2010

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GRCCONTROLLERS

"For Corporate Governance structures to work effectively, stakeholders must be active and prudent in the use of their rights.

In this way, stakeholders must act like owners and continue to exercise the rights available to them."

2005 CFA Institute: Centre for Financial Market Integrity

Board of Directors New Year's Resolution

A GRCControllers White Paper ©

Foreword

There is a great irony in the current draconian Trust, Credit and Financial Crisis that Corporate Governance, Risk and Compliance (GRC) reforms which have come about as a reaction to the major scandals of the last ten years were unable to foresee the potential magnitude of the current crisis and its impact on the global business world.

It is as if GRC reforms were based on the false or at least incomplete or inadequate premise that improved internal controls, risk management, auditing standards etc, were the complete solution. They have proved wholly inadequate to prevent the scandals that have so significantly shaken global investor confidence for the simple reason that most of the recent major scandals were the result of very senior executive level wrongdoings or failures that were not likely to be detected by improved internal controls or risk management designed to prevent routine fraud and unintentional errors. The most recent notorious scandals have been caused by schemes designed by executives far too clever to be caught by normal checks and balances over internal controls that auditors, regulators, and rating agencies follow.

The one common denominator in the great majority of scandals was a lack of robust corporate governance at board level. Without a strong moral and ethical tone at the top starting with the government and flowing down to corporate boards and executive management, no amount of laws, regulations, and standards will prevent the painful scandals of the last decade. Therefore, more effective boards, not better internal controls over the processes and transactions of managers and supervisors, are the key to improved governance, risk management and compliance.

GRC flaws were a major contributor to the recent crisis. The responsibility for the actions that led the global brink of collapse ultimately rests with the people who sat around the board tables and probably those who approved their appointments. Regulators are committed to raise the bar for GRC supervision and management. This paper will attempt to address the weaknesses, look at proposals for strengthening GRC in view of the forthcoming regulations.

This whitepaper provides a concise framework for embedding robust board governance with simple to follow action items that are essential to improving corporate governance, sustaining a high level of confidence by all stakeholders, preventing the disastrous ethical and moral lapses that forced a series of regulatory reforms, and in some cases very expensive over-reactions.

Panic alone will not solve the current crisis.

During these trying times there are substantial differences in requirements for CEOs. It is not enough to have total control over operations. Senior managers must also possess the power and the vision to make sure that the company is able to pull out on the other side of the financial and credit crisis.

In Scandinavia and in several other countries, many senior managers were released of their responsibilities in 2009. Patience is currently not a virtue in the board rooms. The leash given to the President and/or CEO by the stakeholders will probably be even shorter in 2010.

Within the first two quarters of 2010, the President together with other board members will need to clarify the future GRC roles and responsibilities of the CEO and management.

The Chairman of the Board is accountable to the owners, shareholders at the annual meeting in the spring of 2010. In the light of market developments in 2008 and the prospects for 2010, for many it will be no enviable task.

So what can we expect in 2010? Undoubtedly there will be a tremendous strain on the Chairman or the President. The Chairman must deliver plausible explanations regarding the results at the general meeting. Furthermore he must convince the shareholders and stakeholders that the Board of Directors has a firm grip and a plan regarding the situation, including a clear GRC strategy. Not just a survival strategy, but a revised and new growth strategy, seen in the light of the current crisis.

This paper attempts to respond and provide 'solutions' to a series of current GRC concerns related to The Board members and their GRC areas of responsibilities. There are several key areas of GRC capability that present the greatest challenges and opportunities, and which the Board should fully understand in 2010.

The paper further attempts inform the board members and management what they need to know about GRC efforts in the enterprise and the need to be assured that the enterprise is appropriately addressing the critical GRC issues. Some of the hot buttons for 2010 are;

- How to Manage the Business Risk of Fraud in Today's Environment?
- How to Identify, Assess, Control, Test and mitigate Risks?
- How to Control Extended Enterprise Information Risk?
- How to Manage Accounting Change for Competitive Advantage?
- Can We Use a Lean Approach For Compliance and Control?

The Board's role in 2010 will be more significant than ever.

About the authors

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His GRC consultancy, courses and development of compliance tools is based on over 30 years of accounting & finance experience as CFO/CEO in Blue Chip corporations. After his early retirement as Business Controller from ExxonMobil in 2005, Kersi has solved GRC and IT issues with several major multinationals. Kersi is associated with Resources Global as their GRC Project Manager.

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He is the author of *Manager's Guide to Compliance*, (John Wiley & Sons, March 2006), *Governance, Risk, and Compliance Handbook*, (John Wiley & Sons, March 2008), and *The Essentials of Risk Management (John Wiley & Sons, summer 2010)*, co-author with Deborah Cernauskas of *Risk Management in Finance, Six Sigma and Other Next Generation Techniques* (John Wiley & Sons, April 2009), *co-author with Kersi Porbunderwalla of Governance, Risk, and Compliance: How to Achieve the Objectives of GRC Through a Center of Excellence* (John Wiley & Sons, spring 2010)

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Besides MS Consulting Group, he is the CEO of the Nordic Academy of The International Institute of Written Oxford English – a business to business Nordic language training e-learning services franchise for the Rosetta Stone Group (global leader in blended e-learning) and Q group.

He has also held Board positions on a number of professional Boards since 1985 (in Sweden, Norway, Spain, UK and Hong Kong) and was the founding Chairman of the British Chamber of Commerce in Denmark (BCCD) he was appointed the first merged BCCD (British Import Union) President.

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A New Year’s Resolution for the Board of Directors

Abstract
The authors of this whitepaper present current and future solutions to a number of GRC issues that the board and management face. The paper explains how to manage the business risk of fraud in today's environment, how to identify, assess, control, test and mitigate Risks, how to control extended enterprise information risk and further more how to manage accounting change for competitive advantage.

In addition the paper also investigates how we use a Lean approach for compliance and control. The findings conclude that instead of creating new and even more complex processes and organizational structures, the boards should focus on creating solutions that are simple, transparent and hold people accountable for their actions and decisions.

The paper goes into depth in explaining how boards in practice will work with some of the critical issues that they face today in the wake of the current crisis. A series of advantages that a well implemented GRC strategy is outlined and explained. By use of cases and examples the paper explains how the right tools and approaches are applied to correct the GRC state of affairs.

Governance & Risk Management are two sides of the Compliance Coin.

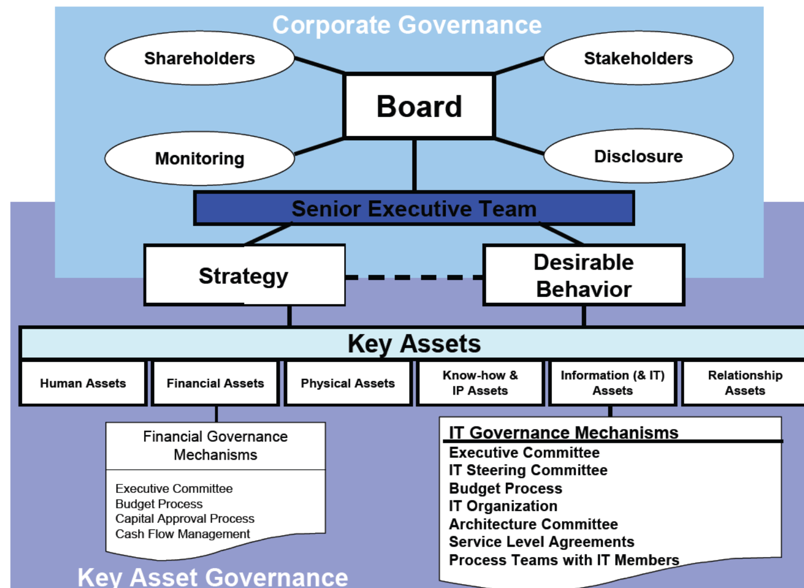
“Crisis” comes from a Greek word that simply means “turning point.” The arrival of the New Year gives corporations a chance for a fresh and clean review of a variety of Governance, Risk and Compliance (GRC) issues. It is an opportunity to decide what adjustments should be made before small issues become major problems. When corporations are well prepared to perform this task, it is far more likely that there will be productive outcomes of the GRC review and the company will reap the benefits from Good Governance and Compliance practices.

This white paper primarily focuses on issues of Good Governance, strongly suggesting that corporations, stock-listed or otherwise, perform an overall check of the GRC procedures at the start of a new year.

This strategy provides that January or the first quarter of the new year will be another fresh start for board members and directors; a time to revaluate policies for Good Governance and re-examine the benefits of prudent GRC.

Start by asking the following question: does the board have the competencies to solve the most common dangers facing the company, like the increasingly complex, and potentially disastrous labyrinth of compliance oversight? A board assessment will provide the company with self-awareness regarding its ability to deal with these potentially damaging ‘turning points.’

Corporate Governance.
If Management manages and the Board provides oversight, a company establishes the setting for good Corporate Governance. With this precondition in effect, clear Governance communications can improve the seamless integration of business objectives and procedures throughout the corporation. Board approval is then only required for issues specified by corporate bylaws or related governance charters.



Source: Copenhagen Compliance Conference

Figure 1: Corporate Governance

Corporate Governance Challenges Facing Corporate Boards in 2010.

