronger when working jointly and also makes it more likely that other stakeholders, like the Board, will rely on the results.”

While some of the responsibilities performed by the different functions may be perceived as overlapping, most interviewees indicated that their work is instead complementary and that the little overlap that could occur was generally useful, as it led to greater scrutiny and helped to avoid gaps in governance. Any inefficient redundancies were attributed, again, to each function operating in a silo and a failure to coordinate and communicate.

BEST PRACTICES FOR EFFECTIVE COORDINATION

Interviewees shared a variety of suggestions to achieve effective coordination and collaboration across functions. Mr. Tugman indicates that it is primarily the responsibility of the Chief Financial Officer to facilitate communication with internal audit.

Richard Chambers, President and CEO of The IIA, takes it a step further, describing a best practice where the chief audit executive is treated as an adjunct member of the C-suite, such that she or he is included in staff meetings to be apprised of all activities and strategies.

Ms. Ong clarifies that building and maintaining trust among the functions is critical, and that this is dependent upon a strong culture of trust and respect that permeates the organization. There must also be mutual respect among the functions, such that everyone understands and values the others’ responsibilities. If one function tries to go it alone, it can lead to poor management decisions and negative organizational outcomes.

Several interviewees said that thoughtful development of a governance plan of responsibility is necessary. Mr. Neate suggests the organization develop a map of the business that lists all key governance activities and then identifies who is responsible for each activity, with organization-wide agreement.

Mr. Bendermacher posits that it is important to start with the same risk taxonomy, which will facilitate communication but offers an important caveat. Straightforward charters for each function and frequent communications to evaluate progress are both necessary to perform this activity effectively. Mr. Bendermacher clarifies that these communications should be focused on avoiding unnecessary overlap and working together while respecting everyone’s distinct responsibilities. Importantly, functions should not use these collaborative efforts as an excuse or pretense to try to exert authority over each other.

⁴ Institute of Internal Auditors. 2013. The three lines of defense in effective risk management and control. <https://na.theiia.org/standards-guidance/Public%20Documents/PP%20The%20Three%20Lines%20of%20Defense%20in%20Effective%20Risk%20Management%20and%20Control.pdf>

ADVOCATING FOR GOVERNANCE

As previously described, good governance requires effective coordination and communication among the Board, the finance function, and the internal audit function. This requires the internal audit function and the finance function to educate all stakeholders about their respective key skills and their vital roles in good governance. Without that knowledge, internal audit and finance can be underutilized or even misused.

To achieve this, both internal audit and the finance function need to recruit and nurture champions within and outside the organization who will highlight the importance of the respective functions and the value they add.

Mr. Chambers notes that The IIA and other professional organizations could improve efforts to convince boards and audit committees they need internal audit to help them be more effective. In other words, we must focus on creating demand for internal audit at the Board level. Chambers notes:

“Nobody likes to be audited. But, we’ve got to help boards and audit committees become more comfortable about allowing internal audit in.”

Mr. Shaikh recalls that before he entered the internal audit function it seemed that many did not understand the value that internal audit can provide to the organization. As a consequence, he did not see many individuals striving to become the head of internal audit or desiring a career as an auditor.

Similarly, the finance function must also advocate for itself and its role in governance. Mr. Tugman points out that in addition to managing the financial transactions, the finance function should provide critical business advice, supported by rigorous analytics. However, to effectively carry out this advisory responsibility, the organization needs to know and trust the finance function. Again, this requires purposeful advocacy to make sure that the organization knows it can and should rely upon the finance function.

CONCLUSION

This paper examines how effective interactions among the Board, internal audit, and the finance function help create value for stakeholders. The common theme from interviewees is that these functions each play distinctive and crucial roles in governance. Yet, because they have complementary roles, the overlap that can occur can lead to more scrutiny and help avoid gaps in governance.

Interviewees identified several key requirements for effective governance, including:

- An ethical corporate culture that empowers effective leaders throughout the organization to carry out good governance processes;
- Effective communication and collaboration among the various roles; and
- Requisite competencies for internal audit and the finance function to earn stakeholder support and respect.

Finally, interviewees say both internal audit and the finance function must have champions within and outside the organization who advocate for their importance and value within the larger organization.

Providing stakeholders a deeper understanding of the distinct complementary roles of internal audit and the finance function will help them make best use of these valuable governance components. Indeed, stakeholders who understand the complex interactions and relationships that influence governance are best positioned to help their organizations succeed.

