Board Benchmarking

insync surveys

Risk management in the boardroom

An Insync Surveys study in conjunction with Board Benchmarking

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Introduction

Views of 625 directors who sit on 79 different Australian and New Zealand boards are shared in this comprehensive study about risk management in their own organisations.

The spotlight is likely to shine more brightly on risk management as economic times become more difficult and volatile. With a tightening economic climate, governments, shareholders, directors and management should expect a significant increase in scrutiny over the next few years. Oversight and review of the risk management practices and culture, in all types of organisations, are paramount. Boards must provide appropriate leadership and direction in relation to these important issues.

Key findings

This study has revealed that:

- most directors (83%) believe they set the right "tone at the top" for their organisations but there are large gaps in perceptions of the "right tone" between directors under 45 years (with just 66% agreeing) and over 64 years (with an overwhelming 90% agreeing) (page 7)
- some boards and management need to do more to get on the same page in relation to their organisation's risk appetite, with only 49% of directors overall saying their board and management have an agreed view on the organisation's risk appetite for each significant risk (page 8)
- some boards can do more to ensure their organisations have appropriate risk management systems, including an appropriate risk culture, internal controls and compliance procedures; with over half of the 625 directors in the research sample either disagreeing or not sure that their organisation has an effective enterprise risk management system (page 9 to 12)
- directors under 45 years of age are considerably more critical of their organisations than directors over 64, with a difference in perception of up to 35%, in terms of internal control systems and compliance procedures (page 11 and 12)

About this study

This study is the first in a series on board performance. These studies will focus on the views of directors regarding the major areas of the effectiveness of boards, based on Board Benchmarking's WhatWhoHowDo™ Framework.

Insync Surveys is an authorised distribution partner of Board Benchmarking's Board Effectiveness Survey.

About the sample

This study is based on the views of 625 directors who sit on 74 Australian and 5 New Zealand boards. They have responded to 120 hard-hitting, best practice survey statements of Board Benchmarking, formerly Leblanc Diagnostics. The boards included in the study represent a broad cross section of organisations ranging from ASX organisations (including in the top 10), to associations, not-for-profits and government entities.

The data was gathered between January 2006 and September 2008. The majority of directors in the research sample are males, non-executive directors and with the largest age segment being over 64. The sample is almost evenly split between organisations with a profit versus a not-for-profit motive.

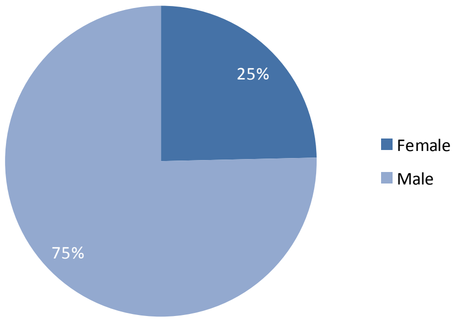
Females are more likely to:

- be under 45 years of age
- be directors in not-for profit organisations
- have less experience as a director

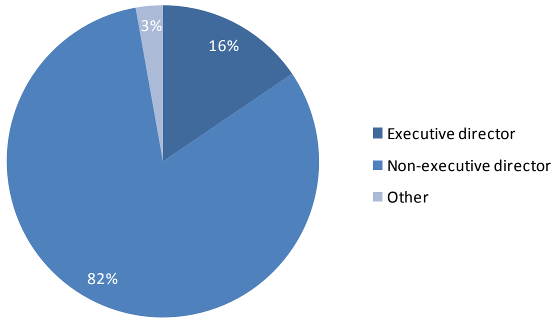
Males are more likely to:

- be over 64 years of age
- hold a director position in a corporate organisation
- have more experience as a director

