REVISIONE INTERNA, COMPLIANCE E GESTIONE DEI RISCHI AZIENDALI

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Today's Agenda

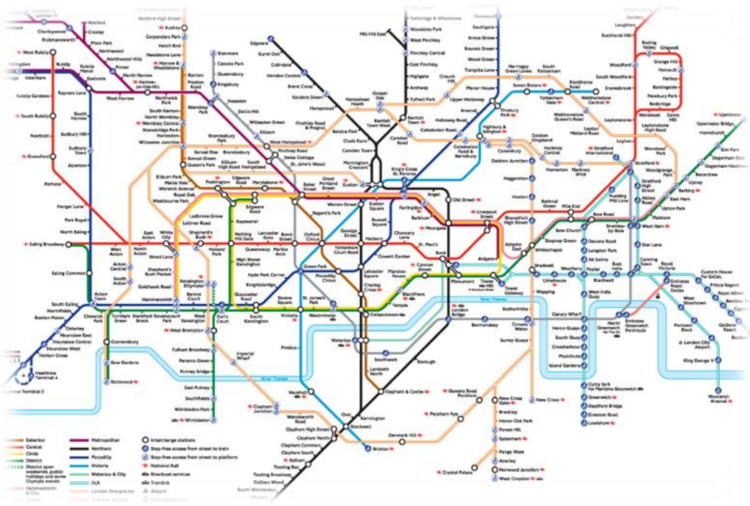
A. Course presentation: program and scope

I. Corporate Governance and Internal Control System. Complexity, evolution, challenges

a) Corporate Governance. Theory and practice. Reference: Last version of the "Italian Corporate Governance code". Case study: "Listed company Corporate Governance Report"

b) The Internal Control System. Reference: Bank of Italy regulation. Case study: "Listed company Corporate Governance Report"

London's Tube Map



c) Internal Audit. Reference: Bank of Italy regulation; The Internal Audit standard. Case study: Internal Audit activity report in a listed company

d) Risk Management: Reference: Bank of Italy regulation; Case study: Risk management process in a listed company

e) Compliance: Reference: Bank of Italy regulation; Case study: Risk management process in a listed company

Today's Agenda

A. Course presentation: program and scope

II. The organizational model pursuant the 231/01 Decree, held by Prof. Sante Ricci

B. References and reading material

C. Evaluation

Corporate governance (Cg) and internal control system

Introduction to the corporate governance

All corporate entities need governing

- Management focal point for the 20th century. Cg primary focus for the 21st
- All corporate entities need a governing body (Board of Directors)
- Cg is about the way power is exercised and covers the activities of the board and the relationships with shareholders, manager, external auditors, regulators and other stakeholder
- The Board is responsible for setting strategies and internal control system and organization's direction

Corporate governance is old, only the phrase is new

- The phrase Corporate Governance came into use since the 80's
- Cochran and Wartick bibliography on Cg in 1988 (74 pages); The Research journal on Cg founded in 1992; Google references 12 million
- 19th century precursor: the limited liability company and the Société en commandité par actions and various states regulated their company
- 20th century: Complexity, dimension, global widespread, Stock Exchange, investors and securities regulation dramatically changed. Berle and Means, 1932 "The rise of the modern corporation has brought a concentration of economic power which can compete on equal terms with the modern state…."

Corporate governance (Cg) and internal control system

Introduction to the corporate governance

- Developments in the 1970s: Audit Committees (“link” with the external auditor), two-tier boards, and corporate responsibilities

- 1980s. Director’s responsibility to increase shareholder value was reinforced following many hostile takeover and some corporate crisis. Boards dominated by powerful executive directors were now seen to need check and balances. In US Boards and Directors come under pressure from institutional investor. US Treadway Commission established in 1985. Creation of the Committee of Sponsoring Organizations of the Treadway Commission (COSO*).

