

The Contribution of a Controls Culture to Effective Corporate Governance

Introduction

As we all know, corporate governance covers a multitude of sins from directors' pay through to the need for codes of ethics. However, we must not forget that underpinning much of this is the need for organisations to have a culture of control that is led from the very top of the organisation.

A recently published paper entitled 'Enterprise Governance' produced jointly by CIMA and IFAC focuses on what is really a truism but one, nonetheless, that we do not reflect on sufficiently often. Their premise in the paper is that performance plus conformance is the true way to achieve sustainable business success. The conformance element of this relates to having effective governance structures in place but also the need for a strong control culture and they cite cultural issues as being key to corporate failure.

Having an effective control environment

Underpinning every corporate framework is the need for a strong control environment and supporting controls to manage identified business risks. So, what do we mean by a control environment? It is widely understood that the control environment covers areas such as:

- Integrity and ethical values
- Management's philosophy and operating style
- Board of Directors and Audit Committee
- Organisational structure
- Assignment of authority and responsibility
- Human resource policies and practices
- Commitment to competence

Many of these are what I would refer to as 'softer issues' focusing around people. After all, when things go wrong (or indeed right) it is largely down to the actions of an individual or a group of individuals.

Although each of these elements is important I would like to select two of them for further consideration:

1. Integrity and ethical values

The tone for integrity and ethics must be set at the very top of the organisation and communicated to all staff. It must also be ensured on a regular basis that all people within the organisation are abiding by the set values. However, some of the high profile organisations where failure has happened had strong codes of ethics. Their failure was due to the fact that senior people did not demonstrate through their behaviours the importance of such values.

People are generally honest and wish to do what is ethical, but they need to understand what constitutes both ethical and unethical behaviours. Giving people excessive performance targets can lead to their cutting corners and acting unethically. After this has happened once, the second time is easier and then it starts to spiral out of control. The rest, as they say, is history!

2. Commitment to competence

I have been working with businesses for over twenty years now. What I sincerely believe, and believe most strongly, is that one of the most important controls for organisations to have is that over the recruitment and development of their people. Yet many organisations fail to carry out even the most basic checks on staff before they employ them. If someone claims to be a qualified surveyor then you need to check that, in fact, they are.

Once you have the people on board then they need to understand the purpose of their role and how this fits in with the achievement of the overall organisational objectives. Simple, you might say; and yet few organisations that I have worked with do this to a satisfactory level.

Simple things such as job descriptions, performance monitoring and development systems are essential to ensure both business and personal success.

Detailed controls

Underpinning an effective control environment are the key controls that need to be in place and operated effectively to manage the identified risks within the organisation. To achieve this, organisations need to undertake an on-going process of identifying and assessing their risk. This needs to be carried out on both a top down and bottom up basis. After all, if you are a retail organisation, who is best placed to identify the business risks within the shops? I would suggest that this is not the board of directors but rather the staff that work within the shops themselves.

Once the risks are understood then controls need to be established to manage these risks. Managers must then monitor the operation of these controls to ensure that they are operating as intended. In practice, many managers tend to rely on internal audit to carry out this monitoring for them. In my view, this is inappropriate as internal audit perhaps look at areas only once a year or, indeed, less frequently. If managers perform this monitoring role properly then warning bells will ring as soon as controls are failing rather than several months after.

What is key here is for managers to understand the critical role that they and their staff play in governance, risk management and control. These responsibilities should be built into their job descriptions and performance objectives and they should be held accountable.

Conclusion

Effective governance is critical within any organisation and needs to be allied with performance. Research and experience demonstrates that those organisations that focus on both conformance and performance can demonstrate sustainable success. Managers and directors must demonstrate through their behaviours that the organisation has a strong culture of control and that breaches of this will not be sanctioned by anyone.

As a final point I would suggest that most organisations currently operate a silo based approach to control and that they need to start on the journey of implementing a culture of control with immediate effect – after all, time waits for no man!