President Barack Obama's Chief of Staff Rahm Emanuel said that the current crisis was too costly to be wasted. As we look, the recent failures, financial institutions are either defunct or brought to their knees, in spite of heavy governmental subsidies. Shareholders and others are therefore raising the GRC bar in terms of the competence and quality of the board and management. The raised bar will enable them to improve concentration on the shifting economic landscape thru the new GRC strategies.

Convergence to best practices is no longer enough. The global credit and financial crisis has clearly indicated that a new and revised international Corporate Governance, Risk Management and Compliance (GRC) order has to be implemented by almost all enterprises. In these turbulent times, emotions sometimes run high as survival is suddenly the order of the day, distorting the strategies and perspectives.

In that light it is therefore alarming that so few companies have taken a complete overhaul of their GRC practices and instead act as if it is Business as Usual. One of the major reasons for overhaul is that GRC works and functions throughout the enterprise continue to be performed in silos. The GRC integration is often not understood and accepted throughout the enterprise because it is quite complicated.

In certain enterprises the Board has come to an understanding that the economic changes that have occurred are structural (not cyclical), that Risk Management is systemic and incomplete if it is thinly spread out and that Compliance activities will increase in the years to come.

These changes in GRC will affect every company in every sector across the world. Therefore there is a need for a true and total GRC transformation depending on the gravity of the situation in the enterprise.

Another reason for the transformation is the continual loss of trust in the world's financial systems, corporations and institutions. A transformation that once again focuses on the responsibilities that company boards are the forerunners of the effort to win back the confidence of customers and investors and all stakeholders alike. Good governance and leadership will help rebuild confidence in our business systems, providing a stable framework for sustainable growth. Therefore a well-balanced and competent board continues to be critical to provide the effective strategic direction.

What each enterprise has to define and determine is: What are the core objectives of good corporate governance that can be achieved from the organization's perspective.

The continued number of major corporate scandals of the past decade has led to increased scrutiny of corporate integrity, ethics and accountability. Surely the element of Corporate Governance was missing which now requires higher expectations for corporate governance practices in the coming decennium.

Therefore the first questions the boards must ask themselves are: What are the most significant GRC practices that have emerged in recent years, do we comply and what is our plan of action if we don't?

Starting from a helicopter perspective, the Board should focus on those good corporate governance elements for each of the coming years and support and provide effective advice, counsel, and sometimes even direction to the CEO and senior management team. Adequate measures are taken to ensure that the board is capable and ascertain that it has the knowledge and data to carry out the required monitoring activities.

Stakeholders all over the world, perhaps with the exception of a handful of countries ask the following questions, whether the board of directors do their job in carrying out their responsibilities

- Did the boards understand the risks their organizations were taking?
- Did the board carry out its key board responsibility to oversee what management is doing to identify, analyze, and manage risk?
- Was there any alignment to the agreed exposure and the company's risk appetite?

Boardroom Challenges

The ability to maintain a balance between monitoring management and providing wise counsel and direction to the CEO to best add value to the corporation for the benefit of shareholders is more easily said than done. We can also add the right information, protocols, and focus; boards are positioned to do what's needed for their companies to succeed to the series of required buzzwords.

Transparency	Composition of the board	Working style of the board
Disclosure levels of board	Board independence	Availability (e.g. frequency of meetings, attendance, availability of the directors)
information about: Directors Remuneration Committees	Diversity (e.g. internationalization, diversity of expertise, gender)	Committee structure Board evaluation (e.g. frequency, leadership, process)
Composition of committees (e.g. independent	chairmanship and membership)	Independence factors (e.g. length of tenure, time on board, turnover)

Pressure to improve GRC practices.

There are pro's and con's for taking a best practices approach when implementing enterprise wide GRC standards for starters. Like everything else, an effort has to be put into whether the Best Practices portray what many boards or companies of the same trade do or whether it is simply a list of lists based on widespread views on GRC matters and issues. It may not be necessary for every enterprise to be The Best solution.

The collapse of banks and financial institutions have proved beyond doubt that corporate officers are not always be well-positioned with the desirable knowledge, skill, and experience to guide the enterprise they have to oversee for a number of reasons.

Most Board members, especially the Chairman complain that they do not have adequate time to address the multitudes of complex issues. This is often because there is a duplication of efforts and there is not a distinct definition and procedure for the segregation of duties between the management and the board.

There is absolutely no excuse for the board members to complain about their inability to devote sufficient time to scrutinize and contest all GRC issues that are brought to their attention and the underlying root causes. Therefore board members, regardless of their compensation structures, should not simply go through the motions without proper consideration of all GRC issues and events, which determine the success or failure of the enterprise. The lack of attention to GRC issues has created liability issues for the board members.

The bad news is that even though the total time devoted to the boards GRC responsibilities has doubled in recent years to about 250 hours, it is bound to increase if the GRC strategies and efforts are not properly structured. Additional time for boards' expanded monitoring duties emanating from new compliance-related requirements has and will surge and still have adequate time to critical strategic issues that create or destroy stakeholder value.

When individuals have accepted directorship of board(s), somebody has evaluated their basic expertise, attributes and characteristics commensurate with their responsibilities. They have further made a personal commitment and put their reputations on stake and accepted responsibility to carry out their fiduciary duties. They must devote whatsoever time and energy needed for guiding, counseling and directing the CEO and senior management team with sufficient diligence towards attaining established growth and return goals.

Executive compensation.
For many institutional investors and corporate governance activists, a hot topic for governance oversight is CEO and executive level compensation. The main gripe is related to the need NOT to offer executives incentives in such a way that would open up opportunities for or create drivers for bad practices – such as compensation linked to share price, or, rewarding for poor performance in relation to severance packages. There is a need to address these issues before they and other similar ones give rise to negative publicity. Compensation committees must disclose and determine compensation schemes by means of an arms-length negotiation methodology and on a case-by-case basis. The chosen methodology including corporate strategy, corporate performance measures and metrics for CEO compensation, will ensure that all parties are treated fairly with the achievement of mutual objectives and are in line with the company's and shareholders' interests.

Risk issues.
The Board of Directors needs to know the major risks the company is faced with and what Management is doing to manage these risks on an ongoing iterative basis to reflect changes in a dynamic business environment. To this end, it is necessary to design suitable methods on refreshing the organisation's risk profile and on "how to" communicate effectively on "risk" issues to achieve a common understanding of what risks the company faces and the decision protocols for responding to them. Establish an ad hoc risk committee (instead of identifying risks on an ad hoc basis) to provide the needed oversight, definitions and how the company will identify and manage the wide range of risks that can impact performance.

Only the prudent board understands that there are a significant number of risks of which the board members are not aware.

Risk Management and Oversight Failure - or Fraud?
The recent collapse of a number of major financial institutions globally has demonstrated that despite being the most regulated sector in every territory, despite the level of oversight and financial reserving or asset set aside required, despite the complexities of risk management supposedly inherent in the business models and engrained in the DNA of financial institutions, something went massively wrong.

That 'something' was at its simplest, inherently 'toxic' products - banks were giving mortgages to people who were clearly unable to pay. Institutions were buying collateralised debt backed by such risky paper. Insurance companies were giving guarantees which, if required to be honoured, would be financially crippling not only to them but the entire financial services industry.

Why? The demand of the market for companies to 'perform' and the consequences of perceived under-performing have driven the need for financial institutions to develop new products, and to find new revenue streams. This has meant increasingly complex offerings being developed and marketed, and, in many ways, the development of a significant financial 'gaming' product sector – short selling, hedging, spreads, derivatives etc. As this grew, developed and matured, the rewards for new product areas and products grew exponentially but of course so did the risk. Unfortunately, the management of risk did not keep pace with the exposure.

How did this situation arise? Why were so many experienced people caught out? This malaise can be summarised in 3 dimensions.

First of all, a primary market where inherently and significantly faulty financial products were, in many instances, sold to clients that either could not afford them or they were based on projected returns which were clearly unrealistic. Quite how some of these products passed risk management review is beyond belief. Also, the integrity of the seller is in question – either by concealing the true nature of what was being offered or packaging them in a non accessible way for management review and authorisation. Unquestionably, the nature of the reported products indicated that fraud has played a major part here.

Secondly, the secondary packaging and collateralising of those products which were sold on without adequate regard by the seller or the buyer of the inherently risky nature of the assets backing them. Again, serious questions remain concerning the buyer's and the seller's risk management and again concealment, misrepresentation and fraud.

Thirdly, need for oversight**.** At some point when the dust settles, questions will be asked about how there could have been such a spectacular failure of not just management controls, but also of regulators and auditors, to identify globally, amongst many leading financial institutions the wholly inadequate level of coverage and the threat to going concern. Some of the products and practices themselves – e.g. short selling – created the circumstances and the need for traders to allegedly manipulate data, create rumours etc to fulfil the short 'prophecy' leading to the downfall of not only some companies but the market – companies and regulators failed to detect or control it until it was too late.