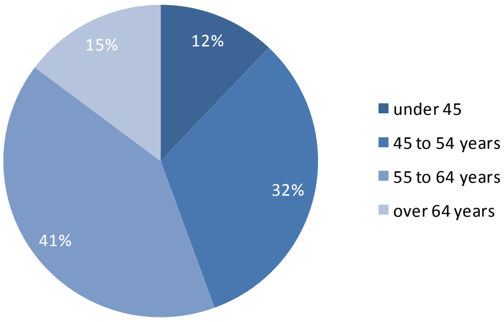
Gender



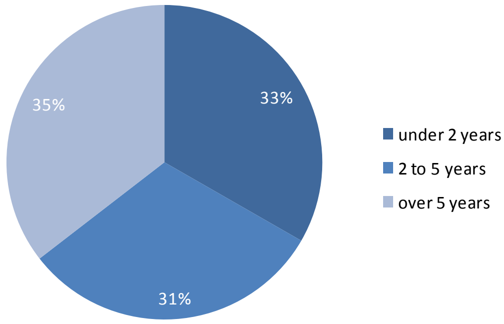
Independence



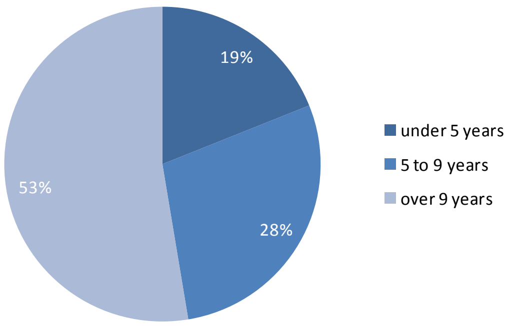
Director age



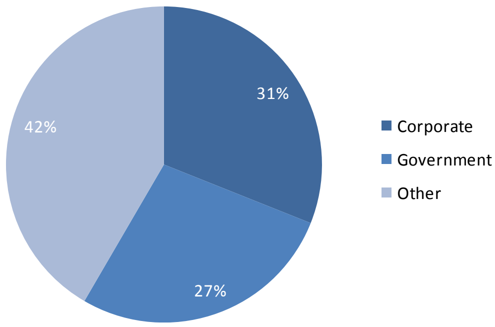
Director tenure



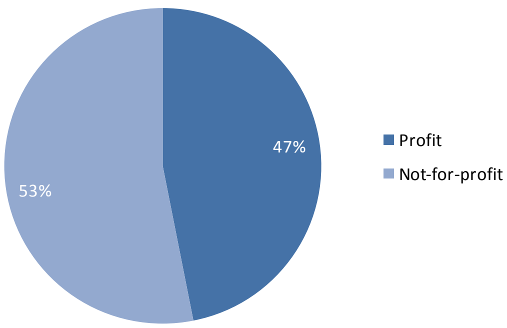
Director experience



Organisation type



Motive



Methodology

Data gathered from the self assessment of directors who completed Board Benchmarking's Board Effectiveness Survey have been used as a basis for this study. The survey is based on Board Benchmarking's unique WhatWhoHowDo™ Framework, as explained at www.boardbenchmarking.com. The Board Effectiveness Survey is used by organisations' boards to highlight areas of strength and areas where improvements can be made. It also acts as a yardstick against which to measure outcomes of improvement initiatives.

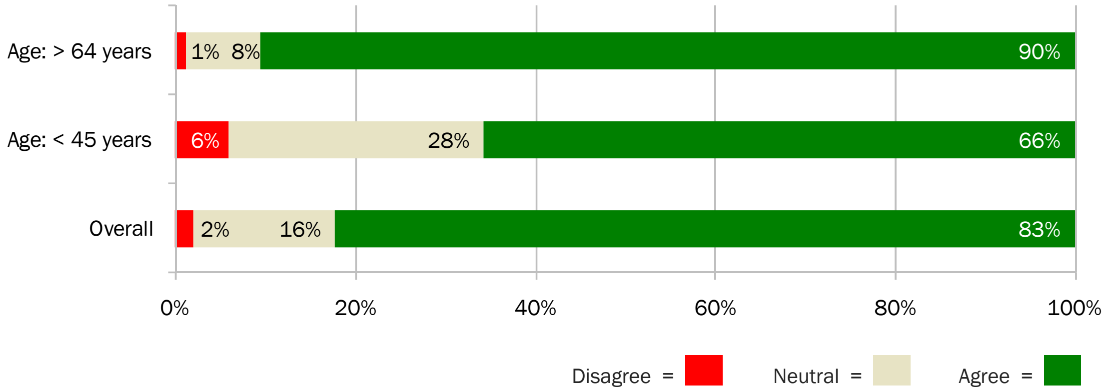
The survey has 120 statements measured on a seven point scale where "one" represents strongly disagree and "seven" represents strongly agree. The survey is unobtrusive and is designed to be completed by directors online within 30 minutes.

