



Family firm succession

'Controlling families may need to adjust their traditional concept of succession and at the same time ensure robust governance of their firms. Modernising the firm's internal corporate governance and making a smarter succession decision (ie non-family succession in highly competitive and risky industries) can help maintain investors' confidence in their investment strategies.'

Dr Yin Hua Yeh

A Board Assurance Framework in practice

'On reflection, Forum committees today bear little resemblance to those that started out on this journey three years ago. Our learning at each of the journey's milestones has helped assemble a BAF model which we collectively believe enables our committees to provide a better service to each board by orienting; aligning; assuring and reporting on their governing priorities - their strategic objectives.'

Alan McDonnell

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A Board Assurance Framework in practice

Alan McDonnell shares some practical experiences from a small Forum of audit and risk committee Chairs in Ireland of developing and using a Board Assurance Framework (BAF).



Source:
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Setting the scene

Within my network of corporate governance clients resides a small Forum of Audit committee Chairs who meet frequently to share knowledge and experiences they can then apply to keep their own committees at the forefront of ever-evolving best-practice and better serve their boards. There are six members of the Forum representing the private, public and not-for-profit sectors in Ireland. This has been a learning journey underway for nearly three years which I have had the pleasure to facilitate.

The members of the Forum have given me permission to share with *Governance* readers what their evolving model of best-practice currently looks like as illustrated above. Reader contributions – critical or otherwise – that will help the Forum on the next stage of their journey would be most welcome. I set the scene for your thoughts by going over the milestones the Forum has encountered from the beginning right up to today.

Milestone 1 - Committee orientation and alignment on strategic objectives

Orientation

At the outset, four of the Forum had mandates covering audit oversight and two included risk. The committee charters were very similar as the definition of audit committees' responsibilities had been well refined internationally by governance institutes, accountancy bodies; standard-setters; and regulators. A typical audit committee was tasked to ...

'Monitor the organisation's financial reporting process; systems of internal control; external audit of the financial statements; and, the independence of the external auditors.'

A focus very much on past accounts and internal matters.

However, questions began to arise as the Forum members whose committee mandate included risk began to share

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insights. In addition to the standard tasks, their mandate stated they should ...

‘Monitor the risk management process to ensure it provides the controls necessary to deliver reasonable assurance to the board that the organisation’s strategic objectives can be achieved within its defined risk appetite.’

This stimulated considerable debate around the challenge this poses to evolving the audit committee’s traditional orientation on internal controls to one that is also externally focused on future strategic objectives.

Strategic Alignment

As the Forum got comfortable with the concept of this additional orientation, conversations turned to the audit and risk committee’s alignment. Up to now it could address each of its activities as isolated tasks. It now appears, by undertaking oversight of risk management, it needs to address these traditional activities in the context of the strategic objectives too.

Deliberations pursued on how such a committee could ensure it is aligned to the board’s primary focus as defined in corporate governance codes. This brought us to refer back to the definition of such focus in the original version of the UK Corporate Governance Code that has remained constant through all its revisions since 1992 ...

‘Corporate governance is the system by which companies are directed and controlled. The responsibilities of the board include setting the company’s strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship.’

Our conclusions following these deliberations were - if an audit committee is charged with the additional oversight of risk management, it should more closely align its focus with that of the board by setting the organisation’s strategic objectives as the context for all its work.

Milestone 2 - Internal audit function

Over time, all of the six committees represented in our Forum were converted to audit and risk which coincided with the emergence of a full-time internal audit function in one organisation and another three sharing a second internal audit officer. These appointments have been a big learning challenge for those committees and have had very positive impacts that will likely to lead to further recruitments.

One of the most important impacts has been how this function has helped committees with their alignment on strategic objectives. In addition, committees now receive assurances on internal controls, risk management and compliance obligations set in the context of these objectives rather than isolated reports.

The Chartered Institute of Internal Auditors has been a large influence on Forum members’ understanding of their strategic role. For example, their guidance titled *What Every Director Should Know* states ...

‘Internal audit is the eyes and ears of the board and its audit committee. Working independently of management, internal audit provides objective assurance to directors that, in the pursuit of the company’s objectives, risks are being managed effectively, financial and other controls are in place, and the organisation is being properly governed.’

Our group now saw the Head of Internal Audit as being a key role to fulfilling a committee’s widening mandate and strategic orientation.

Milestone 3 - Strategic risk and performance

Apart from the HIA role, risk management CRO’s also began to grace our ranks with many salient lessons for the Forum’s committees. ISO 31000 quickly became the common standard and all adopted its lexicon which greatly helped our discussions including its definition of risk as ... ‘The effect of uncertainty on objectives’.

With the strategic alignment adopted in Milestone 1, the Forum found it easy to conceptualise that risk management should be focused on identifying and managing risks to the achievement of our organisations’ strategic objectives and all financial, control, governance and culture risks should also be addressed in that context.

One of the most interesting debates that took place over the journey happened at this juncture. It related to one of the greatest risks to strategic objectives and that is operational performance. The debate centred on how a committee would conduct oversight of this key topic to provide comprehensive assurances to the board. The consensus was that the HIA and CRO would prioritise it in their work with the former providing ratings on progress towards objectives and the latter delivering accounts of controlling related risks.

A committee’s oversight would then include engagement with the executive on arising priorities for relaying to the board in the form of assurances or escalations.

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All six forum members felt that this level of engagement with the executive on strategic performance was critical but required competencies not traditionally associated with audit committees.