Clearly risk management has failed to a spectacular degree at a number of levels from product risk at an institutional level, to oversight and reserving adequacy at regulator level. Of course, as the product matured in the value chain from a simple mortgage to an underlying asset in a packaged offering, complexity and lack of transparency played a major role in concealing the true risk; with hindsight, and indeed better foresight, if the product risk had been better understood at product level, or at collateralisation then it would presumably have been better managed. Unless of course it was and what lies beneath is fraud concealed as business risk. Time will tell.

Compliance.

In the aftermath of the financial crisis, the subprime outrage to Ninjas (No Income No Job or Assets), as well as new directives, standards and regulations, most boards have focused like a laser on compliance. Many boards continue to devote time and effort to compliance matters.

Monitoring compliance is Management's responsibility.

Rather than devote time to operational compliance, the board should issue oversight demands and make it everybody's responsibility to be in compliance. The board should require of management that the compliance and monitoring processes are systematized and their role be one of assurance on the effectiveness of the systems and processes.

The Board must maintain its focus on its critical responsibilities, for example attention to strategic issues, providing the value-added advice, providing

counsel and direction to senior management, and bringing their knowledge, experience and perspectives to critical business issues.

Compliance in practice.
The continuing necessity of many companies to re-state earnings clearly demonstrates that boards need to ensure that the company has the right finance and IT functions in place for proper disclosures – systems, people, technologies, data – as well as a sufficient level of financial knowledge, experience and expertise both operationally AND at board level. In order to enable the board to effectively exercise its dedicated need for financial overview, reporting mechanisms and financial measurements, effective internal controls over financial reporting must also be in place.

The infamous corporate financial scandals of the past few years have proved that the board can no longer afford to be complacent about the possibility of illegal and unethical behaviour on the part of corporate officers. Whilst the reporting requirements and the increased responsibility of audit committees have addressed some of these concerns, the board must also consider and insist upon a code of ethics and conduct for the company, review it often, and make sure that people who violate it are held accountable.

The board must be confident that the company is well prepared and can respond when different factors that can significantly disrupt operations present themselves. Any such disruption will increase the possibility for bad publicity, or a tarnished corporate reputation. In extreme situations, the board may need to deal with potentially ruinous litigations and the actions may alienate customers.

At the same time the board must focus and have a clear understanding of their organisation's purpose and values - the values present in the culture and activities of the organisation.

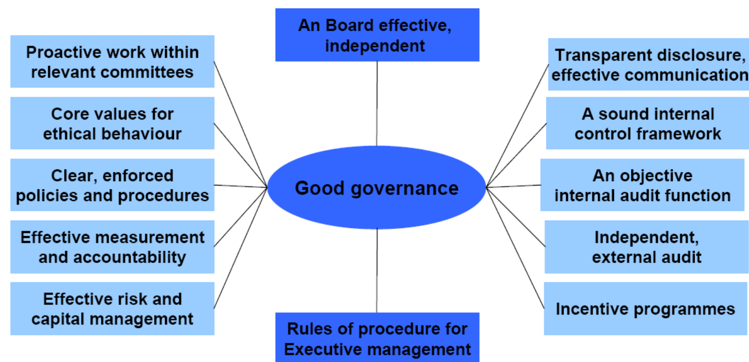
Lord Browne, the ex-chief executive of BP once said that an effective business leadership requires a tight focus on the plot. "Set a clear strategy and organise your resources behind it. Strong values and careful delegation are essential but, above all, keep clear where you're driving, for reputation is a business output. It is not something you manage directly."

Try Non-compliance
Since there are costs involved in the implementation of SOX 404, it is often difficult to place the right dollar amount for executing sound GRC practices. There are major benefits. However the best argument is that if boards feel that GRC is expensive, they ought to try non-compliance to the GR issues.

Several reports demonstrate that there is a clear link between good GRC and increased share value. Most boards are closed forums that dread the word transparency in their work mainly because they feel that oversight and Compliance has gone out of control. Therefore to achieve a true picture of the GRC position of the enterprise, an evaluator must be given access to the boardroom and C-suite. Providing an adequate GRC assessment simply based on disclosures and underlying data obtained from public information is a dangerous evaluation of no value.

As an aftermath of the financial crisis boards now accept that sound GRC practice drives positive performance and provides comfort.

Effective governance



Source: Copenhagen Compliance Conference

Figure 2: Effective Governance

Effective Governance check list.

Governance with a 'G' or a 'g'

Governance involves issues such as corporate culture, environment and ethics, stakeholder relations, organisational design/structure, strategic planning, roles and responsibility, accountability, reporting lines etc.

Governance is a critical component of an organisation's program for self defense. Governance is required in order to ensure that there is a governance system with all its elements in place, to address how the organisation is directed and controlled, all the way from the boardroom to the factory floor.

Good governance needs to become part of the culture of the organisation and governance needs to be embedded into the day to day activities of the enterprise. Focus on governance should not be restricted to dealing with shareholders. Governance involves specifying the distribution of rights and responsibilities among different stakeholders, spelling out the rules and procedures for decision making, involving multidimensional both vertical and horizontal layers.

Successful implementation as outlined above will produce the desired results that reflect the measures and mechanisms in place throughout the organisation including setting and achieving organisation objectives and the means for monitoring performance.

Enterprise governance relates to the shareholders (governance with a "G") and governance as it relates to all of the other stakeholders, including line management and staff (governance with "g").

If you agree on the above definition and implementation strategy we suggest the following checklist to avoid the repercussions and potential damages caused by lack of appropriate preparation and oversight of Management by Governance. The board should make sure that:

- The audit committee regularly reviews the risk assessment for the company. The audit committee periodically updates the board as conditions change and regularly reviews important issues on risks with the entire board. *The success of an executive and the company is more dependent on the capacity and flexibility he or she has to identify and manage risks.*

- The board regularly reviews the company's disaster recovery and business continuity planning cycle to make sure that it has the competencies to oversee the highly critical IT aspects and the understanding of risk and information security.
- A crisis management plan is in place for key issues. The plan must include clear roles and responsibilities for directors and the identification of external consultants/experts who can be called upon for assistance.
- The board includes members with experience in mergers and acquisitions and knowledge of how best to use outside advisers during a takeover process because almost any company is a likely target for a 'hostile' takeover. The independent directors must be prepared to take the lead in framing the deliberations in terms of what's best for shareholders.

The board must thereafter devote a portion of its annual self-assessment to address the most familiar GRC issues and potential corporate governance crises. Secondly it must evaluate the readiness to address the following issues to determine the competencies the board lacks:

- Ensure that the structure, composition, information flow, internal processes, and director qualifications enable it to avoid or oversee crises.
- Ensure that the dynamics that create the atmosphere of forthrightness and collaboration are available. This is essential for navigating a crisis and obtaining suggestions for further and future improvement.
- Ensure that the executive, audit, and compensation committees are aware of their responsibilities. The committees must address their specific findings to the entire board.

- Boards must also look for different kinds of skills as international compliance regulations mandates and encourage more financial, regulatory and marketing expertise in the boardroom.

Board of Directors' Key Issues

The Board of directors currently face extraordinary challenges.
What boards often lack in their diversity are members with Street Credit (points you get for doing something impressive and bold. One can gain street credit in many ways, including, but not limited to, continuing to acquire freshness, constantly hustling, not selling-out, and of course, by making hit records). Perhaps one way to address this issue is to start each board meeting with an episode of Simpsons. Often it is alarming to observe how boards are enclosed in their glass structures without adequate business contact with the outside world.

It will be wise if the Boards position themselves to be effective before 'others' do. There is a cry from the public for legislation to improve board performance. All over the world, there are regulatory proposals that would

give shareholders more say on management compensation, provide easier shareholder access to proxies, allow stockholder proposals to amend companies' governing documents on nominating directors, and mandate separation of the CEO and board chair roles.

Almost all international oversight boards require or will require more disclosures including information on the experience of directors and executive officers, how the compensation program relates to risk management, the role of auditors and consultants and the structure of board leadership and its role in managing GRC to name a few.

Strategy Development

Currently the word *risk* pops up in boardrooms perhaps just as often as *strategy*. Directors however still need to recognize that among their most important responsibilities—along with selecting the right chief executive—is ensuring the company has an effective Risk Strategy in place, in fact a GRC strategy in place.

There is something fundamentally wrong with the way Boards go around preparing a Strategy or a plan for the enterprise. Often the senior management team presents *a strategic* plan and discusses it with the board and getting their approval to fulfill the requirements of the various charters. Probably strategy consultants are involved in preparing the initial paper/draft to make sure that all issues are covered for either the board or managements decision.

Later the Strategy is assembled via a one- or two-day off-site retreat, often using several catch phrases and is probably also in harmony with the strategies from previous plans. This is then a blueprint for the enterprise moving forward.

The board and management then spend a great deal of time to carry out their monitoring responsibilities.

Culture often tell more than numbers

There has to be a better way to update the annual strategy process a same-procure-as every-year approach. The board has to issue directions and guidance ensuring comfort and also includes GRC elements that are prioritized in a long term GRC plan. The elements are not simply based on Porter's five forces of competition theory or Peter Druckers five questions. Boards must not just look at the data. The GRC culture will tell them more than numbers.

Therefore the old methodology does not make sense to achieve a consensus based strategy in the current economic and competitive environments. The Board must make sure that the strategy has a good chance of actually *working* and provides them the feedback that is needed to make prudent decisions.