Mr. Grocholski likens good governance to a collage of disciplines that help achieve desired outcomes:

“Individual pieces by themselves, separate and alone, imply too much control or power with no connectivity,” he said. “For the individual pieces to make a coherent picture, they must be united, connected, and aligned.”

Culture Counts



JOHN BENDERMACHER

John Bendermacher is the chairman of The IIA – Netherlands 2016–2018 and member of Board of Directors for The IIA Global, and the Director of Group Audit for ABN AMRO Bank, a Dutch bank. The bank follows the three lines of defense model⁵ and has mature risk management and compliance functions.

The Netherlands benefit from a well-structured corporate governance code that has been in existence for fifteen years and was most recently updated in 2016. The code aims to define the roles and responsibilities for value-creation, risk and control, effective management and the relationship with shareholders and other stakeholders. Public companies are required to apply the code or provide a “substantive and transparent explanation” for any deviations from the code.⁶ Notably, the code requires that the Board creates a culture aimed at long-term value creation and to encourage behavior that is “in keeping with the values, and propagates these values through leading by example.” Understandably, the role of culture in effective governance was an important theme discussed by Mr. Bendermacher. In particular, he explained that in an effective three lines of defense structure, internal audit should be able to rely on the work performed by the second line, e.g., risk management or compliance, but only if their work included a careful review of culture, behavior, and the broader control environment.

When discussing the three lines of defense model in more detail, Mr. Bendermacher remarked that all three lines, plus external audit as the fourth line, are looking at the same objectives, risks, and controls. Importantly, the model is most effective when there are no walls between each line, but rather each

function has its own clearly defined responsibilities and duties but with greater cross-line collaboration. When he has experienced gaps or redundancies of activities across functions, it is because the three lines have been silo based: “If you talk to the auditees, [often] they tell you that you are the third or fourth person to ask the same question. In a lot of ways that is true. The question is whether you can avoid it... Being less siloed can help in that respect.”

Like several of the other interviewees, Mr. Bendermacher commented on how many organizations are using more nonfinancial information for control and to monitor progress toward the achievement of strategic objectives. As such, he noted that a major governance gap present in many organizations is too narrow a focus on financial data by the Board. As he points out, most of the major scandals of recent years have been caused by a poor tone at the top or inadequate understanding of the relevant risks, *not* poor financial performance.

⁵ Insitute of Internal Auditors. 2013. The three lines of defense in effective risk management and control. <https://na.theiia.org/standards-guidance/Public%20Documents/PP%20The%20Three%20Lines%20of%20Defense%20in%20Effective%20Risk%20Management%20and%20Control.pdf>

⁶ The Dutch Corporate Governance Code 2016. Viewed at: <https://www.mccg.nl/?page=3779>

Internal Audit Needs to be its Own Champion

Richard Chambers, CIA, is the president and CEO of The Institute of Internal Auditors. He has over forty years of internal audit experience, including as the national practice leader of advisory services for PwC. He has been named as one of the Top 100 Most Influential People in Accounting by *Accounting Today* and is the author of two books on the practice of internal audit.

According to Mr. Chambers, “A strong well-resourced independent internal audit function is integral to good governance. Not only does it have an opportunity to provide assurance about how well the governance process is working, but it is *part* of the governance framework of an organization. It is the one truly independent set of eyes and ears that the Audit Committee and Board can look to [to understand] how well risks and controls are being managed within an organization.” Indeed, the internal audit function has had the mandate to be involved in the governance process since the definition of internal auditing was developed in the 1990s.

Despite the importance of internal audit’s role in governance, Mr. Chambers notes that some internal audit functions are apprehensive about auditing the governance process. This apprehension likely stems from internal audit’s reporting structure. While it is designed to ensure independence from the organization, internal audit still reports to the Board. Thus, internal audit is not independent of the board itself and therefore some internal audit directors are not comfortable telling the board that their processes need to be audited or that weaknesses exist. It may be easier to avoid auditing governance all together. But, Mr. Chambers notes, “When internal audit is absent in that process, you end up with an area of the organization where there is risk that isn’t as effectively scrutinized as other risk areas in the business.” To solve this issue, Mr. Chambers suggests that professional organizations such as IFAC and The IIA need to increase advocacy directly to the Board about the importance of involving internal audit in the governance process. By effectively communicating how internal audit can help improve governance, it is likely that the Board will demand more internal audit involvement

in the process. At the same time, Mr. Chambers notes that, “Internal audit needs to be its own champion,” and work to articulate the benefits of including internal audit in the governance process.

