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OIG Insights

Strengthening Organizational Governance

Office of Inspector General
Board of Governors of the Federal Reserve System
Bureau of Consumer Financial Protection

Abstract

Organizational governance involves processes and structures for decisionmaking, accountability, controls, and behaviors designed to accomplish an organization's objectives. A strong governance system can enable an organization to achieve its objectives more efficiently and effectively. In our 2017 report *The Board's Organizational Governance System Can Be Strengthened*, we evaluated organizational governance at the Board of Governors of the Federal Reserve System. In this paper, we summarize insights from that evaluation more broadly, highlighting practices and considerations that other organizations can use to strengthen their governance system.

The Office of Inspector General for the Board of Governors of the Federal Reserve System and the Bureau of Consumer Financial Protection is an independent and objective oversight authority established under the Inspector General Act of 1978, as amended. Our mission is to provide independent oversight of those agencies to improve their programs and operations and to prevent and detect fraud, waste, and abuse.

Contents

Introduction

This paper shares our insights from a previously completed OIG evaluation. It is intended for organizations that want to strengthen their governance system.

Organizational governance involves processes and structures for decisionmaking, accountability, controls, and behaviors designed to accomplish an organization's objectives.[1] It also encompasses establishing an organizational culture and promoting shared values. A strong governance system can enable an organization to achieve its objectives more efficiently and effectively.

In 2017, we issued a report that evaluated organizational governance at the Board of Governors of the Federal Reserve System (Board).[2] Our work focused on the highest levels of the Board, including the Board of Governors, Division Directors, and several of their respective committees, and addressed the Board's organizational structure, delegated roles and responsibilities, communication, and transparency. The evaluation included a review of governance literature from various sources; interviews with senior Board leaders; and benchmarking with Federal Reserve Banks, other countries' central banks, and other federal financial and banking regulators.

Each section of this paper summarizes insights we gained during our evaluation and provides practices and considerations to help other organizations strengthen their governance system. The insights are as follows:

1. Adapt governance processes and structures to fit organizational needs.
2. Clearly define and communicate delegated roles, responsibilities, and authorities.
3. Set expectations for internal communication.
4. Ensure transparency to stakeholders.
5. Periodically review the organizational governance system.

The first section may assist organizations in developing their overall governance system. The next three sections may help to strengthen particular aspects of organizational governance. The final section provides insights for continually reviewing and refining the governance system. While the insights are directed toward our target audience of governing boards and executives, they have broader applicability and may be useful for all levels of an organization.

[1] Dean Bahrman, *Evaluating and Improving Organizational Governance*, The Institute of Internal Auditors Research Foundation, 2011.

[2] Office of Inspector General, *The Board's Organizational Governance System Can Be Strengthened*, OIG Report 2017-FMIC-B-020, December 11, 2017.

Adapt Governance Processes and Structures to Fit Organizational Needs

Organizations have differing purposes, cultures, and legal and regulatory requirements; therefore, no one governance system applies to all. Thus, organizations must decide which combination of governance processes and structures enable them to achieve their objectives while meeting legal, regulatory, and other requirements. Organizations may find that tailoring their governing board, board committees, executive committees, delegations system, organizational culture, and other aspects of their governance system enables them to accomplish their mission more efficiently and effectively.

Governance literature emphasizes tailoring governance processes and structures to an organization's unique situation. For example, the Basel Committee on Banking Supervision notes that an organization's size, complexity, structure, risk profile, and business model all affect how the organization implements governance principles.[3] In designing governing boards, governance literature encourages organizations to have diversity of thought and experience. *Commonsense Principles 2.0* notes that "diversity along multiple dimensions, including diversity of thought, is critical to a high-functioning board."[4]

Based on our evaluation of the Board's governance system, including our benchmarking efforts and review of governance literature, we identified the following practices and considerations for organizations that are establishing their governance processes and structures:

- Determine the appropriate size, structure, and composition of the governing board based on legal and regulatory requirements as well as stakeholder and organizational needs. Organizations should also establish board member qualifications, such as a specific skill set or background, and seek diversity in board composition, including having members with varying backgrounds, skills, and experience.
- Consider various types of board committees and executive committees to help senior leaders focus on specific aspects of the organization. For example, organizations may create board committees that focus on core business areas, administrative functions, or both. Many organizations also establish executive committees to assist in leading and overseeing their activities.
- Document governance processes and structures in bylaws, committee charters, policies, procedures, and other documents. Documenting these details helps to maintain the governance system during turnover in senior leadership and may satisfy certain legal requirements.
- Establish the desired organizational culture by setting a "tone at the top." Senior leaders can be a key contributing factor to establishing the desired organizational culture and should communicate shared values throughout the organization.