Therefore Board must refrain from excessive focus on addressing issues such as the company's organizational structure or the necessary resources to support effective implementation of the strategy. Instead they must make sure that the strategy is understood, reporting requirements can be achieved and that management is fully committed to its implementation across the organization.

A board must also see that the GRC performance measures align with both the strategy and e.g. compensation schemes for the CEO and top management team. Bonus and Compensation is a lightning rod for oversight boards, institutional investors, and analysts. Like Bonus and Compensation schemes, there are several other GRC elements (e.g. a plan for a sudden GRC crisis situation, communication with shareholders, including transparency in financial reports and maintaining an open channel for major shareholders, etc). A pre pared plan will help that the solutions are in alignment with long-term corporate GRC performance.

Porter's five forces or Petert Drucker's five questions: What is our business (or mission)? Who is our customer? What does the customer value? What are our results? What is our plan? can be improved to include GRC elements:

What is the social compact of our business? Who is our customer? How do we create stakeholder value? What are the risks we should mitigate? What is our GRC plan?

Or In other words as Drucker said: "I never predict, I simply look out the window and see what is visible but not yet seen."

GRC strategy

To determine whether a board has chosen the right GRC strategy and most challenges are met, as well as a preparing a practical implementation plan for each of the GRC elements, ensuring that the people and processes in place for effective execution, and monitoring of the results including tests, can be achieved by obtaining independent verification.

Proper inclusion of the GRC elements in the enterprises strategy will ensure that these vital elements are not put on the back burner and become the basis for developing a sound GRC plan, both in an emergency and in the longer term. The advantages are:

1. GRC makes the Board of Directors more cohesive.
2. GRC strategy makes you think both strategically and operationally.
3. GRC strategy also takes care of IT Governance and IT Strategy.
4. GRC makes strategy practical, operational and sustainable.
5. GRC is not both whip and carrot. Provides the pace and direction of trust.
6. GRC focuses on safety and security.
7. GRC strategy provides the needed checks and balances required for monitoring at all levels depending on your responsibility as the board or management.
8. GRC focuses on Risks instead of conflicts (e.g. in Porter's strategy model)

Enterprises are now pretty complex. This understanding requires management structures and strategic and operational goals that are aligned to the complexity that the enterprise faces.
Just to address these 3 questions is a major task in itself:
Given the (known) complexity, what sort of governance structures do we need across the organization to effectively attempt the execution of related Risk and Compliance issues, and still be flexible to address the evolving business landscape?

Given the (known) complexity, what sort of risk management structures do we need across the organization to effectively attempt the execution of related Governance and Compliance issues, and still be flexible to address the evolving business and GRC landscape?

Given the (known) complexity, what sort of Compliance structures do we need across the organization to effectively attempt the execution of related Governance and Risk issues and elements, and still be flexible to address the evolving business landscape?

Embedding GRC
Experience shows that enterprises that have established accurate and effective GRC processes can anticipate the issues coming up for the boards and thereby turn major problems to opportunities and achieve competitive advantages. But let us first make sure that the Board understands that GRC strategies, management and processes are not just ad hoc and limited.

There is a clear need for embedding GRC identification and implementation throughout the enterprise to ensure that emerging GRC issues are evaluated timely and actions are taken to manage and report the GRC failures by reorganizing business units, processes, and personnel by placing GRC resources where they provide the best results.

Establishing an Enterprise-Wide GRC Management program requires building an important company culture and a disciplined organisation. It requires that the tone-at –the middle enforces the organisation to respect the rules and abide by them. Certain questions need to be answered:

- How will the introduction of an Enterprise-Wide GRC Management fit into the current organisational culture?

- What are the immediate Risks to be mitigated and Compliance efforts to be reinforced?

- Will GRC implementations represent an opportunity and create greater value?

- Will GRC Management value proposition of protecting and enhancing shareholder value require implementing a practical and effective Enterprise GRC Management framework?

- Current GRC processes have identified and assessed GRC elements. Can we effectively measure and act to improve the current GRC position?

Only if properly orchestrated, ensuring GRC strategies and total implementation of the entire set of key GRC variables could create *The Perfect Storm* for the enterprise and lay the foundation for prudent management for the years to come.

Integrity and Ethical values
With the recent scandals fresh in mind, directors of financial and non-financial companies alike are looking more closely at how risks in their companies face are being managed. Regarding integrity and ethics, scandals often propel boards to take the necessary steps to become comfortable that management has set the right “tone at the top,” not only through words but also by actions

that permeate the culture of the organization. Perhaps the board must now ask the question whether 'the tone at the middle' was incorrect.

The current credit crunch and badly damaged economy require that directors focus on revenue and profitability goals. However Boards must consider not only whether they are happy with the company's code of conduct, but also with the effectiveness of related support systems and how the company deals with customers, suppliers, business partners, and other stakeholders while carrying out its business activities.

Embedding a strong ethical culture in the entire enterprise is not a simple task. The culture is recognized over the history of the enterprise and the managements response to internal and external events. Changing the ethical values that determine the Corporate culture takes effort and time. The enterprise's culture is shaped by management's philosophy and operating style, organizational structure, tone at the top and tone at the middle, adherence to company's policies, processes, and people.

The financial crisis has however shown that troubling circumstances require a strong executive decision for disclosures and discipline. Chairmen and Boards have succeeded in changing their organization's Integrity, Ethical values and Culture rather quickly. This decision to do the right thing, requires courage as it often forfeits short-term gains, but earns long-term benefits.

Strong FCPA investigation and enforcement
The Boards members must ask themselves: Why are the trials under the Foreign Corrupt Practices Act (FCPA) multiplying, 30 years after the annexation of the law? Is it yet another example of a decade long non compliance issue, which has provided the Securities and Exchange Commission with almost a billion dollars in penalties? Are we in compliance to FCPA? Similar questions can be placed to evaluate other GRC requirements.

FCPA and compliance to EU directives on corruption and the corresponding laws are a vital part of chief compliance officers' jobs these days.
Several companies insist that their employees put up with the regular hassles that otherwise could be solved with a 'small bribe' because the alternative is a violation of local law. Facilitation Payments are never a good thing in the world of compliance because:

- These payments provide incentives for low level government officials to make more demands
- The price of other transactions goes up.
- Bribes have several security implications due to the intrinsic illegality of such payments under local laws of several countries.

For over 3 decades prosecutions under the FCPA, enacted in 1977 in response to widespread corporate bribery scandals, were rare. In the past few years, FCPA prosecutions have exploded, landing high-profile executives in prison and netting the Department of Justice and the Securities and Exchange Commission almost a billion dollars in penalties.
The Board must make sure that there are policies and controls in place that the enterprise does not 'cut corners' to beat out a competitor and secure a multimillion-dollar contract. FCPA violations during the recent verdicts have involved successful companies utilize the influence of foreign officials for corporate gain.

Given the current climate of strong FCPA investigation and enforcement, The Board must ensure that effective anti corruption policies are implemented and followed.

A complete *top-down/ risk-based* due diligence review of the specific policies and guidelines on anti corruption is a must. The old ways of doing business globally won't be tolerated any more. The government is watching and the risks are too high.

Audit Committees.
The new EU directives require the establishment of Audit Committees. Our experience is that most audit committees have too much on their plate. It is the board's responsibility to avoid audit committee overload and strike the right balance to provisions, which improve internal processes.

The plate includes items like overseeing financial reporting, risk management, compliance with laws and regulations, non-financial controls, corporate social responsibility, special investigations, overseeing the work of the internal and external auditors, financial management, whistleblower process and related matters.

European Audit Committee Setup
From 2010 European Stock-listed companies has to set up an Audit Committee, consistent with international conclusions, EU directives and for example, SOX rules. The purpose of the committee is to;

- review and evaluate the company's reporting procedures;
- review and evaluate business procedures;
- handle internal controls in relation to financial reporting;
- assess reports from the external auditors;
- oversee accurate financial reporting and disclosure;
- sustain regulatory compliance;
- strengthen internal controls;
- improve risk management;
- improve the efficiency and effectiveness of internal audit.

To meet these objectives, it is advisable that the company has already set up an internal audit function, which reports to the Audit Committee. The work of the Audit Committee is conducted in close cooperation with both the internal audit department and our external auditors.

Sarbanes- Oxley (SOX) legislation of 2002 includes many of the previous blue ribbon recommendations into law. Since then the focus on audit committees and internal auditors has increased by leaps and bounds.

Overtaxing the audit committee
The scope of audit committee responsibilities can be overwhelming. However it is advisable not to put too much of accountability, identification, managing, and monitoring, that rightly belongs to the management on the plate of the Audit Committee.

The first thing the audit committee needs to do is fully understand its charter and how internal audit can complement and support the responsibilities of the Audit Committee.

The Institute of Internal Auditors (IIA) has been a strong advocate for internal audit to report directly to the audit committee. The audit committee plays a vital role in creating, designing, and molding the mission, strategy, and focus of the internal audit.

Quality Assurance Review
To comply with the IIA "International Standards for the Professional Practice of Internal Auditing," internal audit departments need to obtain a Quality Assurance Review or do a self-assessment and obtain an independent review every 3-5 years.

