

# The Evaluation of Corporate Governance: Evidence from the Field

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## **The Evaluation of Corporate Governance: Evidence from the Field**

**Abstract.** Corporate governance research focuses primarily on the inputs into effective governance, yet we know little about how companies monitor and evaluate their governance systems on an ongoing basis. This is important because investors are increasingly relying on information about corporate governance in their portfolio management decisions. To bridge this gap, we interview 29 Chief Audit Executives (CAEs) from publicly traded companies in the U.S. to learn how they view the key objectives of corporate governance, evaluate corporate governance on an ongoing basis, and report issues to the board. While CAEs can propose rich processes for an evaluation of governance that goes beyond the boardroom and C-suite, our analysis reveals that companies' actual evaluation practices are often piecemeal and lack a cohesive view of the full governance system. Informed by the concept of decoupling from institutional theory, our findings reveal a need for additional research on corporate governance evaluations as well as consideration of standard setting to enhance the rigor of companies' internal evaluation practices.

**Keywords:** corporate governance; evaluation; institutional theory; decoupling

## 1. Introduction

Despite a large body of extant research that examines corporate governance (e.g., Carcello et al. 2011; Larcker and Tayan 2015), we still lack an understanding of how companies monitor and evaluate their systems of governance on an ongoing basis. An evaluation of corporate governance might examine various aspects of the board (e.g., whether board members are competent and willing to challenge management), tone and culture throughout the organization, enterprise risk management, regulatory compliance, stakeholder interactions, and other aspects of governance that run from the top to the bottom of the organization to ensure a corporation is working towards achieving its objectives. As governance-driven investment strategies expand as part of environmental, social, and governance (ESG) portfolios, it is important to understand the extent to which companies actively evaluate their governance choices for effectiveness.<sup>1</sup> Thus, the overarching research question in our study is as follows: How and to what extent do companies evaluate their governance systems? We seek to not only understand current practices, but also obtain a better understanding of the challenges involved in evaluating something as complex and subjective as “corporate governance.”<sup>2</sup>

To answer our research question, we considered three potential parties that are in a position to shed light on how organizations evaluate corporate governance: governance committees within the board of directors; members of management who oversee legal aspects of compliance with stock exchange listing requirements (i.e., corporate secretaries and general counsels—abbreviated as GCs); and chief audit executives (CAEs) who oversee all internal audit processes. Clune et al. (2019) interview governance committee members and fail to observe systematic evaluations of corporate governance since this committee limits its process to overseeing board evaluations. Their study identifies several threats to

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<sup>1</sup> See, for example, Larry Fink’s most recent ‘Letter to CEOs’ (Fink 2022): “We see a growing interest among shareholders—including among our own clients—in the corporate governance of public companies.” Investors use information about a company’s governance to make investing and voting decisions.

<sup>2</sup> Notably, a governance evaluation is expected to go beyond financial reporting-related processes that must be tested under Sarbanes-Oxley Act of 2002 (SOX) rules. Companies can operate with effective financial controls and still be subject to failure if comprehensive governance systems are not in place to define and guide the achievement of corporate objectives. In this study, we focus on the comprehensive set of internal processes and organizational features that improve decision making (Larcker and Tayan 2019), rather than exclusively the legal aspects of governance (e.g., shareholder protections and antitakeover provisions).

governance committees' objective of improving board effectiveness, including the lack of commitment and culture to support meaningful processes, significant CEO involvement, and fear of litigation. Conversations with directors, heads of internal audit, and experts in the field of law suggest that GCs focus on legal compliance and structures of corporate governance (e.g., designing committee charters and ownership structures), but do not systematically evaluate overall governance systems for effectiveness. Thus, we focus our investigation on how CAEs evaluate corporate governance because the internal audit function is responsible for systematically evaluating the effectiveness of a wide range of compliance, operational, and reporting-related activities. Extant research also highlights that the internal audit function is well-positioned to evaluate a company's governance system including the actions of the board and top management (Ege 2015; Trotman and Duncan 2018; Christ et al. 2021). In fact, the CAE is the only member of management with a functional reporting line to the board, other than the CEO. Appendix A details the CAE's role and the standards that guide their performance.