This study highlights differences among demographic groups. To do this, the seven rating options are aggregated under the titles of "disagree", "neutral" and "agree" as follows:

Disagree =	Neutral =	Agree =
Strongly disagree (1)	Slightly disagree (3)	Agree (6)
Disagree (2)	Neither agree nor disagree (4)	Strongly agree (7)
	Slightly agree (5)	

1. Establishing the right "tone at the top"

Response to the survey statement: "Our board establishes the right 'tone at the top'".



The view of directors that their boards establish the right "tone at the top" is ranked in the top five survey responses out of the 120 survey statements responded to by the 625 directors in the study. Overall, 83% of directors agree (as shown in the figure above). This is very encouraging.

Controversially, directors aged less than 45 are shown to be more critical, compared to their colleagues aged over 64. Only 66% of directors aged less than 45 agree with the statement, while an overwhelming 90% of directors over 64 agree.

The importance of directors individually and boards as a whole setting an appropriate tone for senior management, all employees and other stakeholders, cannot be overstated. That tone, which needs to be reinforced by the CEO and senior management, will ideally embody insistence on:

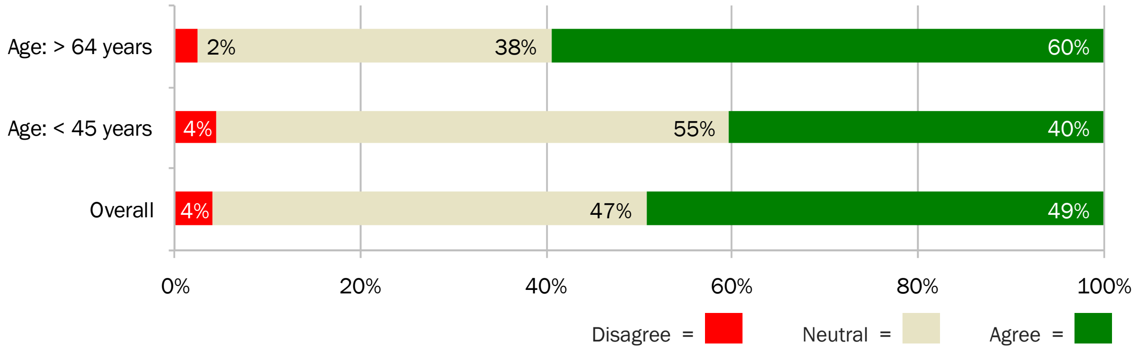
- a high standard of integrity and ethical behaviour
- the integrity and accuracy in financial reporting
- excellence in integrated risk management

Directors, CEOs and senior managers will be aware of the need to be consistent and vigilant in their actions. A single inappropriate action or comment can quickly bring all the previous good efforts undone.

It is pleasing to see that only a small number of directors believe their board doesn't set the appropriate "tone at the top". Directors who are concerned with the tone set by their board have a duty to raise their concerns with their board chair and other directors to ensure they are appropriately addressed.

2. Reaching an agreed view on risk appetite

Responses to the survey statement: "Our board and management have an agreed view on the organisation's risk appetite for each significant risk".



It is disappointing that only 49% of directors overall agree with this statement. When looking at the different demographic groups, women and younger directors are least likely to agree with the statement, indicating they are less content with the board's level of agreement on risk appetite. These directors need to speak up and ensure their concerns are addressed.