It is therefore vital that there are not overlaps in the roles and responsibilities of the audit committee and internal audit charters.

The audit committee is also responsible for the appointment, compensation, and oversight of the external auditors but does not require the same level of supervision over internal auditors. Many audit committees now believe it makes sense to take on this role as well. Due to increasing scrutiny and skepticism, it is important for auditors and audit committees to review their working relationships.

The audit committee must address whistleblower complaints and establish procedures for the maintenance and treatment of criticism regarding accounting, internal controls, and auditing matters.

Because Risk Management is a moving target it is inevitable and probably can never be eradicated; it needs to be identified and controlled in the appropriate context of the company.

Toward Best Practices
The internal audit should provide ongoing updates and identify new risks going forward and must be involved continuously in various company enterprise risk management activities and periodic assessment of key controls and corporate governance audit.

Investors want reassurance that companies are doing more than the bare minimum in terms of legal compliance. The audit committee can use internal audit as one of the tools to create a sustainable process to improve risk management, business ethics and good governance.

Therefore based on the above requirements, roles and responsibilities, the composition of the Audit Committee demands experienced executives who possess both financial and business knowledge.

The challenges facing audit committees have never been greater. This is a demanding time for everyone involved in the Corporate Governance, Risk and Compliance process.

Policy Issues for the Audit Committee on Whistleblowers
The Audit Committee should be involved in setting policies and overseeing the ongoing implementation of the Whistleblower policies. It cannot be farmed out to a third party or delegated to the company. Periodic reports from management of the third party institutions are inadequate.

The following questions on Whistle Blower policies are the responsibility of The Audit Committee:

- Are there procedures and controls in place to ensure and maintain that the complaints as confidential and anonymous?
- How and when should the complaint system be communicated and reinforced to the company's employees and relevant third parties?
- Who should and should NOT have access to the complaints?
- Who gets copies of the complaints?
- When should the day to day management be actively involved based on the type of complaint?
- What type of complaints or summary should the audit committee receive?
- What are the components and processes that determines the level of effort given to each complaint?
- What documentation should be maintained regarding the resolution of each complaint?
- When a pattern of potential misconduct exists, what level of overall review is obligatory to ensure that complaints are not dismissed individually?
- When and what level of voluntary reporting or public disclosure is required (does not address SOX Section 301 compliance)?

Comply or Explain.
EU has opted for 'comply-or-explain' as standard, probably because it simply follows the trail from the English Cadbury Report. The knowledgeable EU Commissioner Charlie McCreevy is familiar with the English combined code of corporate governance, from his time as an Irish accountant, minister and politician.

Based on the review of recent annual statements of European stock listed companies, it seems that there is further need for explaining the EU's Comply or Explain principle.

We therefore approached Professor of Financial Markets Law, Jesper Lau Hansen, dr. jur. & LL.M. (Cantab) from the University of Copenhagen to explain the principle.

The purpose of these actions is to strengthen confidence in the financial statements and annual reports of listed companies in Europe by making the company situation more transparent. The aim is also to establish a dialogue with stakeholders of the company.

Dr. Jur. Jesper Lau Hansen's objections are important, because it provides a much better understanding of how businesses can comply with EU directives if they understand the legal reasoning or the lack of the same behind the principle.

1. Comply or explain assumes that recommendations may be perceived as the main rules, i.e. which are applicable to most of the companies. It is doubtful whether this can be the case in several instances where the standard nevertheless is used - and thus used under the wrong assumptions

2. The principle of Comply or explain is often misunderstood; probably because of the argument stated in No. 1 as if the recommendations are the core rules and therefore should not be waived. This is just a

misunderstanding, because the standard explicitly requires that it can be exempt, provided that there follows an explanation on why it is not followed.

3. Dr. Hansen recommends, instead, a principle of comply **and** explain. Why should one not explain why they choose to follow the recommendations rather than choosing another option? It should be recognized that compliance with recommendations provides no guarantees.

It could possibly be useful to follow a show-and-tell principle, known from the accounting standards in the Notes to the financial statements.

Accounting Standards provide no recommendations, and thus avoid the incorrect assumption mentioned in paragraph 1, which probably lies behind the problems in § 2 and 3 and thereby avoid misinterpretation.

On the other hand the 'comply or explain' approach on corporate governance is probably well suited to the European culture, because it takes into account the individual situation and the differences between national, legal and regulatory frameworks of the 27 member states.

The audit committee must be empowered to perform at the highest levels. Non-mandated responsibilities should be removed to other committees or the board as a whole.

"Darwin learned that in a competitive environment an organism's chance of survival and reproduction is not simply a matter of chance. If one organism has even a tiny edge over the others, the advantage becomes amplified over time.
In 'The Origin of the Species,' Darwin noted, `A grain in the balance will determine which individual shall live and which shall die.'
I suggest that an independent, attentive board is the grain in the balance that leads to a corporate advantage.
A performing board is most likely to respond effectively to a world where the pace of change is accelerating. An inert board is more likely to produce leadership that circles the wagons."

Ira M. Millstein, New York Times, April 6, 1997, Money & Business

The Science of Compliance

The rose colored glasses and delusions of invincibility which preceded both the most recent IT bubble burst and the current equity meltdown will need to be replaced by a visibility and accuracy that has never existed. This should restore investor confidence and consumer spending, both measureable sources of hope.

Compliance also means that CEOs and their Boards will become increasingly dependent upon those people who see how the details of compliance fit into the larger business picture and can communicate this intelligibly.

Does the future of commercial enterprise belong to empire builders or technical consultants? Will an IT/accountancy degree become more precious than an MBA?

The Board of Directors (BoD) Decision Planning Guide		
Decisions Delegated to the Board of Directors		
Annual business plan, Officer hiring and compensation plans, Stock options, Capital structure and liabilities, Dividends, Risk management, Insurance Policies, Acquisitions, divestitures, and capital expenditures above X million, Litigation settlements above X million, Fines and penalties above X million, Restructurings that exceed X million, Tax settlements that exceed X million, Contingent liabilities above X million, Pension contributions that exceed X million		
Processes	Create an annual calendar that specifies major subjects for review by the BoD.	The annual calendar of the BoD could prescribe 6-8 vital subject areas, one for each of its board meetings. (Strategic planning in January to next year's budget in November).
	Prepare committee charters that define the decisions for which each committee is responsible for.	e.g. The charter of the compensation committee requires that directors choose independent compensation consultants and approve compensation plans, equity awards, and executive employment agreements.
	Use a decision protocol to identify issues and the type of decisions that should be brought to the BoD.	The list of "issues reserved to the board," specifies that items such as executive compensation, large transactions, and new businesses fall under the BoD approval
	Send "strategic" decisions to the board.	Directors and executives are instructed that "important impact decisions" or those that "will change the future" of the company should be made by the BoD.
Principles	Take to the board decisions that touch on a company's core values. (even if they have modest in financial impact).	The CEO of a large investment-management company asked the BoD to decide whether to close its rapidly growing China equity fund, despite customer demand to invest more in the particular fund.
	Research and review the decision options before approving a plan of action.	The investment-management company's BoD asked for detailed analysis of customers and the Chinese stock market before reaching a decision on the China equity fund.
	Subdivide large strategic decisions into smaller, sequential ones.	Segregate vital decision on whether to go ahead with a large investment into three separate pieces: authorizing development, initiating sales, and commencing manufacturing.
	Remain engaged in secondary decisions that flow from primary strategic decisions.	After giving the go-ahead for a large investment, continue to monitor the manufacturing and sales efforts to ensure that the program stays on track.
	Sustain ongoing dialogue between the CEO and the non-executive or lead director.	Instruct the non-executive or lead director to report to the BoD on acquisitions or divesting operating units. The directors are jointly aware, which decisions should be presented to the board.
	Request and evaluate explanations and assumptions for proposed executive decisions.	Directors are encouraged to challenge BoD recommended set of units for divestiture. Acquisitions etc altering the final list.

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Source: Compliance Weekly/The Harvard Business Review

Table 1: The Board of Directors' Decision Planning Guide. Sources and inspiration: Compliance Week, Harvard Business review, Financial Times, Wall Street journal, Copenhagen Compliance Conferences and own research.

Corporate Governance in Whistleblower
Various forms of fraud are detected 40 percent of the time by tips. Whistleblower systems are the leading method of detecting fraud. There is however the fear of retaliation by either peer groups or by supervisors.

A whistleblower hotline is probably the most straightforward and least classy methodology that improves corporate governance. An independent reporting mechanism that uses employees to report mal practices.

Earlier detection of fraudulent activities is the best way of limiting the loss. A study by the Association of Certified Fraud Examiners reported that fraud discovered through a tip had losses that were 50 percent smaller than similar frauds detected through other methods

Reports show that coworkers are aware that something was incorrect well before management had a clue. An open-door policy does help. A surprising number of employees report that they have previously informed management of their concern, yet they believe that no action is being taken.

Ernst & Young conducted an employee survey that demonstrated that almost 40 percent said that they would likely report if they could remain anonymous. 80 percent said that they would be willing to report a co-worker's unethical or illegal conduct.

An early detection and response to discrimination or harassment claims can substantially limit liability.