Ideally, the internal audit function will be performing broad assessments of the effectiveness of the overall governance function, including a review of organizational culture. However, Mr. Chambers notes that this likely requires a mature internal audit function with auditors who are comfortable and confident with using their professional acumen and judgement.

When discussing how the internal audit function can best coordinate with the finance function to effect good governance, Mr. Chambers suggested that the chief audit executive should have a good working relationship with the CFO and be included in finance staff meetings so that internal audit is aware of the practices and initiatives in that function. This would allow internal audit to have a “seat at the financial table” which would provide a clearer understanding of the financial risks and controls that could affect governance.



RICHARD CHAMBERS

It's a Balancing Act



PATRICIA COCHRAN

Patricia Cochran, CPA & CGMA, spent twenty years as the Chief Financial Officer of Vision Service Plan, The United States' largest specialized health plan for vision care. As Chief Financial Officer, Ms. Cochran had direct responsibility for many managing the areas of the organization including financial and regulatory accounting, taxes, treasury, internal auditing, and financial analysis. Now retired, she serves on a number of audit committees, and has previous experience as an external auditor. Therefore she has firsthand experience in each component of good governance.

According to Ms. Cochran, good corporate governance "allows us to manage risk while achieving the objectives of the organization. It is important that organizations set objectives that will help them succeed – achieve its mission, benefit its shareholders, etc., but it must also be recognized that this is happening in challenging environments. So we must also be aware of the risks that we face in light of our objectives."

But good governance isn't just about setting objectives that can easily be achieved and confirming success. It should also be about continuous improvements. Strategies should include stretch objectives that help the organization grow. Ms. Cochran continues, "It's a balancing act. We want to be bold; we want to achieve awesome objectives; we want to look to the future. But there is also that risk. So governance has to come up with ways to manage the risk while still moving the organization forward."

Effective governance starts with open communication. Although it can be challenging to create, you need open dialogue with free flowing ideas between the board and management, without any defensiveness. If you can achieve an environment where people can share things that are going well and those that aren't, and people will be open to alternatives, it will lead to a better outcome for the organization. Ms. Cochran summarizes, "In my whole career, communication has been key. If you can actually be open in your discussions, you have a better chance to achieve the objectives you've set out."

Ms. Cochran also commented on the use of various tools and frameworks for effective governance, such as the COSO ERM framework or the COSO Integrated Internal Control Framework. "The tools that we have today have allowed organizations to become more disciplined. Following these guidelines gives us a better chance to be successful because there is a common methodology that has been proven to work across different kinds of organizations. [These frameworks] provide opportunities for discussion and also to measure ourselves against. If you can't measure it, you can't hold people accountable for it. So, it is important that we use these tools and get buy in from everyone on the team about how we are going to evaluate ourselves."

When describing the different components of effective governance, Ms. Cochran described the key role of internal audit as follows: "The assurance function is also very key because it is the report card that tells you whether you are achieving what you set out to do. I have found that the best internal audit functions are those that are looked upon as collaborative partners with the management team. Not as policemen. Those who point out areas for improvement and help provide a methodology through the corrective action planning and reporting process to make sure that these changes have actually been achieved. It's probably one of the most difficult jobs to be an effective internal auditor. Because they are walking that tightrope of being a part of the organization – being a collaborative partner to management – but also performing an assurance function of whether the internal controls are operating as designed and whether the risk management is effective."

Encouraging Performance and Conformance

Rachel Grimes is the Chief Financial Officer, Group Technology Finance of Westpac Group, a multinational financial services firm headquartered in Australia, and currently the President of IFAC. She has more than 25 years of experience across the financial services sector, working with Westpac and BT Financial Group as well as for the Big Four firm PwC. She has also served on the board for several not-for-profit organizations.

When describing the objectives of good governance, Ms. Grimes has a clever motto: It's all about "encouraging performance and conformance." For performance, governance helps bring out the best work to fulfill the vision and the mission of the company in terms of producing or selling goods, providing services, etc. For large part conformance relates to complying with applicable laws and regulations. But, she clarifies, "even more so, in today's social media age, I think it's [conformance to] the community or public expectations, as well." This public responsibility aligns well with the ethics of the accounting profession. "We're built on a code of ethics, and that's what sets our profession apart from many others."