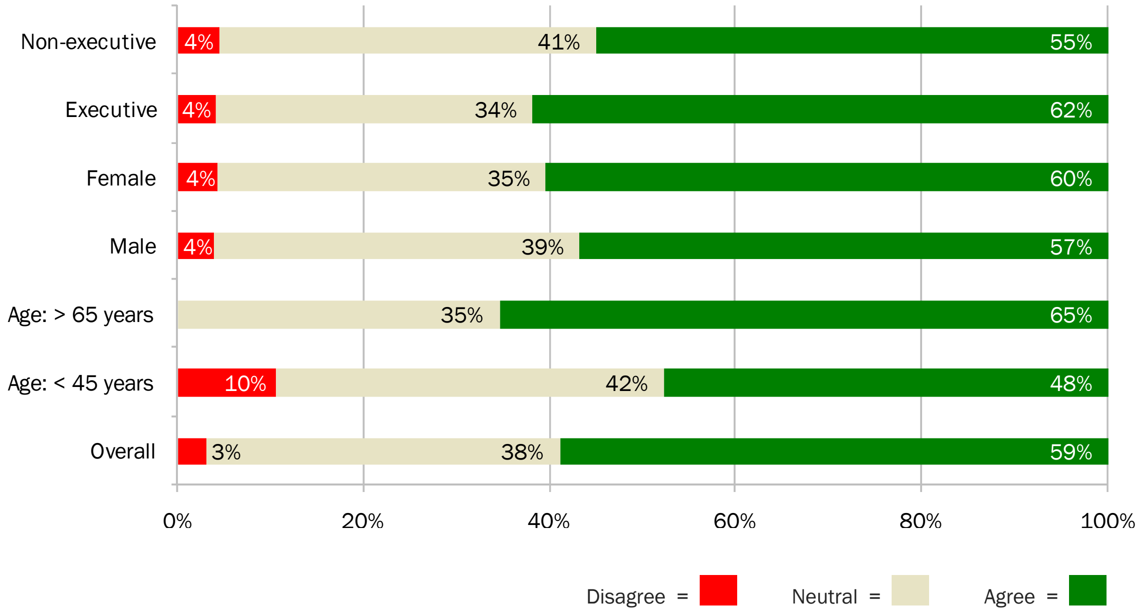
If the board and management don't have an agreed view on the risk appetite that is appropriate for the organisation, and assuming the board has an appropriate understanding of the drivers of the business and the related risks, one of two problems may occur:

- management may enter into transactions and activities that have an unacceptably high level of risk that may unnecessarily expose the organisation; or
- management may be overly conservative in relation to the transactions and activities they enter into, which may stifle innovation and add unnecessary bureaucracy to the organisation's decision making and the implementation of its business plan.

If directors and management don't have an agreed view on the risk appetite appropriate for their organisation, they need to spend the time to discuss, debate and fully explain their views to get on the same page. This may be assisted by an independent party that could assess and articulate differences in management's risk propensity and the board's tolerance for risk. During the period where full agreement hasn't been reached with management, it is the obligation and responsibility of the board to specify the risk appetite that they believe is appropriate for the organisation and ensure management's actions and the organisation's culture is adapted accordingly.

3. Aligning culture to agreed risk appetite

Responses to the survey statement: “Our organisation at all levels adapts a culture that is consistent with our agreed risk appetite”.



Around 41% of directors overall either disagree or are uncertain that their organisation adopts a culture that is consistent with the organisation’s agreed risk appetite. Once it is agreed, it is essential that the CEO and management team ensure the organisation’s culture is adapted accordingly.

Having a process for striking the appropriate balance between reward, risk and capital usage across all areas of an organisation is an important task. It is also important for management to ensure that business unit plans are appropriately aligned with the organisation’s agreed risk appetite.

It is equally important that employees on the front line know what risks are, and are not, acceptable in their work group. Clarity is essential.

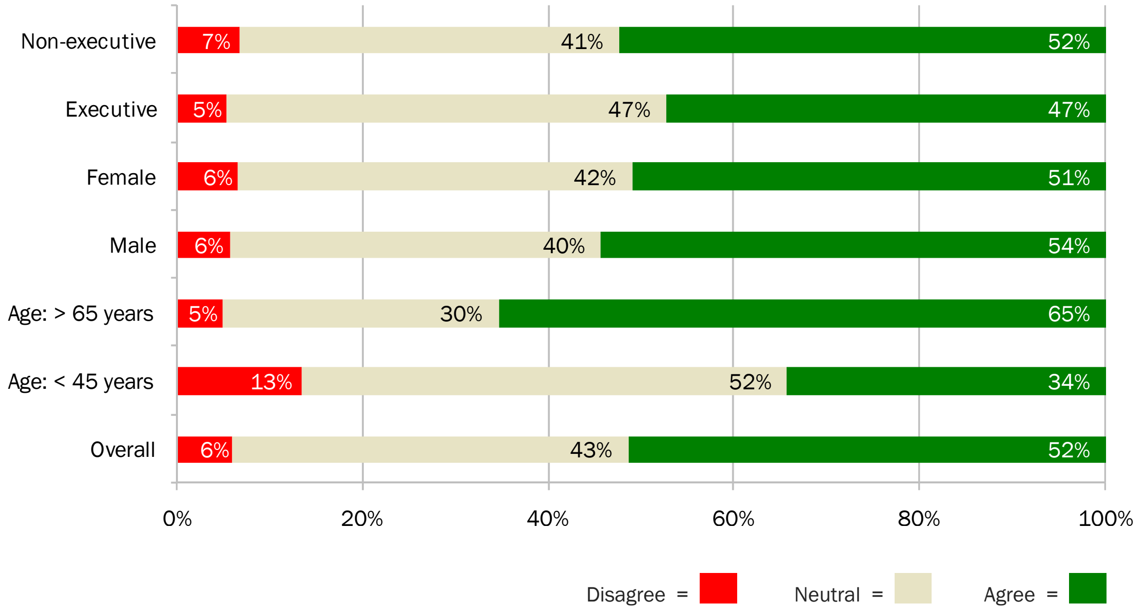
Directors need to ask themselves how well risk management is embedded in their organisation’s business processes, including in employee induction, job descriptions, performance management practices and at each level of management.