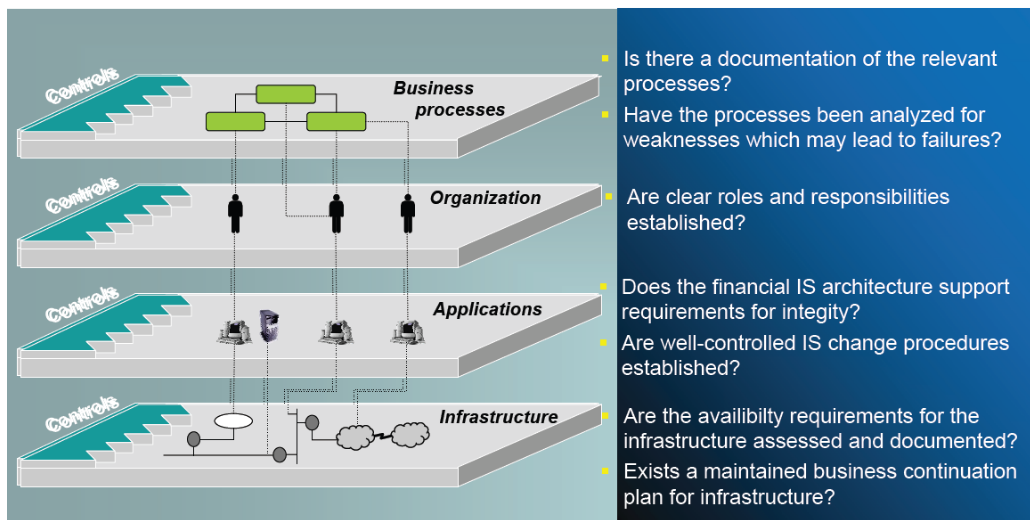
Human interaction is preferable to ensure that information is understandable, absolute, and consistent.

Succession Plan
Several investigations prove that a significant number of companies fail to perform effective succession planning. The risk of a sudden CEO vacancy can turn into a crisis, either through an extended search for a successor or an ill-considered appointment due to time restraints. For example;

In 2008/9, 37 of Norway’s 183 stock listed companies parted with their CEO. In a majority of these changes, several months elapsed until a new CEO was appointed. No board can afford to be caught without a succession plan.

The lack of a comprehensive succession plan often results in an obsession with external CEO candidates who are seen as charismatic saviors of corporations. Often this selection does damage to corporate governance mandates and company performance. Furthermore it undermines internal candidates, staff excellence and wide ranging succession plans for the organization, while putting unrealistic demands on the new CEO to perform miracles.

Patience is currently not a virtue in the board rooms as there is quite a bit of pressure on the Chairman of the Board. During these trying times, there are substantial differences in requirements for a CEO. It is not enough to have total control over operations. Senior managers must also possess the power and the vision to make sure that the company is able to pull out on the other side of the current emergency.



Source: Copenhagen Compliance Conference

Figure 3: 4-layer model of the Business environment

From Corporate Social Responsibility (CSR) to Sustainability

With six syllables, 'sustainability' is an awkward term for many, yet it is the coming year's favourite business buzzword. Sustainability is an all-embracing term covering efforts to solve the world's social, environmental and economic problems, probably replacing CSR.

Sustainability as compared to CSR is first and foremost about being customer-driven. Climate change will be the single biggest business issue of the next decade and the boards have got to be on the right side of the results of the global warming issue.

One of the reasons for the decline of CSR could be that it was conceived as an area that asks for funds as reparation for making profits, rather than of being a part of conducting the business.

Another reason could be that not all companies or industries produce a CSR report. Sustainability on the other hand addresses the building of a business for the long-term, taking into account the interests of all stakeholders.

Yet, sustainability is increasingly also applied to wider political and social dangers and provides a balance between corporations and communities and a sustainable market economy. Corporations have to understand the environmental effects and long-range problems that communities face. Sustainability is more than the business pressures of costs and competition. It addresses economic and social sustainability on the environmental agenda.

Stakeholders

In a recent survey of 66 chief executives, including 58 leading FTSE100 companies, the question of how they run their businesses revealed severe differences on the focus between employees, shareholders and customers. Some 38% said that the shareholders are their most important stakeholders. However 24% of the CEO's said that the customers are more important. Some 13% valued their staff above all others. The remaining 25% said that all stakeholders are ranked equally.

This conflict between stakeholders is one of the important issues that the nominations committee fears most when they are appointing the CEO.

Stakeholder Relationships
Daniel Tarullo, the Fed governor is clear on how they envision their role: "Supervisory initiatives can reinforce the impetus for change already coming from shareholders and market participants."

A strong board is aware that shareholders, majority or otherwise, must not have the responsibility to oversee management. It is part of the 'new dialog' that stakeholders, oversight boards, institutional and other investors want to expand their influence. There are certain advantages when stakeholders are gaining influence especially in the GRC area for greater transparency through the skylight window related to the workings of the board.

EU directives require that shareholders have the right to take certain actions, for example, in establishing communication channels. Shareholders can only reap the payback if they let management do the managing, and let the board carry out its oversight responsibilities.

This is an area where the boards and management have to open up in order to receive valuable feedback from the stakeholders. In the past, boards have simply ignored comments from stakeholders or shareholders. The result is annual general assemblies similar to the ones conducted by the politburo in USSR, mainly clapping at them. Comments from the floor were an unwanted nuisance and labeled as activists, even though the comments were far from joint action that could have major implications to the operations.

As a result of the failures of the boards in enacting their duties shareholders' voices are getting louder and being heard in parliaments, oversight boards, regulators, resulting in a rebalancing of their roles, rights and obligations.

CSR requirements have enhanced the need to listening in an appropriate forum to input from knowledgeable stakeholders and can be helpful in establishing relationships.

Managers and employees
A strong driver is the need for employees with the ability to get things done. To achieve outstanding results, you need outstanding managers and employees. The ideal employee has the Ivy League brains and blue-collar brawn and the intellectual power and ability to absorb a huge amount of information reasonably quickly and select priorities.

The ideal manager needs high levels of people skills and emotional intelligence. It's about how he/she motivates employees to align around a set of results. A good leader has many followers. A bank's differentiation is often not in strategy as it competes for a particular piece of business; its differentiation is in execution, which is all about managing employees. An employee who is a bad fit has a profoundly negative effect on the company.

Therefore, clarify the drivers - executives of top companies need to lead their businesses and strike the right balance between control and innovation by determining the priorities, balance and importance related to customer, shareholders and employees. How is talent managed? Is there space for the odd maverick?

Globalisation in the boardroom
In the Scandinavian boardroom English is rarely spoken in the largest of the stock listed companies. The board members are often from the 'local old boy's network'.

Danish companies are at the bottom of the European list when it comes to their share of international board members (7% predominantly Scandinavians). The characteristic of a typical board member in Denmark is that he is a man, he is 57 years of age and he is primarily Danish.

Their Swedish counterpart has 16% international board members compared to a European average of 19%, while in Great Britain almost 36% of the board members are foreigners.

Gender equality on the board
Norway has for long been a leader in promoting gender equality in politics. But the corporate world remained an exception. In 2003, there were 254 women among the country's 2,800 directors of public companies. From 2008, Norwegian public companies are required to fill 40 per cent of board seats with women.

Norway has the highest proportion of female directors in the world at 39 per cent. Sweden is second and USA is third. Denmark has a very long way to live up to these standards, unless legislation similar to Norway is passed. Of the 20 companies on the OMX index, the female representation is currently 18%. The irony is that more than twice that number (71 in all) of Danish female executives are currently appointed to the boards of Norwegian stock-listed companies.

One of the 'advantages' of forcing the gender issue on corporate boards has been that overall, boards represent a lesser percentage of lawyers. This could be a blessing in disguise.

Compliance with Laws and Regulations
Boards often complain that with the explosion of legal and regulatory requirements across all industries, dealing with the rules is a nightmare. The cost of compliance, and potential cost of compliance failure, in terms of reputational damage and direct loss of business, continues to rise to where compliance has become a major burden.

In the past Boards often only reviewed the key GRC elements provided by the legal or compliance officer like the code of conduct, policies dealing with specific legal and regulatory requirements, whistleblower and then provided direction, support, or need for further reporting

Now the boards must be acquainted with all relevant GRC elements and ensure that the processes can stand up to legal scrutiny. What works best is a comprehensive and embedded GRC program, where the code of conduct for example is updated with clear input from legal counsel to the various business units and line managers to encompass their area of responsibility.

Boards spend the funds to build an integrated process where new rules are readily absorbed into existing management and IT processes.

What works best is a comprehensive and embedded GRC program, where procedures for effective implementation, training, reporting, and monitoring are adhered to.

One-off policies and procedures for each new law or regulation, is a thing of the past.

GRC is here to stay
For many years Governance, Risk and Compliance (GRC) have been viewed with some skepticism, and as an area that has been related to cost and a nuisance, with continuous demands from regulatory authorities. But understanding and using the area actively can change GRC into a significant business advantage.

The code of conduct for good business management that has developed through the recent years has showed a growing interest in the interaction between Governance, Risk and Compliance. Regulators such as the EU has also been following these trends and through the EuroSox directives been given influence on the daily activities of the business community.