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[3] Basel Committee on Banking Supervision, *Guidelines: Corporate Governance Principles for Banks*, July 2015.

[4] Tim Armour, Mary Barra, Ed Breen, and others, *Commonsense Principles 2.0*, October 18, 2018.

Clearly Define and Communicate Delegated Roles, Responsibilities, and Authorities

Senior leaders' delegated roles, responsibilities, and authorities should be clearly defined and communicated throughout the organization. Defining these aspects eases the transition of new senior leaders by providing them with specific guidance concerning expectations for the position. Communicating these roles, responsibilities, and authorities to others in the organization promotes a common understanding among staff and provides the governing board with criteria for assessing senior leaders' performance and a mechanism for holding them accountable.

Governance literature suggests that providing clear roles, responsibilities, and delegated authorities is essential to an effective governance system. The Institute of Internal Auditors Research Foundation notes that "in an effective organizational governance framework, roles, responsibilities, and accountabilities are defined" and "the assignment of authority, responsibility, and accountability must be documented and communicated to all personnel."[5] Governance literature also supports providing orientation to new senior leaders and offering them ongoing training. *Governance for a New Era* notes that "new [board] members need a thorough orientation before they take up their duties, and the full board and its committees need regular educational sessions on the topics and issues they will confront."[6]

Based on our evaluation of the Board's governance system, including our benchmarking efforts and review of governance literature, we identified the following practices and considerations for defining and communicating senior leaders' delegated roles, responsibilities, and authorities:

- Determine how much authority to delegate to senior leaders based on organizational needs. Organizations can empower senior leaders through structural or cultural changes to enable them to execute their delegated roles, responsibilities, and authorities.
- Develop job descriptions, checklists, policies, charters, or other documents that include key information about senior leaders' delegated roles, responsibilities, and authorities. In addition, organizations can develop organization charts to illustrate and communicate the relationships and relative ranks of senior leaders within the organization. Make these documents available to senior leaders and others in the organization, as appropriate, for reference.
- Develop an orientation program to introduce new senior leaders to their roles, responsibilities, and authorities. The program may include an overview of the organizational structure, operations, industry, relevant laws and regulations, and key office resources (such as subject matter experts or reference documents).

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[5] Dean Bahrman, *Evaluating and Improving Organizational Governance*, The Institute of Internal Auditors Research Foundation, 2011.

[6] Benno C. Schmidt, *Governance for a New Era*, American Council of Trustees and Alumni, August 2014.

Set Expectations for Internal Communication

Communication among senior leaders and between senior leaders and staff can be improved by setting clear communication expectations. Setting expectations can help ensure that (1) senior leaders receive the information that they need to fulfill their roles and responsibilities and (2) staff receive senior leaders' insights and guidance when executing delegated functions. Without clearly defined expectations, information sharing can be insufficient, inconsistent, or even excessive.

Governance literature emphasizes the importance of establishing communication expectations, particularly at the governing board level. The Basel Committee on Banking Supervision notes that governing boards should be informed of material matters such as business strategy changes, the organization's performance and financial condition, internal control failures, and legal or regulatory concerns.[7] An article published in the *Graziadio Business Review* notes that, ultimately, it is up to individual senior leaders to determine their information needs, and that once they have done so, they can establish a system of accountability for delivering that information.[8]

Based on our evaluation of the Board's governance system, including our benchmarking efforts and review of governance literature, we identified the following practices that organizations may incorporate when setting communication expectations:

- Clearly document and define expectations for internal communications in policies, procedures, charters, bylaws, or other documents when practical so that staff understand what information should be communicated to senior leaders.
- Support open communication in the organizational culture to ensure that senior leaders receive necessary information, and encourage employees to share their opinions. Senior leaders should solicit the input of staff and facilitate open deliberations before making decisions, as appropriate.[9]
- Create overlap between members of various committees. In many organizations, senior leaders form committees to monitor specific areas of operations. Overlap, where senior leaders participate in multiple committees, can foster communication between senior leaders. Alternatively, organizations may require committee members to periodically update the rest of senior leadership on the area they are monitoring.

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[7] Basel Committee on Banking Supervision, *Guidelines: Corporate Governance Principles for Banks*, July 2015.

[8] W. Bradley Zehner II, PhD, "What Directors Need to Know," *Graziadio Business Review*, vol. 3 (3), 2000.