Directors also need to understand whether the organisation’s incentive plans have an appropriate balance between risk and reward or whether they encourage inappropriate risky behaviour.

Younger directors aged less than 45 may have a role to play here as they are more critical, with 10% of these respondents disagreeing that their organisation adapts a culture that is consistent with the organisation’s agreed risk appetite. These directors need to help drive appropriate changes.

4. Effective risk management systems

Responses to the survey statement: "Our organisation has an effective enterprise risk management system".



It is disappointing that almost half of the 625 directors in the research sample either disagree or are not sure that their organisation has an effective enterprise risk management system. Principle 7.2 of the ASX Corporate Governance Principles and Recommendations states that directors should require management to design and implement a risk management system to direct the organisation's material business risks.

Director views on this matter differ based on their age more so than other demographic splits such as gender or executive vs. non-executive. Those aged over 64 are more relaxed about whether or not their organisation has an effective enterprise risk management system.

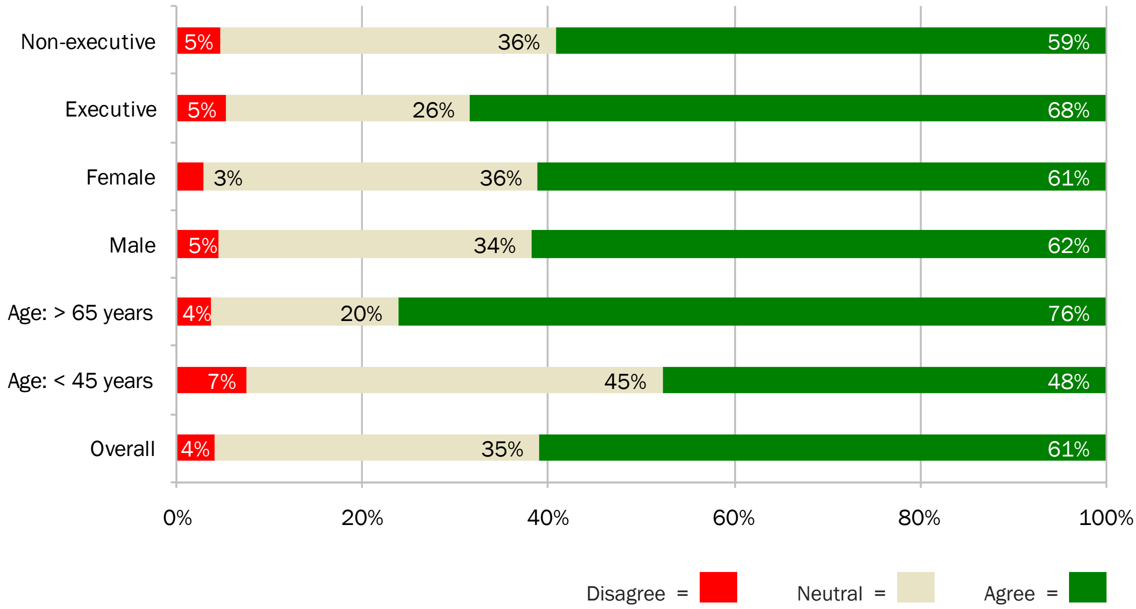
Boards and management have progressed a long way in recent years in improving the depth, breadth and sophistication of the risk management systems of their organisations. This, in part, has resulted from the pressure and increasing demands from shareholders and regulators following a number of high profile corporate crashes around the globe, including in Australia. Sarbanes-Oxley, Basel II, CLERP 9 and the like, have added significantly to risk management demands.