Accordingly, we conducted interviews with 29 CAEs employed with publicly traded companies from a range of sizes, industries, and structural governance features. On average, our participants have 27 years of professional experience, and interviews lasted 70 minutes. We asked CAEs to provide their perspective on the key objectives of an effective system of corporate governance, approaches to evaluate governance, and strategies to report potential issues and concerns to the board to conclude the evaluation process. Because governance evaluation and board reporting processes are largely a "black box" lacking commonly accepted frameworks or guidelines, field study methods are well suited to our inquiry due to their strength in understanding how organizational practices unfold (Yin 2013; Evans et al. 2015).

To develop our expectations and inform our data analysis, we rely on accountability theory and the concept of decoupling from institutional theory. Organizational accountability refers to an organization's ability to explain and justify decision-making and behavior to relevant stakeholders when called upon (Crane and Matten 2004; Frink et al. 2008). We conceptualize the task of evaluating a company's corporate governance system as a key accountability mechanism. If accountability theory proves to be the dominant lens for understanding our data, then we expect organizations to have in place comprehensive and analytic

governance evaluations. In contrast, institutional theory suggests that peripheral structures in an organization—such as its governance systems—are likely driven by symbolic actions and external forces (Meyer and Rowan 1977; Scott 2005). The concept of decoupling within institutional theory refers broadly to a separation between outward appearances and actual internal processes (Westphal and Park 2020).<sup>3</sup> Bromley and Powell (2012) extend institutional theory by distinguishing two forms of decoupling: symbolic adoption and symbolic implementation. If we find that companies' evaluation practices are weak, have little focus but to confirm data in required governance disclosures, and have few resources devoted to them, then we expect that institutional forces are likely at play that result in decoupling through symbolic adoption. Alternatively, if we find that companies devote resources to internal governance evaluations but these evaluations have little relationship with the organization's goals, then it is more likely that these evaluations reflect decoupling through symbolic implementation. In either case, institutional theory will appear to be the more relevant lens for our field study.

Consistent with the practical importance of governance for public companies, we entered the field with some expectation that public companies would have well-developed internal processes for evaluating their governance systems.<sup>4</sup> Contrary to our expectations, our interviews revealed that organizations face various obstacles to fulfilling this accountability demand. Five respondents specifically admitted that their organizations had weak or nonexistent evaluations; one of these respondents went so far as to suggest that governance evaluations at their Fortune 500 company had a “mom ‘n’ pop” feel. The remaining 24 respondents identified some evaluation practices, but these practices lacked a comprehensive view as they generally focused on narrow aspects of corporate governance that are either formally part of the internal audit plan (e.g., employee compliance with the code of conduct) or the result of benchmarking against best

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<sup>3</sup> Meyer and Rowan (1977) put forth a specific proposition concerning *evaluation* practices, suggesting that organizations might seek to minimize evaluation to maintain their legitimacy. That is, in addition to the possibility of decoupling of an organization's corporate governance practices, organizations might also decouple actual evaluation practices from those they purport to conduct in their proxy filings—the latter is our focus. It is important to note that decoupling is not necessarily a deliberate choice. For example, poor implementation may arise when there is an absence of consensus between what evaluations could achieve and what organizational members are willing and able to put in practice (Crilly et al. 2016; de Bree and Stoopendaal 2020).

<sup>4</sup> As part of SEC rules, listing exchange requirements, and best practices in voluntary disclosure, the companies in our sample made general references in their proxy filings to evaluations of the board, executives, and the company's corporate governance policies and guidelines. Some companies specifically referenced that they assess “overall” corporate governance and report findings to the board on a regular basis.

practices on an *ad hoc* basis (e.g., recommendations to improve culture). In contrast, when we instead asked CAEs how they would evaluate corporate governance as peer reviewers with unlimited time and resources for *another* organization (i.e., to “start fresh” in designing an evaluation), they provided rich, comprehensive, and practical evaluation processes. Therefore, companies appear to have incomplete processes in place to evaluate their system of governance even though CAEs seem capable of developing a summative and meaningful evaluation.<sup>5</sup>

