ACCURATE AND RELIABLE

INSIGHT PAPER · GOVERNANCE & INTERNAL CONTROL

The Components of Governance

Objectives, structure, implementation and improvement — the four foundations on which sound governance is built, and what each requires in practice.

IN THIS PAPER

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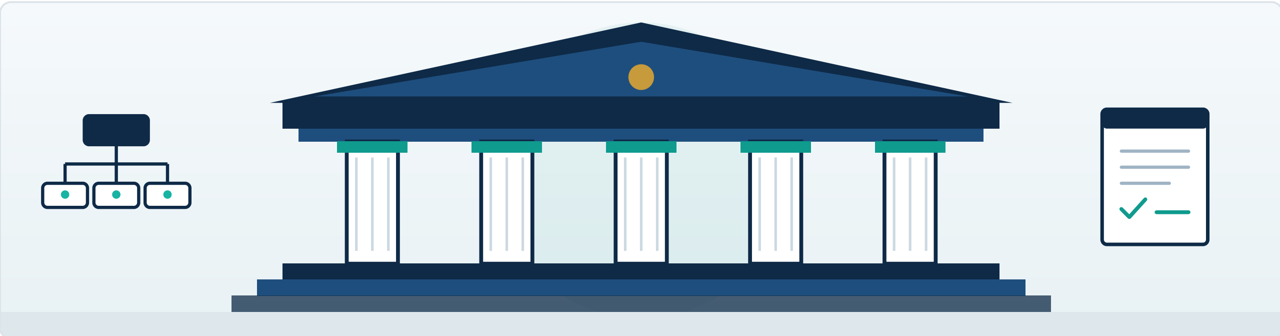
01 — THE DEFINITION

What governance is for

The IIA has defined governance as providing a mechanism for management and other employees to take care of their responsibility and their activities for the achievement of the enterprise's objectives.

That mechanism should plan for sound internal control and risk management activities, support efficient and effective operations with the required level of monitoring and reporting, and establish effective independent control and assurance. Governance is basically composed of the following main components:



Governance rests on more than one pillar — and a weakness in any of them shows up in the others.

01 — FIRST COMPONENT

Objectives and direction

Before a structure for the enterprise can be raised that caters for ordered, efficient and effective operations, a **foundation needs to be laid** comprising the established mission, vision, values, objectives, and strategies of the enterprise. The identification and formulation of these components are important, not least to motivate and inspire all employees to work in alignment.

02 — SECOND COMPONENT

Structure

A sound structure, with viable decision-making processes, clear division of responsibility and authority, appropriate information and communication processes as well as remuneration and reward schemes, is **key to an enterprise being in a position to achieve its strategies and objectives**.

1

Organisation, responsibility and authority

The organisational structure with a clear delineation of responsibility and authority is appropriate to the enterprise. An effective structure consists of a system of delegation which balances and distributes the roles, responsibility and authority in the organisation. The relationship between superior and subordinate should be clarified, from owners out to the individual employee, and rules of impartiality which secure adequate objectivity in decision-making should be established. The Board has a supervisory role helping to support value creation and avoid loss of value.

2

Information and communication

Relevant, reliable and sufficient information is made available and timely communicated. Information is a prerequisite for the management and development of an organisation, and must be made available to those who can make use of it both within and outside the organisation. This requires processes and criteria for identifying who receives what type of information, and decisions on when and how information is to be sourced or obtained.

3

Remuneration and reward schemes

Remuneration and reward schemes support the enterprise's objectives and values. They should include all employees and reinforce those objectives and values, reward an employee's contribution to long-term and ethical value creation, and contribute to the avoidance of unnecessary conflicts of interest.

03 — THIRD COMPONENT

Implementation

The enterprise's objectives and strategies should be rendered into **concrete action plans at an operational level**. Comprehensive and co-ordinated management of the core processes translates into efficiency and quality in the operational phase, and they are supplemented by support processes, such as financial and risk management. At the same time, laws and regulations must be complied with, and organisational values maintained and protected.

1

Operational planning

Strategic objectives are rendered into specific goals and action plans for organising and implementation. The plans should provide clear direction as to how the strategies are to be implemented and the goals achieved, whilst ensuring that organisational values are taken into account and realised in practice. The achievement of goals is monitored in relation to plans made and the desired progress.