When discussing what the finance function and the internal audit function bring to good governance, Ms. Grimes says that they all rely on various frameworks that facilitate good governance. These frameworks allow for effective decision-making. Critical components of these frameworks include: (1) accountability, (2) transparency and openness, (3) the clear delineation of roles and responsibilities, and (4) integrity, which includes stewardship over assets, the efficiency of use of those resources, and leadership skills and foresight to appropriately vet governance activities throughout the organization. A very important point about appropriately implementing these frameworks is that they allow for repeatability of activities and responsibilities. Therefore, although the leadership within the organization could change, the governance policies and processes can be sustained.

Ms. Grimes notes that there are likely to be overlaps among the responsibilities and activities of the finance function and the internal audit function, but that these overlaps are sometimes necessary for good governance. There may be some duplication effort, but that is less important than the risk that there are gaps in the process. Most importantly, these roles should not be siloed and each should be viewed as a critical part of the organizational value-chain.

Part of good governance is understanding *all* of the risks to the organization and its objectives, and therefore the roles and responsibilities of each component of the governance process have expanded. But gaps in the process may exist because of the culture of some organizations. Ms. Grimes notes that there are many examples from industry of employees masking bad news or poor performances that eventually come to light and can create a major organizational crisis. In these cases, it is important to consider what it is about the culture of the organization that lead individuals to hide results. Why isn't there sufficient trust for people to share all relevant information without fear? Why aren't there strong people in these roles who can stand-up to scrutiny with confidence? The impact of these poor decisions can be immense, and Ms. Grimes summarizes, "Good governance helps an organization achieve its objective, but poor governance brings about the decline of an organization."



RACHEL GRIMES

Respected Governance



GREG GROCHOLSKI

Greg Grocholski is the Vice President of Internal Audit at SABIC, a global chemical products company headquartered in Saudi Arabia. He has had over 35 years of continuous leadership during which he has served mid-level and C-suite managers as head of finance, and two audit committees as the chief audit executive. He also draws from global assurance industry experience through The IIA and ISACA.

Mr. Grocholski sees that the role of governance is “to align the various factions of investors, and other stakeholders such as, the community, employees, board, management, and the broader public wherein this alignment and good governance allows the culture that instills the proper vetting of discussion to ensure decisions are made in light of the proper context, content, transparency, risk and return.” This definition differs from most of the others provided in that it includes a focus on the effects of governance to the broader community in which the organization operates. As he further describes, “If you are a public company, you have a concrete relationship with investors, regulators, the public, etc., because you are operating in the community. It brings with it greater responsibility and therefore a need for greater accountability and transparency.”

This theme of accountability and transparency comes up again as Mr. Grocholski describes the role of the internal auditor. Often, we hear that internal auditors should have a seat at the table and should be involved in strategy setting.

“The strongest mantra of governance [is to] have a culture that allows for proper vetting,” he said.

So, if these can be aligned – culture, strategy and internal auditor independence – it can enhance the overall governance model. Mr. Grocholski refers to this open culture, which invites varied perspectives, as “respected governance.” True governance failures occur if one party exercises too much control and others are not given the opportunity to be heard.

When discussing the roles involved in effective governance, Mr. Grocholski describes “a collage of disciplines to help achieve desired outcomes.” This includes the Board of Directors and its committees, executive management, the CFO and its finance function, operational management and internal audit. Each of these functions must work together to create effective governance. Any one group working in isolation will be unable to achieve the objectives of the organization. While there may be duplications of effort from time to time, these may be necessary to ensure that there are no gaps.

Communication and Emotional Intelligence

Lesedi Lesetedi, CIA, QIAL is the Deputy CEO for the Botswana Open University (BOU) since January, 2017. She is responsible for directing and coordinating the planning and implementation of strategies of differentiated non-academic support operations, covering functions of Institutional Strategy, Human Resources, Financial Services, Procurement, Office Services (Administration & Facilities), Information Technology, Corporate Relations & Marketing, and for ensuring adherence to good corporate governance principles. Ms. Lesetedi recently came from the Botswana International University of Science and Technology (BIUST) where she has been from 2009 to 2016 as a founding Director of Internal Audit. She is a professional internal auditor and serves as a Director-at-Large for the Institute of Internal Auditors Global Board.