To understand why many companies do not administer comprehensive governance evaluations, we asked respondents to identify the challenges associated with such a task. The first set of identified challenges involves the resources required to evaluate governance. Specifically, respondents pointed to concerns regarding time, budget, and expertise. In addition, CAEs believed that they needed—but did not necessarily have—buy-in from and access to senior management and the board for the evaluation. The second set of challenges relates to the testing and documentation for a governance evaluation. Many respondents felt that corporate governance is subjective and hard to measure; thus, it is not easy to provide evidence for whether governance is “good.” This challenge is compounded by other factors such as the absence of a guiding framework. Occasionally, respondents suggested potential ways for overcoming some of these challenges, which we discuss in the paper, but none were sufficient for moving toward a comprehensive governance evaluation.

Another key finding of our research relates to an important element of a governance evaluation—reporting issues to the board and, specifically, the audit committee (AC). Aligning with prior research and

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<sup>5</sup> An alternative explanation is that we failed to identify the correct party that is expected to evaluate corporate governance. However, if that were true, the CAE should still be aware of any comprehensive evaluations conducted by others within the organization, given internal audit’s role in evaluating processes and controls throughout the company. Further, we asked several interview participants whether there was anyone else within the organization that we should interview; they consistently noted that governance committees limit their focus to board evaluations and that GCs’ views of governance were driven by regulatory “check the box” requirements rather than in-depth evaluations. To verify these statements, we emailed six directors and three GCs of publicly traded companies not part of our sample and asked the following question: “Are you aware of anyone within the organization that has ever completed an evaluation of the overall corporate governance system—someone other than the internal audit department?” These individuals did not identify any other internal parties expected to systematically evaluate governance systems. One GC confirmed our focus on CAEs by stating: “I’m not aware of such person beyond internal audit.” One of the directors noted, “I’m not aware of an organized, comprehensive program for evaluation of the entire corporate governance system of any organization. It might be out there, but I haven’t seen or heard of it.” Another director indicated that some companies in the U.K. engage third party consultants to perform such an evaluation. Thus, we do not believe that this alternative explanation drives our findings that U.S. companies appear to evaluate governance on a piecemeal basis rather than a thoughtful, comprehensive basis.

the Institute of Internal Auditors' (IIA) performance standards (Norman et al. 2010; Roussy 2013; IIA 2016a), our data suggest that internal audit almost always prioritizes management over the board despite CAEs' functional reporting line to the AC. While there are important benefits of doing so (e.g., ensuring the CAE has all of the correct facts and information), this approach also brings potentially undesirable effects (e.g., management filtering the information). Though respondents presented themselves as being comfortable taking issues to the board, their main reporting challenge centered on discomfort associated with the task. This discomfort was recognized in a variety of ways such as the board not always being open to feedback, difficulty when communicating subjective issues, and fear of retribution. Respondents described various strategies for overcoming some of this discomfort such as leveraging a strong relationship with the AC chair to guide the reporting process, using structured approaches based on facts and protocols, and purposely removing emotion from the task.

Collectively, the evidence in our study reveals decoupling of governance evaluations from the underlying formal governance policies. A few companies in our sample represent decoupling through symbolic adoption as they barely have evaluation processes in place to assess the effectiveness of their governance system. The remaining companies reflect decoupling through symbolic implementation as they used piecemeal approaches that focused on specific areas of governance but did not lead to an *overall* conclusion on the effectiveness of corporate governance. In these instances, resources are devoted to various evaluation activities but these activities are not coherently linked to the company's overarching objectives. We discuss potential reasons for and implications of these findings in detail within Section 5.

