# Corporate Governance «Theatre» and the possibility of a continuing Assurance gap

By
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## Crises in the past, crises today

I've been working in the field of corporate governance, auditing and assurance for the past 15 years; 7 years as a Chief Audit Executive (CAE) and 8 years as a consultant. Through that time, we have seen many corporate governance and assurance crises. Specifically:

- In 2001/2002; Enron/WorldCom (concerning Financial Accounting standards and external audit quality).
- In 2007/2008; the financial crisis (concerning, inter alia, issues with understanding the risk of certain financial instruments and inadequate liquidity / capital reserves in financial services).

Since then we have other corporate governance crises including:

- BP (Deepwater Horizon, in 2010), Volkswagen (with the diesel emissions scandal, in 2015)
- And in 2018 we have seen the collapse of Carillion in the UK (a going concern failure) as well as numerous scandals in the charity sector.

Of course, the full list of disappointments, crises and collapses over time is very substantial.

## Responses to these, some more substantial than others

Each of these governance and assurance failures was met with some sort of enquiry followed by recommendations for change. In the case of Enron and Worldcom, the USA enacted the Sarbanes Oxley legislation. It sought to address, amongst other things, concerns about the rigour of financial reporting and the independence of external auditors. Similar legislation has been enacted in some countries (notably Canada, Japan and France), but it is worth noting that the rigour of these accounting/auditing standards has not been adopted across all countries.

In relation to the Financial crisis, the root causes were attributed to factors such as «greedy bankers» influenced by a «bonus culture», «weak board oversight» as well as short-comings in regulations and regulatory supervision and - again - a range improvements were proposed and many of these were implemented in relation to the banking and insurance sector. Again, it is worth noting that implementing lessons learned from the financial crisis was mostly confined to the financial services sector, and not used to significantly strengthen the corporate governance of other industry sectors.

In the case of «one off» corporate governance and audit scandals since then (e.g. BP, Volkswagen, Carillion etc.), enquiries are carried out, reports are written and specific actions are recommended and implemented, often by the companies concerned (if they are still in existence), or, sometimes by regulators and other oversight bodies.

## Are we making progress? And how might we make more?

From one perspective, you can look at where we are now, with more rules and regulations and «lessons learned» reports and argue that things have improved and we won't have these same problems again. From another point of view you could argue whilst some lessons are being learned, overall we don't seem to be able to head off major, even catastrophic, corporate governance and assurance issues,

despite rafts of regulation, governance bodies (e.g. boards and risk committees), pages and pages of internal policies and procedures and many inspection and audit bodies (e.g. internal auditors, external auditors and regulatory bodies).

One analysis of these failures in corporate governance and assurance is to argue that individual boards, and/or executives, and/or auditors have failed; but this risks scapegoating those specific individuals or groups. Another perspective is to blame the whole set up - e.g. collapses or short-comings in commercial enterprises are used to argue that the whole capitalist system does not work; or disappointments in the way public services operate are used to attack the whole notion of public services. In each case, prior beliefs, political leanings and other motivations (such as commercial interests) may colour our ability to look dispassionately at the patterns of problems in both private and public sectors and seek a deeper understanding in relation to their root causes; specifically, why major failures continue to occur despite often substantial governance, risk and compliance (GRC) processes as well as a range of assurance activities.

## The problem of governance (GRC) theatre and a continuing assurance gap

Bruce Schneier, a security expert and author of «Beyond Fear» reflected on the 9/11 (twin towers) tragedy of 2001 and the additional security measures were put in place at airports etc. and suggested that much of what has been done is «Security theatre» - measures are put in place that reassure the public, and make a good TV or radio «sound bite», but do not necessarily address serious, determined threats.

I am increasingly worrying that despite our efforts to date, there is a real risk that some, or even a lot, of the GRC activities that go on is just «theatre»; policies and processes are well-intentioned, and can catch some, even many, issues - but when it comes to the crunch - some of the most sinister and catastrophic risks and issues that are lurking, or may emerge, can be missed.

To guard against this, many will think that external audits, internal audits and regulatory inspections should act as an additional line of defence, to provide assurance that things are working, but - as we have seen up to now - there is often a gap between the assurances we think we are getting and the assurances that are actually being provided.

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**Potential root causes and the consequences of not addressing them**

Why are these issues continuing to recur? As I see it, the root causes of the problems we are seeing are multi-dimensional and often systemic. They lie beyond scapegoating individuals and the private vs. public debate. The specifics root causes of catastrophic problems occurring vary from case to case, but as I see it, a number of recurring themes can be seen:

- A blindness to identifying some risks («failure of imagination») and/or a reluctance to collect information and data that might challenge the status quo (i.e. «inconvenient truths»); and/or
- Challenges to pin down accountabilities within, and between, increasingly complex organisations (with limited understanding of, and use of, accountability mapping techniques); and/or
- Gaps between the ambition levels and appetite for change from leaders (who want to be seen to be doing something) and what is possible, (with weak feedback processes to "pierce the bubble" of their thinking); and/or
- Difficulties in talking openly and honestly about organisational dilemmas, resource and other practical constraints; and/or
- An underestimate of the human and psychological factors that are often in play, including allegiances between senior managers and board members, group dynamics (e.g. «group think», «dependency» and «fight/flight»), which can be further compounded by the ways that self-serving («foxy») managers «play the game» and/or
- Perverse incentives (e.g. banker's bonuses).