Milestone 4 - Committee competencies

This topic consumed a number of Forum meetings that referenced many guidances and thought papers. What emerged was a blueprint of four committee enablers namely:

- (a) terms-of-reference;
- (b) annual workplan;
- (c) competency framework: and,
- (d) performance evaluation.

It was felt that these needed to be carefully calibrated and reviewed annually.

Some of our biggest influences were the resources available from the KPMG Audit Committee Institute. The findings from their *ACI Global Pulse Survey* hit the spot with us.

'Board Composition and Alignment with Strategy is a Key Priority.

Survey respondents identified that given the demands of today's business and risk environment - not to mention increasing scrutiny by investors, regulators, and the media a critical priority for most every board is to align boardroom talent with company strategy.'

We concluded these ACI findings were equally important to the audit committee if it were to fulfil its widened strategic mandate.

Milestone 5 - External audit orientation

The ACI library includes a 2015 research study titled *The Future of Audit* which had a key finding that reads ...

'Value beyond the statutory audit scope

Bringing wider perspectives to the table including leveraging audit work to help companies understand the strategic risks they face and financial information outside the statutory annual report.'

In addition, their *2017 Audit Committee Handbook* repeatedly refers to the evolving character of audit committee oversight. It says ...

With the strategic alignment adopted in Milestone 1, the Forum found it easy to conceptualise that risk management should be focused on identifying and managing risks to the achievement of our organisations' strategic objectives and all financial, control, governance and culture risks should also be addressed in that context.

'Traditionally, audit committees have been concerned with the oversight of external audit and internal financial controls. However, in most jurisdictions today, the remit of audit committees includes responsibility for monitoring the effectiveness of internal control and risk management systems company-wide. This goes beyond the financial reporting process and encompasses the system of risk and control associated with other areas such as operational matters and compliance with laws and regulation.'

However, we found, in reality, audit scopes were not evolving with audit committee widening mandates. International Standards on Auditing (ISA) state that external auditors only consider internal control and risk management systems to the extent necessary for them to form their opinion of the financial statements. And, the EU Directive SI 312 goes no further.

Our Forum found this divergence in orientations between the evolving audit and risk committee and traditional external audit scope to be a topic it could not resolve. The Forum today shares it with the *Governance* community to widen the debate in search of a resolution.

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Milestone 6 - Board Assurance Framework

This recent milestone saw Forum members consulting with their respective boards to determine what the prevailing expectations were of their audit and risk committees. Committee Chairs had been very diligent in keeping their board colleagues in tune with the Forum's journey. This enabled board members to articulate their expectations in forms that encapsulated what the Forum had developed so far. Their wise counsel was evident in a collective declaration of expectations they issued to the Forum which read ...

'The board requires its Audit and Risk Committee to provide it with assurances on the organisation's performance in the achievement of each of its strategic objectives and that related risks do not exceed the board's risk appetite. Assurances on audit, financial controls, compliance, internal controls and other matters the board delegates to the committee should also be set in the context of the same strategic objectives.'

The Forum welcomed the clarity of this declaration and the emphasis it placed on committees' duty to provide assurances. The concept of a Board Assurance Framework (BAF) had been on our 'radar' for some time. We were familiar with the *UK Treasury BAF Guidelines for State Bodies* published in 2014. We'd seen how the UK Department of Health had, ten years earlier, established its BAF model for NHS Boards who, in turn, published BAF Guidances for their network of Trusts. In recent times we've noted how this model is spreading into the education, business and third sectors.

A Forum member - one of Ireland's largest charities - volunteered to be our test case in implementing a BAF that the rest would duly replicate if it proved a success.

Milestone 7 - Board assurance reporting

With a stroke of good fortune, the start of the BAF test-run coincided with the publication of the ICSA 2017 *Guidance on How to Build a Charity Board Assurance Framework*. In it they define the four core components of the BAF which we've adopted and adapted ...

1. *Strategic objectives* – board-approved overarching objectives consistent with the organisation's mission and powers contained within its governing document set within a board-formulated and monitored ethical culture.
2. *Strategic outcomes* – this includes a range of key performance indicators to be achieved over a three to five-year period that track the achievement of the board's strategic objectives. These will be the key focus of BAF reports designed to facilitate focused board engagement in oversight of strategic performance.

3. *Risk management* – details of the main risks and threats to the strategic outcomes, and the overarching strategic objectives, alongside controls in place to manage and minimise those risks.
4. *Assurance reporting* – the reporting of evidence to the board to assure them that the organisation is operating effectively and achieving its strategic outcomes through:
 - effective strategic performance;
 - risk management arrangements; and
 - in accordance with the organisation's statutory requirements, internal controls and established standards of financial oversight.

As of 2018 Q2 three boards represented on the Forum have decided to adopt the BAF reports as the primary output of their audit and risk committees. The others will review progress in Q4.

2018 Forum journey update – the evolving audit and risk committee model

On reflection, Forum committees today bear little resemblance to those that started out on this journey three years ago. Our learning at each of the journey's milestones has helped assemble a BAF model which we collectively believe enables our committees to provide a better service to each board by orienting; aligning; assuring and reporting on their governing priorities - their strategic objectives.

Any pearls of wisdom?

We thank you for the opportunity to share these experiences with you and hope you found them of some value.

As we recognise this journey is never-ending, we'd greatly welcome any observations or pearls of wisdom the *Governance* community can share with us. To facilitate this the Publisher has mounted this article on this LinkedIn Discussion Page <https://www.linkedin.com/company/10142210/admin/updates/v> where all contributions can be shared. We thank you in advance.

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