2

Management of core processes

Core processes are defined, managed and documented. Typically, an enterprise's core processes will often consist of the production and distribution of goods and services with a given quality in the most efficient way. Processes that normally encompass many different departments and systems should be defined, managed and documented. This ensures targeted and coordinated processes and activities leading to the best results possible, and provides a basis for knowledge transfer and quality improvement.

3

Risk management

Risk management assists in the management of uncertainty in respect of the achievement of the organisation's objectives. It is a tool to manage and control uncertainty in respect of the enterprise's ability to create, protect and realise value as well as to achieve its goals. Uncertainty here means both possible unplanned negative outcomes and potential positive outcomes. Risk management should be an integrated part of governance. Established good practice is that it should have a holistic perspective ("Enterprise Risk Management") which is integrated across the organisation and harmonised with other management activities.

4 Compliance with laws and regulations

The organisation operates in compliance with laws and regulations. The Board has the overall responsibility to ensure that the organisation operates in compliance with external and internal regulations and has an oversight role which contributes to this. Senior management has the operational responsibility to ensure compliance by monitoring their areas of responsibility, identifying any compliance gaps and implementing necessary measures to close these gaps. The risk of non-compliance is an operational risk and work with this type of risk should be coordinated with and assessed as a part of the organisation's operational risks.

BOARD RESPONSIBILITY	MANAGEMENT RESPONSIBILITY	NON-COMPLIANCE
Oversight	**Operational**	**An operational risk**
Ensuring the organisation operates in compliance	Monitoring, identifying gaps, closing them	Assessed as part of the wider risk picture

5 Financial management

Financial management supports decision-making and contributes to the organisation's access to and use of resources. The organisation should consciously manage the inflow and use of resources in order to achieve its objectives. The planning of inflow and use of resources is expressed in the budget and financial forecasts, while the financial statements reflect what has actually happened. The budgets and financial statements are an important support for decision-making by the board, management and other internal and external stakeholders.

6 The management and protection of other assets, resources and processes

Other assets, resources and processes are identified, managed and protected. There will normally be other important processes in an organisation; these processes and resources must also be managed, and their value advanced and protected.

04 — FOURTH COMPONENT

Learning and improvement

An enterprise which has established structures and processes for planning and daily operations will need to supplement this with satisfactory processes for learning and improvement. The external context and internal conditions will be frequently changing, and it is therefore important to have satisfactory processes for continuous learning and improvement so that the organisation will be well prepared and equipped for the future. **Learning and improvement takes place at all levels in the organisation.**

1

Monitoring and evaluation

Systematic monitoring and evaluations are established for all key activities so that deviations and undesired trends may be discovered and mitigated.

2

Control functions independent of line management

Control functions independent of line management contribute to the development and improvement of the enterprise's governance and operations. In a number of industries and sectors there are official requirements as to the establishment of such functions, often called second line functions. Even when this is not an imposed requirement, enterprises of a certain size will often find them useful. They should be independent of the operational activities and function as controlling and advisory entities, with an open dialogue with the rest of the enterprise and access to all information of importance to perform their tasks.

The control functions can be important contributors to the development of governance and decision-making principles, and the administration of frameworks for governance and control.

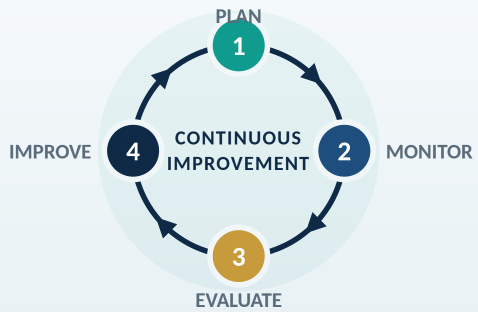
Learning happens at every level

Monitoring and evaluation catch deviations and undesired trends early. Independent control functions bring an outside-the-line view to the same evidence. Together they turn day-to-day operating data into changes that stick.

05 — FIFTH COMPONENT

The Three Lines Model

The four components above — objectives and direction, structure, implementation, and learning and improvement — provide the foundation. The fifth brings them together by setting out who does what: who owns and manages risk, who oversees and challenges it, and who provides independent assurance over both.



The external context keeps changing — so learning and improvement is a standing process, not a project.

The fifth component: the Three Lines Model

To learn more about the three lines model, or to know more about the remaining governance components, please contact us.

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