* COSO is a voluntary private-sector organization dedicated to guiding executive management and governance participants towards the establishment of more effective, efficient, and ethical business practice. It sponsors and disseminates frameworks and guidance based on in-depth research, analysis, and best practices.

Corporate governance (Cg) and internal control system

Introduction to the corporate governance

- 1990's. Corporate governance codes arrive
  - UK Cadbury Report (1992):
    1. Wider use of independent directors. Independence from mgmt and other business relationships with the company (independent judgment)
    2. Introduction of the Audit Committee with independent directors
    3. Separation between Chairman and CEO
    4. Introduction of the Remuneration Committee to oversee executive compensation
    5. Introduction of the Nomination Committee to propose new board members
    6. Regularly disclose The comply or explain statement
  - Organization for Economic Co-Operation and Development (OECD) develops global guidelines on Cg

Corporate governance (Cg) and internal control system

Introduction to the corporate governance

- US. Company must follow State Company law, General Accepted Accounting Principles (GAAP), Securities and Exchange Commission regulation if listed, and the Statement on Corporate Governance (1997, 2002)

  i. Duty of the Board of directors is to select and oversee the CEO and senior management
  ii. Management responsibility is to operate in an ethical manner to produce value for shareholders
  iii. Management responsibility is to produce financial statements that fairly present the financial conditions and results of operations, under the oversight of the Board and the Audit Committee
  iv. The Independent Accounting Firm is responsible to carry out its work with independence, competence and according the generally accepted accounting standards (GAAS)
  v. Mandatory compliance with law and regulation, no “comply or explain principle”

- Critics to and influence of the Cadbury Report

Corporate governance (Cg) and internal control system

Introduction to the corporate governance

- Early 21st century developments:
  - Cg codes in places in most countries. New call for director appraisal, training, board performance review
  - Academic research try to find correlation between good Cg practice and stock performance
  - Big companies collapses: Enron, Worldcom, Tyco, Arthur Andersen, Parmalat
  - The response is more regulation
  - In 2001 a Commission set up by National Association of Corporate Directors (NACD), published a Director Professionalism:
    i. Boards with a majority of independent
    ii. Board should require that key committee be composed entirely by independent directors
    iii. Each key committee should have a board approved written charter
    iv. Audit Committee duties should include oversight of the quality and integrity of the financial report and the process that produces them and the oversight of the management of risk
    v. Other key improvements: Lead independent director, CEO performance evaluation, periodically assess the compliance and reporting system, audit committee meeting periodically meet Internal and external auditor, induction program,….

Corporate governance (Cg) and internal control system

The Financial crisis

The first run in 2007: Northern Rock, Bear Stearns, Fannie Mae and Freddie Mac, AIG

The 2008 crash: Lehman, Iceland banks, Royal Bank of Scotland, Lloyds TBD, HBOS. Bailouts in US and UK.

The financial crisis raised some corporate governance issues:

- Where were the directors? Did they understand the inherent in the companies' strategic profile?
- Were where the banking and the financial regulators?
- Where were the external auditors, the credit agencies and how worked the Internal Control System in the financial institutions?
- Did the excessive bonus and stock options pay create a misalignment in risk taking managers?

The response was more regulation and new corporate governance codes (UK Code 2010)

Corporate governance (Cg) and internal control system

New challenges for Corporate Governance

According a research from the Harvard Business School the recent failures differed from the previous ones (Enron,…), attributable to management malfeasance, and were rooted in the growing corporate complexity. Six areas of improvement identified:

i. Clarifying the Board's role
ii. Acquiring better information and deeper understanding of the Company
iii. Maintaining a sound relation with the management
iv. Providing oversight of the Company strategy
v. Assuring management development and succession
vi. Improving risk management

The investor/shareholder chain of intermediaries and agent is changing, adding complexity and needs for accountability and transparency

Board responsibilities for the Enterprise Risk Management is crucial. Do the directors know/understand the risk the Company is exposed to?

The schism between principle/rule approach

The dilemma on the director expertise