Organisations that treat excellence in enterprise risk management strategically have a clear understanding of what risks are core to their business and which the organisation is competitively advantaged to handle versus those risks which are non-core and those which could be outsourced or transferred.

Directors need to ensure that the organisation's culture is sufficiently robust to ensure risks are appropriately identified and managed. A well designed, enterprise-wide, integrated risk management system will be accompanied by a robust risk culture, in which bad news, problems and matters of concern are not suppressed, but rise quickly to higher levels. Other important elements of a robust risk culture were dealt with in an earlier section of this paper (page 9).

5. Effective internal controls

Responses to the survey statement: "Our organisation has an effective internal control system".



While the majority of directors believe their organisation has an effective internal control system, directors under 45 years of age are significantly more critical of their organisation's efforts in this area compared to those aged over 64. The level of agreement differs dramatically among this demographic split, with just 48% of directors aged under 45 agreeing their organisation has an effective internal control system while those aged over 64 have a high agreement level of 76%.

It is an essential role of the board to oversee and monitor how management go about assessing the adequacy of the systems of internal control and then whether there are appropriate processes and plans to assess whether those controls are operating effectively to protect the organisation from risk.

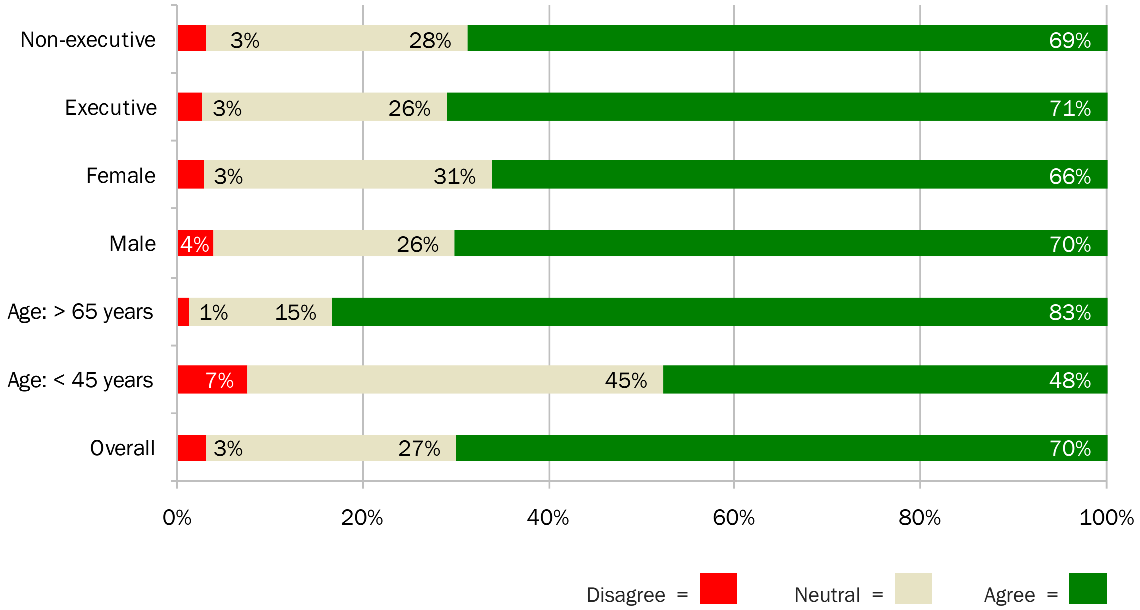
Many boards allocate the workload for the detailed oversight of this area to an audit and/or risk committee, which regularly reports to the board on its activities, findings and recommendations.

If an audit and/or risk committee is established, it also often has the role of overseeing the appropriateness of the audit plans of both internal and external auditors and their effectiveness at carrying out their roles, including their review of the adequacy and effectiveness of the organisation's internal control systems.