When considering what is necessary for good governance, Ms. Lesetedi suggests that there are some differences in the requisite skillset based on role. Of course, both finance professionals and internal auditors need to be knowledgeable about the organization and need to have a strong understanding of the risks that it faces in pursuit of its objectives. Similarly, they both need to have strong analytical skills. But, internal auditors must also have a strong focus on soft skills such as

communication and emotional intelligence. “There is nothing the internal auditor can do in isolation... internal auditors need to be good communicators. If they don’t have good soft skills they will fail the auditing process before they even start.”

This emphasis on soft skills stems from the extent to which internal auditors must interact and communicate with higher level management – often discussing difficult or sensitive topics. Ms. Lesetedi continues that internal auditors need to have confidence in their work and their expertise so that they can effectively communicate the issues that arise during an audit. Further, their role needs to have sufficient stature to command respect. These sentiments echo some of those from other interviewees who also indicated that without strong communication, which prompts management to listen and make process improvements accordingly, the internal audit function does not effectively contribute to good governance.

As the internal audit function and finance functions both need effective technical skills, continuing professional education and certification is vitally important. Ms. Lesetedi describes considerable support for certification throughout her organization.



LESEDI LESEDEDI

It's the Tone at the Top



MELVYN NEATE

Melvyn Neate has over 30 years' experience in internal audit and has led internal audit functions in both the private and public sectors including manufacturing, logistics, banking, financial services and central government, most notably as Director of Internal Audit for Her Majesty's Revenue and Customs, the UK's tax authority. He is a past President of the Chartered IIA for the UK and Ireland and has given numerous presentations on audit, fraud, and risk management, both in the UK and overseas. He is currently an independent member of the audit committee for the Office of Rail Regulation, the safety and economic regulator for Britain's railways.

According to Mr. Neate, good governance has two key objectives: 1) to facilitate better decision making, which includes the effective use of resources, accountability for actions, and performance that benefits stakeholders, and (2) to create trust between the organization and its stakeholders. The effectiveness of governance is dependent upon the ethics, values, and tone emanating from the top. Furthermore, the board must effectively articulate and communicate these values throughout the organization. What direction does the Board provide and what behavior and values do board members want employees to exhibit?

Measuring the effectiveness of governance can be somewhat challenging for most objectives, but Mr. Neate sums it up with a simple sales example: "What do you do with your best salesman, who's earning the company a lot of money, if you find out he's not selling ethically? Do you fire him? Do you put him on the right path? Or do you reward him? If you reward people for unethical behavior that is not according to the tone at the top, then governance is not going to work." In organizations with strong governance, the tone at the top is consistently communicated, it is embedded in

training, and it becomes a key component of the organizational culture.

While the Board plays an integral role in governance by setting and communicating the tone, other functions including management, the finance functions, internal audit, risk management and legal counsel all play prominent roles, as well. Mr. Neate notes that there may be overlaps in responsibilities across these groups – especially between finance and internal audit, but these overlaps can be acceptable. Ultimately he concludes that, "having multiple heads looking at the same problem is better than no one at all," which suggests that gaps in the governance process are a bigger risk. To avoid gaps, Mr. Neate recommends mapping out the governance process by documenting all of the key governance activities and then documenting the appropriate person or function responsible for each activity. While this is harder than it sounds, it can and has been done effectively.

Mr. Neate emphasized the importance of continuing education and certification for accountants and internal auditors. In his organizations, internal auditors were required to be professionally qualified and the organization developed its own continuing professional training program. Professional organizations, such as The IIA and IFAC, can provide meaningful training and guidance on governance processes. But, Mr. Neate thinks that the importance of governance could still be better promoted and become more of a focal point for professional organizations.

Collaboration and Communication

Christine Ong is the Senior Group General Manager of Internal Audit for IGB Corporation in Malaysia. She has more than 30 years of experience in internal audit, external audit, accounting and finance in various industries, and has served as the chair of the Audit Committee of World Vision Malaysia. She also served on the Board of Governors for the Institute of Internal Auditors Malaysia and the Global Board of Directors of the Institute of Internal Auditors and has been involved with developing guidance for effective internal audit functions for directors of publicly listed companies in Malaysia. Ms. Ong's varied experience gives her a broad perspective on the distinctive responsibilities of each of these functions within the corporate governance mosaic.

Collaboration and communication are two of the primary drivers of effective governance according to Ms. Ong. In particular, good governance requires a careful balance of four pillars: an effective board, competent (general and financial) management, a sound internal audit function, and independent external auditors. These four pillars must work together effectively, and if any pillar is weak or missing the organization will suffer. This requires tremendous collaboration in conjunction with careful communication so that everyone understands, not only their own role, but also the roles and importance of these others.