I wonder whether we are making enough effort to recognise and name these complexities and darker sides of human nature (beyond scapegoating individuals) in the way we look at what has happened. If my fears are justified, then I can quite easily imagine another long list of corporate disappointments and disasters in the next 5, 10 or even 50 years.

**What would need to happen to turn the tide?**

The encouraging news is that as governance and assurance failures continue with depressing regularity (e.g. safeguarding issues at charities, and the UK Carillion collapse) members of the public, stakeholders and politicians are starting to express increasing dissatisfaction about how organisations are being governed and the quality of the assurances being obtained. I believe these common-sense challenges in relation to the current levels of governance and assurance in place are justified. Bluntly put: there are still too many instances where senior managers and board members operate on a «no bad news is good news» basis; and the public, and other stakeholders, are entitled to argue that surely there must be a lot of «smoke and mirrors» going on for externally published governance and assurance statements to appear to be so good on the surface, while catastrophes are lurking around the corner.

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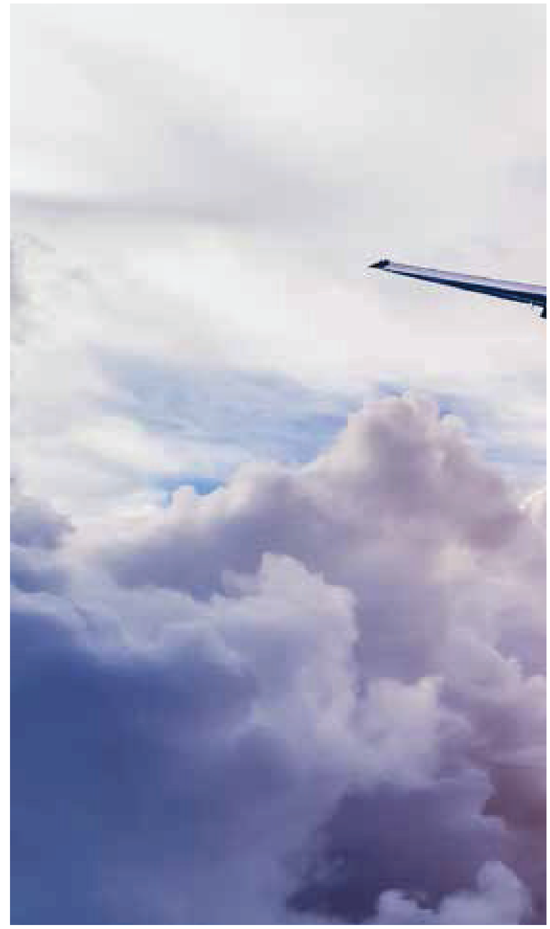
As I see it real progress will require us to focus on, and more determinedly look at the subtle and various «hairline cracks» that still exist in the GRC and assurance



activities of organisations, even those regarded as leading; and to more diligently call these out and act on them on a timely basis.

Note that the implementation of a GRC system does not eliminate the possibility of GRC theatre! Such systems may have a role, but I have heard on numerous occasions risk and compliance experts and managers talking about the time and effort of «feeding the machine», with an uneasy sense they should be working on the management of real risks, rather than spending time setting up and operating the GRC system. And even when GRC systems are implemented, let's not forget the «garbage in / garbage out» challenge!

This requires us to be braver in calling out the GRC theatre that is - to this day - all around us and to probe more diligently the assurances we are given by auditors and regulators, who - at the moment - use terms such as «reasonable assurance» as a convenient «get out» clause for any short-comings in what they have missed.

**A fool's errand?**

Some readers of this article may worry that asking for a step-change improvement in the way we understand and learn from organisational failures is a fool's errand. You can argue that human history is littered with bubbles and bursts, of rises and falls, and it's a simply reflection of living in an imperfect world, and due to human nature, that problems occur.

My response to this is to agree that problems and disappointments will follow mankind through history; but my question, at this point in time, is: are we really learning everything that is to be learned, quickly enough, about shortcomings in governance and assurance? Are we getting to the real root causes? All too often I fear that enquiries into, and debates about, crises are tainted by the desire to scapegoat others and to grab headlines, which fills me with a sense of déjà vu when reading lessons learned reports (note that the Grenfell Tower tragedy was proceeded by the Lakanal fire, and enquiry, and numerous recommendations, not yet implemented, several years before). Often I feel we are going around in circles and I suspect this is one of the reasons that a degree of resignation, or even cynicism, can creep into discussions about crises, corporate governance and lessons to be learned.

**Reasons for hope - but not optimism**

But let's look at this another way: If every organisation that failed was an airplane that had crashed would we feel the same? In the past, air crashes were more frequent, but over the past decades we have - by and large - made real progress, to the point that, nowadays, we expect engineers to design quality into airplanes and to have high standards in constructing, operating and monitoring these. And to the credit of many, we have reached a state where the safety of airplanes is clearly objectively better than it has ever been.

My hope is that we can take some comfort from what has been achieved in «high precision» and «high safety» fields (such as the airline industry), and use this to work more diligently in relation to our current governance and assurance efforts, to try to reduce the frequency of catastrophic failures. I'm not especially optimistic that we will eliminate organisational failures, but I reject a pessimistic view that nothing more can be done. And when you think about the many small traders, and their families, whose lives have been destroyed by the Carillion collapse, and others who have been let down by pension fund and other collapses, it has got to be appropriate that we «try harder.»

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