Although many see these restrictions and demands for documentation as a further escalation of the regulatory demands, there are also opportunities to create added value. Used as a strategic tool, it is a new way of understanding business and is turning some of the established norms of GRC into a sustainable competitive advantage. From being a described as "An in-convenient truth" of the financial world, GRC is being viewed as a way to add value through sustained and significant risk reduction.

GRC Management
Board meetings don't last very long these days before one of the words Governance, Risk or Compliance management come up.

The major concern is the inability of the boards of the major financial institutions that fail to understand and monitor normal and systemic risks in those organizations satisfactorily. What went wrong?

Was it because the board only asked management to report on the "top" 5- 10 risks facing the company?

Is it because the risk assessment exercise is ranked and designed to focus only on the most significant GRC issues?

Is it due to the fact that in the past the boards failed to recognize that a risk assessment clearly was outdated when reviewed by them?
Were they aware that reviewing the top 5-10 top risks could well omit issues that potentially could cause damage?

Therefore boards now require management to establish a process that embeds GRC throughout the organization.

Therefore boards now require management to identify, analyze, manage, and report all significant risks to the board.

Boards now require management to initiate the GRC exercise continuously and aggressively, so that a deeper look at the GRC systems would not reveal an

irregular, unstructured, ad hoc approach with large potholes on how risks are identified and managed.

Corporate Governance and IT
Technological innovations and international collaboration drives today's business environment to adapt to these changes at a high pace. Hence, for entire industries, their prevailing business models and their players compete on flexibility and speed to implement these strategic changes from business objectives down to the process level. Today's organizations are in a constant mode of adaption and reengineering.

A fundamental concept that provides the system architecture, for processes in all departments (not just the IT-department) sufficiently agile and to be able to adapt their all of the business processes to the ever changing market conditions, is a Service-Oriented Architecture (SOA) approach.

However, introducing a SOA gives rise to new challenges in terms of security policies, segregation of duties and information lifecycle management. In a mature GRC implementation, a SOA should be based on governed services, i.e. services that include basic components such as logging of audit trails, security policies and support for business activity monitoring.

On the other hand capital markets and regulators require a risk oriented management style that applies business performance measurement and financial reporting as a key element of a Corporate Governance structure. The challenge for the enterprise of today is to adjust and harmonize these internal controls to the changing business process environment and steer the organizational change.

Business Continuity Management
Business Continuity Management is an essential GRC discipline. Incidents occur daily that threaten to impact the smooth running of any organization. Regardless of their cause or severity, management often has no warning and little direct control over them. Yet their significance to the organization can be managed, if people have anticipated and prepared for them appropriately.

A senior executive has a responsibility to reduce the likelihood of such incidents and to minimize the impact should they occur. This duty of care is to all stakeholders: staff, shareholders, customers, suppliers and the community.

Business Continuity provides a method in which that duty of care and corporate social responsibility can be addressed and delivered in a practical and effective manner.

The future should be more financially stable because legislation requiring documentation and accountability for decision makers will make risk lower and more manageable. Experts in implementing compliance with all these requirements will be among the key responsible people in this new economy, and they will oversee the balance between risk and governance.

Being optimistic is not a solution in itself. Optimism is an attitude that generates the toughness to persist in moving towards goals. An American proverb says, "When the going gets tough, the tough get going." This is exactly what GRC activities are about.

Case Study: Lessons from the IT Factory fraud case

Earlier the people of Denmark witnessed the unraveling of the largest fraud case in several years, namely the IT Factory scandal. Very appropriately the case surfaced in the media, after a press conference held by the Chairman of the Board, Mr. Asger Jensby. He reported that Mr. Stein Bagger, the CEO of IT Factory, a company that only days before had been proclaimed winner of a prestigious growth company award, had disappeared during a holiday trip to Dubai and that apparently the company had been the victim of a massive fraud at the hands of the CEO.

Each following day brought new revelations. It was a “Christmas calendar” for adults with every Hollywood ingredient imaginable – fraud, violence, drugs, a mistress, secret homes, fast cars, luxury yachts, missing files, shady business associates and so on. The entire Danish press had a field day. The rich mix of ingredients provided for great entertainment value, especially for the tabloids. No dinner conversation was missing a chat about the IT Factory (ITF) scandal. But apart from the entertainment value, was there really that much to be learned from this debacle?

To begin with the conclusion, there was very little to be learned. This statement is based on a few key facts from the case.

Two-tier corporate governance model
Corporate governance for limited companies in Denmark rests upon a two-tier management system; a non-executive Board of Directors and an executive management. ITF had only the minimum structure required, namely a 3 person Board and a CEO. But since the CEO also sat on the Board there were actually only two independent directors. Furthermore, it was revealed that in contrast to normal practice, the ITF Board met very infrequently indeed. In effect, the company was run as a partnership between the CEO and the Chairman. By his own admission the Chairman of the Board had borrowed more than 3 million USD to finance his private home, from the CEO!

In summary, the two-tier management corporate governance model at ITF was completely broken. Rules and regulations can be ever so fine, but if they are blatantly disregarded, they are of little value. The remedy is to punish those that break or disregard the law; not more legislation.

The second part of the recipe for the ITF scandal was an almost complete lack of supervisory oversight from the Board, notably the Chairman. Despite strong documented warning signals received by the Chairman, including knowledge of previous charges of criminal fraud against the CEO and warnings from whistleblowers, the Chairman failed to act. An effective two-tier structure is no match for an incompetent or blinkered Chairman. In the temporary absence of the culprit, Stein Bagger, the inquisitive press turned their attentions to the Chairman. They uncovered several skeletons in his closet, stretching back over a 20 year period. The total picture painted by the media was not so much that of a criminal, but certainly of a person of dubious personal integrity. So whilst the Chairman may have been deceived by Stein Bagger, it is perhaps not surprising that he chose to overlook the warning signals. Once more this is a personality flaw, not a systemic fault.

Finally, there is the question of culpability of the auditors. Of course, the press was quick to point the finger of blame, aided and abetted by "experts" from academia. In fact, it is far too early to be able to make any assessment of the professional conduct of the auditors. Fraud committed by a CEO, possibly in collusion with foreign outside parties, executed by counterfeiting the Chairman's signature and based upon a secret loop of leasing transactions involving intangible assets, is well beyond what any normal audit is designed to uncover.

Thus from the superficial facts, it is impossible to assess whether the auditors failed in their duties. Naturally, their work will be closely scrutinized by their peers and by the authorities, and in due course, probably two or more years from now, we shall find out whether the auditors, like the Chairman, were guilty of inexcusable omissions of duties.

Denmark is time and again ranked as being amongst the most corruption free societies in the world. Furthermore it is also characterized as a place where the population has the highest levels of trust in the business community for any country. It is no co-incidence that these two traits co-exist. Scandals like ITF only occur once or twice a decade, and since none of them in past 20 years have involved the general public (consumers) or politicians, it seems highly unlikely that ITF will have any lasting impact on the general standing of the business community. Thus probably avoiding any panic-like Sarbanes-Oxley legislation stemming from this scandal.

In the absence of lessons learned, are there recommendations to be made in the light of the ITF scandal? Well, yes – at least one, which might not have helped the blinkered ITF chairman, but may prove very valuable to his more competent peers. The recommendation has to do with the communication between the Board and the external auditors.

In Denmark, there is a unique communication vehicle between the Board and the Auditors. It is known as the Audit Book Comments. It is a non-public document, where the auditors can convey how they performed their audit and the observations resulting from their work to the Board. Also, there is a tradition that in all major companies, as well as in a large number of medium sized companies, the auditor attends the Board meeting at which the annual financial statements are approved.

Both of these practices represent strong corporate governance elements. However, the full potential of effective communication between the Board and the auditors is rarely achieved. Why? The reason is that if the auditor only communicates with the Board *after* performing the audit, there is no assurance that the audit strategy is aligned with the Board's perception of risks.

Why is such an alignment important? As the ITF scandal shows, simply looking at the transactions recorded does not give the complete picture. Also, the resources of the auditors are very scant, and it is simply impossible in any large company for the auditor to review more than a fraction of the transactions executed by the company. The auditor *must* base his work on an assessment of the internal controls. Which internal controls the auditor focuses on is guided by an assessment of risk.

That assessment results in the audit strategy. The audit strategy should be discussed and agreed *ex-ante* between the Board and the auditors. That

discussion takes place all too rarely these days. Hence, we need to break the mould on how Boards and auditors communicate.

So why don’t Boards and auditors just do the right thing already? Well, it takes two to communicate.

The External Auditors
In Denmark, the young accountants have been taught that the engagement of auditors is a “one-sided contract”, where the auditor independently decides the scope and methods by which the audit will be performed. Nothing could be more wrong or more dangerous. We need to change that mentality amongst the auditors. Dialogue with the Board is not an infringement of their independence. Rather, it is a method to ensure that the knowledge of the Board is embedded in the audit strategy and that the audit resources are directed where they will be most effective.