In particular, "It is important that the board creates the right tone at the top. It must have the right diversity of skills and knowledge. Management, in turn, must have the foresight and vision and the leadership to lead the organization, while also understanding risk to the organization's (strategic) objectives and the value that internal controls bring to the organization. Of course, internal audit plays a very important role. It is the eyes and ears of management and Internal Audit can provide considerable value as an independent and objective assurance function. Finally, external auditors need the knowledge of financial reporting and contribute

further by providing good advice to the board. Everyone has to work together for the organization to succeed."

As described by Ms. Ong, the governance roles of each function are distinct, with little overlap. "It's complementary. It works best if all parties understand their respective roles." But, it is also critical that the organization isn't set up in siloes of responsibilities. Internal audit can play a key role in facilitating communication and coordination across the division to make sure that there are no weaknesses or gaps in the governance process due to siloed responsibilities. Internal audit can provide recommendations about improved coordination as part of its advisory role. Importantly, there must be trust among the various participants in the governance process. Mutual understanding and respect for each other's roles and strengths is key. Everyone has a part to play in good governance and the effective board helps to set this cooperative tone.



CHRISTINE ONG

Integrated Audit to Improve Communication and Coordination



KHALILULLAH SHAIKH

Khalilullah Shaikh is currently the Head of Supply Chain at K-Electric, a Pakistan-based power utility company serving over 2.5 million customers. He served as Chief Internal Auditor of the Company for around 5 years from 2012 to 2017. Previously, he also served K-Electric as the Director of Finance and Administration. During his tenure, he has worked with multiple CEOs, CFOs and Boards of Directors, providing him with varied experience with different governance styles and priorities.

When describing the key roles responsible for carrying out good governance, Mr. Shaikh says that it all starts with the Board of Directors because they set the tone for the organization. “If the board is focused primarily on short term results and less on the processes and improvements that can be made within the system, management will follow-suit.” Next, the CEO plays a critical role because (s)he also establishes the tone that lower level management will follow. Some CEOs can be defensive and reject the findings and recommendations provided by internal audit which can be detrimental to achieving good governance. On the other hand, more effective CEOs use internal audit as their eyes and ears.

Other key roles in governance include the CFO and the finance function. It is within this division that you often see risk management and compliance – the second line of defense. They work closely with the business and therefore have to juggle the responsibilities of partnering with the business while also performing a critical control function. Finally, the internal audit function carries out key responsibilities as the third line of defense. But, importantly, Mr. Shaikh notes that internal audit’s effectiveness depends on its reputation within the company. It must be perceived as a constructive value enabler and preserver to have

a positive impact on governance. If internal audit is seen only as a critic, pointing out loopholes, it will be ineffective. One effective way to improve the perception of internal audit is by highlighting positive practices and process improvements when noted and reporting those to the Board; not focusing solely on the errors. This “positivity of mindset” can improve internal audit’s relationship with others across the organization.

Mr. Shaikh also notes that one of the most fundamental gaps in organizational governance is a failure to consider the *business*, the first line of defense, as a critical component. “The first line of defense is the best defense.” It is important to allow the business to own risk management, even when the formal processes and models are overseen by a separate risk management function.

Once each of these components of good governance is in place, it is imperative that there is good coordination and communication across the various lines of defense. At K-Electric, Mr. Shaikh has implemented integrated audits to ensure that the audit team has the requisite skills to effectively understand the business and conduct the most beneficial audits. He brings together individuals from internal audit, accounting and finance, and the business to perform an audit that not only recognizes and addresses the right risks to the organization’s (strategic) objectives, but also can provide value added recommendations. As an additional benefit of this practice, the skillset of the internal audit team strengthens as they learn from the operations and finance personnel on the project.

Providing Accurate and Reliable Information to the Board

Charles Tilley is a thought leader on integrated reporting and thinking. As the chair of the IFAC Professional Accountants in Business (PAIB) Committee and the Executive Chairman of the CGMA Research Foundation, he has been a prominent advocate for global reform of corporate reporting, and has provided commentary on a wide range of business issues. He was the Chief Executive of the Chartered Institute of Management Accountants (CIMA) from 2001 to 2016. Prior to joining CIMA, he had 14 years of external audit experience and has held finance leadership positions. He has served as the chair of the audit committee on several boards. He resides in the UK.