If the oversight and monitoring of the effectiveness of the internal control systems is not carried out by a separate committee, the oversight and monitoring activities must be carried out by the board.

6. Effective compliance procedures

Responses to the survey statement: "Our organisation has effective compliance procedures".



While most directors over 64 years of age agree that their organisations have effective compliance procedures (83%), only 48% of directors under 45 have the same view. The fact that younger directors are more critical may be partly because they have developed professionally in an environment that has been faced with significant corporate failures, increasing demands from shareholders and regulators, and a rapid introduction of new legislation both in Australia and globally.

Overall, directors consider that their organisations have more effective compliance procedures than they do in relation to the effectiveness of risk management systems (figure 4) and internal controls (shown in figure 5). This may be because compliance is more 'black and white', less subjective than internal controls and risk management and possibly easier to understand and measure.

It is vital that an organisation understands all its compliance obligations and that its directors understand the organisation's main compliance obligations, including trends and expected changes therein. Appropriate reporting of incidents and non-compliance is also important.

Organisations will need to understand and comply with many national, state and local laws and regulations of the countries in which they operate, trade and interact. As these laws and regulations are numerous, a systematic and thorough approach needs to be taken to their area of compliance.

Organisations also need to clearly understand and document their contractual obligations to third parties and ensure that such obligations are not breached, either inadvertently, or otherwise. Senior management will need to ensure that all relevant employees are made aware and have appropriate education and training in the organisation's compliance obligations that affect their role.

Directors should also oversee how the organisation ensures compliance by employees with codes of conduct, ethical standards and important organisation policies.

7. Board Effectiveness Review to increase performance

It is important that boards ensure they have set the right tone at the top, have an agreed view with management as to the appropriate risk appetite for each of the organisation's signification risk and oversees an appropriate risk management framework, culture, systems and practices.

The oversight of risk is a core function of the board – a function that periodically needs to be evaluated to ensure the board is performing that, and other key functions, effectively.

Most people understand the importance of a regular health check to determine whether they have any risks to their health and if they are operating at their optimal capacity. Even if there are no obvious signs of ill-health, most people after a certain age ensure they have an annual check-up.

They do that check-up with a competent doctor who knows dozens of the most common areas of poor health and early warning signs of disease. Such doctors know what blood tests, scans and other tests to carry out. Occasionally, extra tests are needed if certain initial tests are not conclusive.

In a similar way, Insync Surveys recommends a regular check-up for boards and board and management committees to determine if there are any risks to their "health" and if they are operating at their maximum capacity or contrary to accepted practices.

Insync Surveys offers the following world class surveys that determine the extent to which boards, committees and directors are effective.

	Individual matters covered	Time to complete (mins)
Board Effectiveness Survey	120	30
Audit Committee Effectiveness Survey	120	30
Board Risk Survey	75	25
Board Risk Committee Survey	98	30
Management Risk Committee Survey	98	30
Director 360 Survey (of all directors)	24	30

Other surveys important to boards include:

Organisation Alignment Survey (for employees)	120	25
Employee Risk Culture Survey		
senior employees	56	15
all employees	27	7

Feedback from users of these surveys commonly include … "easy to complete"… "searching and comprehensive questions" … "focuses things quickly" … "hits the mark".

Further details are available at www.insyncsurveys.com.au and www.boardbenchmarking.com.

About Insync Surveys

Insync Surveys has a range of leading edge integrated benchmarked stakeholder surveys. Its surveys are distributed in over 40 countries and in over 15 languages and include surveys for employees, customers, boards, board committees and many other organisation stakeholders.

Insync Surveys has carried out surveys for some of the largest organisations in Asia Pacific and has offices or representatives in Australia, Asia, North America and the United Kingdom. Insync Surveys' technology also powers the surveys of Board Benchmarking.

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About Board Benchmarking

Board Benchmarking has two world class measurement tools: its Board Effectiveness Survey and Audit Committee Effectiveness Survey. Both are available globally and are distributed via authorised distribution partners, which include: KPMG Australia, Insync Surveys, Oppeus, Westlake Consulting and Gerard Daniels.

Board Benchmarking has carried out over 100 board and audit committee surveys for organisations ranging from large public companies and government organisations to private companies, associations and not-for-profit entities. Board Benchmarking's surveys are powered by integrated benchmarked stakeholder survey specialists, Insync Surveys.

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