The Board
Experience based on observations from attending board meetings is that in many Boards, the attitude is that the Board really just wants to get an annual message from the auditor saying that everything is well and that they can carry on with the serious business of conducting business. ”Don’t bore us with facts; just tell us we have no issues. If it is broken, just fix it”. The Board does not care much about how the auditor gets to the desired answer. Since the Board only meets with the auditor once annually, and since that meeting is perceived to have the approval of the annual accounts as its main purpose, there is a natural tendency to focus on accounting principles, disclosures and taxation matters. And anyway, the wording of the Directors report is a much more stimulating topic than internal controls; everyone has an opinion on the wording of the report, few have an interest or competence in assessments of internal controls.

The external auditors *could* provide the Board with a unique opportunity to assess just how effectively Management manages and controls the company. But as described above, for various reasons neither of the two parties has traditionally really been given the incentive to do so. We need to change the current practices.

A final observation applicable to the large, listed Danish companies: because of EU legislation they will now be forced to appoint an audit committee (many already have one). This is a vehicle that offers a highly appropriate solution to the challenge described above. Unfortunately, the new legislation will probably not meet the expectations of the public for two reasons.

Firstly, an exemption has been created whereby the entire Board can act as audit committee. Given the current less than satisfactory practices, this exemption risks seriously diluting the whole intent of the law, since it is very unlikely that the entire board will increase its workload by 75% from one day to the next; and a 75% increase is what is actually required to ensure the committee’s effectiveness according to international experiences from countries that have long since required audit committees.

Secondly, the audit committees currently in operation are conspicuous by their complete lack of any auditor trained members. Three out of the four main areas of the audit committee charter relate to the audit (only the last relates to accounting). Being a CFO is *not* a sufficient qualification to enable one to

engage in an in-depth evaluation of a proposed audit strategy; auditing is not accounting. Not to mention all the Board members who do not even have a formal education in accounting, let alone auditing.

Thus, here too, practices must change. In addition to a far greater adoption of the use of separate audit committees, we need to radically revisit the guidelines and practices by which the Board and the audit committee are composed.

In closing, the vast majority of Danish companies conduct their business in an ethical and professional manner, and they have both the intent and the ability to comply with corporate governance standards. Rare occurrences such as the ITF scandal must not be allowed to distort the picture and nothing in this case study is likely to do so.

However society’s demands of good corporate governance are continually evolving and this case study has sought to identify areas where current GRC practices could be usefully improved.

At his trial Mr. Bagger pleaded ‘guilty’ and was sentenced to seven years imprisonment and several other court cases are still pending.

Conclusion:

Keep it simple
In the same context as we started this white paper, let us go back to the New Year and in conclusion, let us learn from the animal world.

At midnight on each New Years Eve, the horses on every farm will age a year. That is the custom - every horse has the same birth date. Like all annual events, this is a human convention. The horses make no fuss about their common birthday or the coming of the New Year. The horses will be standing, dozing on their feet, ears tipping back and forth at the slightest of sounds.

Out of the tens of millions of species on this planet, only one indexes the passing of time through Governance, Risk and Compliance resolutions. Please review the attached New Years Calendar for Board and the Board of Directors Decision Planning Guide. That is one way to describe corporate nature, as a mandate, where resolutions can be meaningful.

> “The job of being the CEO of a major corporation is one of the most challenging in the world today. Only extraordinary people are capable of performing it adequately; a small portion of these will appropriately be able to commit some energy to directorship of one other enterprise. No CEO has time for more than that.”
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> *Robert A.G. Monks, “Shareholders and Director Section”, DIRECTORS & BOARDS (Autumn 1996 p.158)*

‘Expert’ Predictions for 2010 on a variety of International Issues

The Big Trend for 2010
Investors will continue to be risk averse, over-subscribing Treasury offerings by two to three times (as they have in 2009). Foreign central banks will buy Treasuries at little or no yield while the public sells equity mutual funds to buy fixed-income funds. Credit markets signal the future direction of equity markets, but no one ever pays close attention.

The U.S. recovery. Big bank stocks will continue to climb because of favorable interest conditions and, of course, unprecedented government support. The Treasury's ownership of warrants to purchase big bank stocks provide an incentive for the government to support big banking operations. Smaller banks will suffer from commercial real estate losses while the big players, supposedly off government assistance, will snap them up. This will be the largest banking consolidation since the 1990s.

The U.S. economy will pick up steam, but the gains will be unequally distributed. Job-seekers, those in overbuilt housing markets and low-skilled workers will suffer. Slimmed-down corporations and equity investors will thrive as growth accelerates. Emerging markets, by contrast, will suffer a jolt.

The Unconventional Wisdom
The Fed won't raise interest rates in 2010 because there is no expectation of inflation. The Consumer Price Index will be negative. The reason: They want to let Citigroup, Wells Fargo and Bank of America re-capitalize by borrowing money at 0.25 of 1% and investing in Treasuries at 3% with 20 times leverage. That's a return of 60% a year.

China will be exposed for lying about its GDP numbers and productive capacity while downplaying the squalor of the majority of its people. Emerging markets will remain firmly coupled with the U.S. economy. The death of American hegemony is probably exaggerated. Gold will fall and the dollar will strengthen without taking stocks down.

The asset that investors most hate today--the dollar--will bounce back. The asset they most love--U.S. Treasuries and other bonds--will get crushed.

The Misplaced Assumption is

- Emerging markets are good no matter what happens in developed markets. That notion is nonsense because so much hot money flows thru the emerging markets from hedge funds. At the first sign of trouble, funds are out of emerging markets to reduce their leverage.

- A lack of credit caused the recession and that repairing the credit markets will fix the economy. The truly systemic problems are stagnant wages for too many Americans and a legal and regulatory system that favors large established companies over smaller and more creative enterprises needed for a long term boom recovery.

- China is on the verge of emerging as the world's economic superpower. It is a bubble waiting to burst. When it does, in the next year or beyond, it will be exposed as a paper tiger with a flimsy backbone.

Sovereign financial stability
The prediction is there probably will be more Dubais and Icelands. Greece, Spain and Eastern European troubles will hurt banks throughout Europe.

Wells Fargo and Citigroup (when will they leave The Troubled Asset Relief Program (TARP)); Goldman Sachs, JPMorgan Chase (which will rule Wall Street?).

President Obama may implement economic initiatives as the nation realizes it needs healthy companies and bearable taxes to thrive. Citigroup will sell off major pieces of itself. Visa and MasterCard will face rising calls to cut their bank interchange fees. Morgan Stanley and Blackstone will disclose big losses in real estate funds.

The Bold Prediction
There will be no military attack on Iran because although they will make the nuclear bomb, they won't use it--meaning no oil crisis, no $200 oil and no inflation caused by high energy prices. Residential real estate will be the distressed investment flavor of 2010.

Some of the AIG traders tasked with unwinding credit default swap transactions will indeed get fed up with the pay limits and walk into better jobs at newly capitalized and expanding competitors. Enough finance wizards are out of work who can replace them, and the skills needed for the job aren't as rare as some would have us believe. AIG will still be a major boondoggle for the American taxpayer and will count for the single largest TARP losses.

The political pendulum will begin swinging back toward free markets, with the US 2010 midterm election being the centerpiece of the movement.

Source: 3 editors of Forbes Magazine

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For questions please contact info@eurosox.dk

Table 2: The Board of Directors' Annual Calendar

Sources and inspiration: Compliance Week, Harvard Business review, Financial Times, Wall Street journal, Copenhagen Compliance Conferences and own research.

The Board of Directors Annual Calendar				
Month	**Board of Directors**	**Audit Committee**	**Corporate Governance Committee**	**Compensation Committee**
January	Provide oversight to Management on 3 relevant issues for 200X	Review draft of The Tax return alongside the company's audited financial statement		
February	Review annual plan and quarterly results; evaluate board and committee performance	Evaluate performance of committee; review quarterly results.	Evaluate performance of committee; review Corporate Governance guidelines	Evaluate performance of committee; review director and executive compensation plans
March	Conduct annual review of executives and equity awards	Review financial risk exposure and performance of independent auditor		Review executive performance and compensation
April	Review committees' reports and quarterly results	Review quarterly results	Review management reports. Focus on Transparency	
May	Review results from the ad-hoc risk committee	Review management reports, focus on Non-Financial Controls		
June	Conduct annual review of quality of care	Review prior year's quarterly reports for follow-up items		Review current trends in compensation & authorize annual equity plan
July				
August	Review committees' reports and quarterly results	Review earnings release, guidance for investors, and quarterly results	Review management reports, Focus on Independence (BoD, Non-Executive directors, Auditors etc).	Review benefits program for Directors and Senior Management for 200X
September	Review compliance and internal audit	Review management reports. Focus on financial reporting and disclosure procedures	Review management reports. Focus on Conflict of Interests and Segregation of duties	Disclose and determine compensation schemes on a case by case basis
October	Review committees' reports and quarterly results	Review internal audit function and Audit trails		Review executive compensation philosophy and policy
November	Review report on Corporate Social Responsibility	Review compliance procedures and quarterly results.	Assess and evaluate BoD nominees	
December	Review 200X budget	Review internal controls v/s internal processes	Review management reports. Focus on Accountability & Authorizations	Review performance goals of CEO and other senior executives

Source: Compliance Weekly/The Harvard Business Review