When describing governance, Mr. Tilley focuses first on the primary responsibilities of the board of directors: (1) setting the organizational objectives and (2) overseeing management and the organization as it aims to carry out those objectives. It is this second responsibility that really defines governance. And it is here that both the finance function and the internal audit function provide critical support. In particular, the finance function typically provides the information that describes and supports that way the business has chosen to execute its strategy. That is, it provides most of the information about the progress of the organization. Because the board must rely on this information, its integrity is of the utmost importance. This is where the internal audit function adds critical value by assuring the quality of the data and relevance and reliability of the information. According to Mr. Tilley, "If you don't have internal audit providing assurance over this information, you have a weakness in your controls."

Finance and internal audit must adapt to a changing business environment. In the context of integrated thinking and reporting, and in a multi-capitals world, as the key providers of information to the board, the responsibilities of the finance function and internal audit are even broader. They both must have a keen understanding of the business and external environment, so that they are able to identify the key value drivers of the organization. These value drivers are then tied to metrics, which must be evaluated and incorporated into the information finance provides to the board and the internal audit function assures. Importantly, in today's environment, organizations can no longer rely on financial metrics alone and therefore a broad understanding of both the financial and non-financial value drivers is key.

Given the complementary roles of finance and internal audit, it is imperative that everyone clearly understands the respective responsibilities. This requires a professional relationship between the two groups. Mr. Tilley notes that there should be little overlap in responsibilities or actions and that implementing a solid business model can help ensure that, together, the groups provide complete and accurate information about the value created by the business to date, as well as anticipated value creation in the future.



CHARLES TILLEY

Everyone Has a Role in Governance



LAURIE TUGMAN

Laurie Tugman currently serves as a corporate director in Canada, is chairman of the Strategy, Management Accounting and Finance Advisory Board for CPA Canada. Over the course of his forty-plus years in business he has gained a broad perspective on the roles of the finance and accounting department and the internal audit function. In particular, he has watched the role of internal audit grow through the 1980s, and then shrink during periods of downsizing before roaring back in reaction to the Sarbanes-Oxley Act of 2002.

As a CFO and a CEO with experience as both an internal and external auditor, he notes that, "... many people view [internal audit] as a necessary evil—to verify that everything is okay—but they don't really see it as a value add. It *can* be a value add if it is utilized properly because [then] you can rely on the fact that you've got good internal controls. Better organizations understand that they've got to have controls, and they've got to understand whether or not they're working," which is where internal audit is key. Mr. Tugman notes that internal audit and the finance function have some overlapping responsibilities. Although finance should be responsible for implementing and operating effective internal controls, while internal audit's focus is on testing those controls to ensure effectiveness, "a diligent finance function would also be testing the controls themselves." So, there may be duplication of effort, but in an effort to ensure good governance.

Furthermore, Mr. Tugman asserts that good governance is not just the responsibility of the board, internal audit and finance. Rather, it is the responsibility of everyone (with a leadership role) in the organization. As an example, other functions,

such as environmental health and safety may play critical roles for compliance and evaluating internal control effectiveness. While the CFO may have the ultimate responsibility for the organization's ERM processes s(he) should rely heavily on those other experts in the organization with more specialized knowledge for each area. In sum, if a manager is responsible for achieving certain objectives, s(he) should also be responsible for managing the related risk.

Mr. Tugman notes that there are several key skills needed by both internal audit and the finance function to ensure good governance. In particular, both groups need to have sound business judgement, which requires good intuition and effective analytical skills. Managers from the finance function, in particular, also need to be strategic thinkers so that they can help the organization carry out the objectives set forth by the Board. Both internal auditors and finance professionals need to have the requisite competencies to carry out their responsibilities. With respect to internal audit, Mr. Tugman further clarifies that to be effective, an internal auditor needs more than just on-the-job training. They need the professional training and designations offered by the Institute of Internal Auditors so that they can continuing learning about emerging risks and best practices.

Overall, Mr. Tugman, describes an effective governance program as one that supports the board in its mission to provide oversight, advice and support to the organization. The finance and internal audit functions are key components to helping the board meet these goals.

International Federation of Accountants
529 Fifth Avenue,
New York, NY 10017
USA
T +1 212 286 9344
www.ifac.org

The Institute of Internal Auditors
1035 Greenwood Blvd. Suite 401
Lake Mary, FL 32746
USA
T +1 407 937 1111
<https://na.theiia.org>