[9] In 2017, we published a separate report, *Leadership and Management Best Practices to Increase Employee Willingness to Share Views*, which addresses in more detail root causes that contribute to employees' reticence to share views and ways to address these root causes.

Ensure Transparency to Stakeholders

Transparency, or the disclosure of timely, relevant, and accurate information about an organization to stakeholders, is a vital aspect of corporate governance.[10] It enables stakeholders to monitor and assess the organization's performance while helping the organization build public trust and satisfy legal requirements. Alternatively, a lack of transparency may attract public scrutiny of an organization.

Governance literature encourages organizations to make a wide array of information available to stakeholders, typically related to the organization's governance, leadership, financial position, mission, and objectives. For example, the Organisation for Economic Co-operation and Development (OECD) notes that "the corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company."[11] The *Good Governance Standard for Public Services* adds to this, noting that "real accountability is concerned not only with reporting on or discussing actions already completed, but also with engaging with stakeholders to understand and respond to their views as the organisation plans and carries out its activities."[12]

Based on our evaluation of the Board's governance system, including our benchmarking efforts and review of governance literature, we identified the following practices that organizations may incorporate to foster transparency to stakeholders:

- Identify what information to disclose by reviewing relevant legal requirements, industry standards, and governance literature and considering the needs of stakeholders.
- Institutionalize accountability for transparency by building it into the structure of the organization. For example, the Institute of Internal Auditors Research Foundation suggests creating a board or executive committee to oversee disclosures and transparency.[13] Alternatively, organizations may delegate responsibility for making disclosures to specific senior leaders in the organization.
- Make disclosures easily accessible to stakeholders. For example, organizations may create a well-organized public website that includes a governance section containing such documents as bylaws and committee charters.

[10] An organization's stakeholders will vary depending on its industry and business model. Stakeholders may include shareholders, bondholders, customers, suppliers, legislatures and policymakers, the general public, and others.

[11] Organisation for Economic Co-operation and Development, *G20/OECD Principles of Corporate Governance*, OECD Publishing, Paris, 2015, http://dx.doi.org/10.1787/9789264236882-en.

[12] The Independent Commission on Good Governance in Public Services, *The Good Governance Standard for Public Services*, 2004.

[13] Dean Bahrman, *Evaluating and Improving Organizational Governance*, The Institute of Internal Auditors Research Foundation, 2011.

Periodically Review the Organizational Governance System

Senior leaders should periodically review the organizational governance system to ensure it continues to help their organization achieve its objectives. Organizations evolve over time due to growth, turnover in senior leadership, changes to the legal or regulatory landscape, and various other reasons. A governance system that suits an organization at one point in time may not suit the organization at another. For example, as an organization grows, senior leaders may conclude that they need to delegate more day-to-day responsibilities so that they can focus on strategic matters.

Governance literature supports senior leaders' periodically evaluating their organizational governance system. The OECD notes that the governing board is responsible for monitoring the effectiveness of the organization's governance practices and making changes as needed.[14] The Institute of Internal Auditors Research Foundation indicates that fully integrating continuous improvement practices is one aspect of an optimized governance system.[15]

Based on our evaluation of the Board's governance system, including our benchmarking efforts and review of governance literature, we identified the following practices that organizations may incorporate to aid in the periodic review of governance:

- Delegate to a senior leader or group of senior leaders the responsibility for monitoring and assessing the organizational governance system. For example, an organization may create a board committee or subcommittee to oversee organizational governance. Although all senior leaders are responsible for governance, delegating responsibility helps to ensure a continual focus.
- Conduct governance reviews that assess the overall design of the governance system to ensure that it continues to meet the organization's needs. These reviews could include evaluating the delegation of roles and responsibilities, committee structures, internal communication methods, and practices for disclosing information to stakeholders.
- Conduct governance reviews that focus on the ability of senior leaders and committees to fulfill their roles and responsibilities within the governance system. These reviews could include self-assessments by governing board members, reviews of governing board and executive committees to determine whether those groups are accomplishing their objectives, and performance evaluations of senior leaders to determine whether they are effectively executing their roles and responsibilities.

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[14] Organisation for Economic Co-operation and Development, *G20/OECD Principles of Corporate Governance*, OECD Publishing, Paris, 2015, http://dx.doi.org/10.1787/9789264236882-en.

[15] Dean Bahrman, *Evaluating and Improving Organizational Governance*, The Institute of Internal Auditors Research Foundation, 2011.

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