Our study contributes to extant research and practice in several ways. First, we contribute to the developing stream of research that aims to understand how the governance process actually unfolds (Gendron et al. 2004; Gendron and Bédard 2006; Beasley et al. 2009; Cohen et al. 2010; Hermanson et al. 2012; Clune et al. 2014, 2019; Boivie et al. 2021; Free et al. 2021). In contrast to this prior research, we focus on the issue of whether and how companies *evaluate* their governance systems. Based on our interview data, this evaluation could go beyond listing exchange or SEC disclosure requirements by incorporating reviews of culture, ethics, and compliance with policies and procedures throughout the

organization. Despite the perceived importance of governance, our data reveal that companies are not engaging in reflective and proactive approaches to critically evaluate their internal governance systems. This is concerning because timely identification of governance issues is likely a key factor to avoiding major events such as corporate failure, and investors are taking an increasing interest in governance issues.<sup>6</sup>

Second, our evidence confirms the significance of shifting focus from symbolic adoption (i.e., policy-practice decoupling) to Bromley and Powell's (2012) distinction of symbolic implementation (i.e., means-end decoupling). Though research tends to consider only symbolic adoption, there are consequences to ignoring symbolic implementation. Regarding the latter, organizations appear to be more serious about aligning their formally-stated policies and practices with certain external pressures and, as such, may invest substantial time/budget to do so. The addition of symbolic implementation brings to the fore issues within organizations that need help moving from implementation of a practice to achieving results. Our study offers evidence of the two forms of decoupling, with the majority of organizations succumbing to symbolic implementation. If scholars and practitioners alike are able to detect symbolic implementation, then they may be able to remedy some of the challenges to full-scale implementation of governance evaluations that our study identifies. Moreover, reaping the potential benefits of a governance evaluation could improve organizational performance if integrated with the company's core goals.

Finally, our field study is also novel in its approach; most related research considers governance topics through archival, survey, or experimental methods (see Carcello et al. [2011] for a synthesis). Even when studies employ interviews to shed light on the black box of governance, external auditors or AC members are usually the subject of inquiry. Instead, we interviewed CAEs because of their unique perspective from inside the organization and their expertise in designing and executing assurance over a variety of processes (Eulerich and Eulerich 2020; Christ et al. 2021). ACs face considerable oversight responsibilities in the post-SOX environment and, as a result, are increasingly relying on internal auditors to provide greater assurance (Trotman and Trotman 2015; IIA 2016b; Free et al. 2021; CAQ and Deloitte

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<sup>6</sup> This is consistent with increasing shareholder activism, for which governance proposals are the most common (Orowitz et al. 2021).

2022; Cunningham et al. 2022). Our study suggests this is an area where companies could improve their evaluation of governance by taking advantage of the insights and capabilities of CAEs.

## **2. Context and Theoretical Lens**

### **2.1. Corporate Governance Overview**

Corporate governance relates to a broad spectrum of issues across multiple disciplines. Thus, it may not be surprising that no generally accepted definition of corporate governance exists. However, there is significant overlap across the various definitions such that the following could be used as a definition of corporate governance (IIA and UT 2019):

*Corporate governance is the overarching set of policies, procedures, and relationships that enable an organization to establish objectives, set ethical boundaries to the acceptable means with which those objectives will be met, monitor the achievement of objectives, reward successful achievements, and discipline unsuccessful or inappropriate attempts to meet objectives in order to keep the organization aligned with the needs and interests of its primary stakeholders.*

Rather than focusing on whether or not the company adopts certain structural features, Larcker and Tayan (2019, 1) provide a similar view of governance based on the “set of processes or organizational features that, on average, improve decision making and reduce the likelihood of poor outcomes.” There are many relationships that support corporate governance, beginning with the stakeholders of the organization, the board of directors, and management. An important intangible element that is embodied throughout the organization—from the board down to lower-level employees—is a company’s culture and set of ethical boundaries.

Extant research in accounting often focuses on how different governance characteristics are associated with the quality of a company’s financial reporting (Carcello et al. 2011). In contrast, finance research generally concentrates on how governance is associated with company performance and valuation (Larcker and Tayan 2015). Both streams of research are primarily limited to analyses using publicly available data regarding various governance characteristics. For example, prior research examines the following board characteristics: independence, expertise, attendance, size, committee structures, busyness,

diversity, and compensation, among others.<sup>7</sup> However, since a company's governance system may lack substance even though it looks good in form, a significant limitation of these studies is the fact that the presence of a desired characteristic is not sufficient to guarantee recognition of the expected benefits. Attempting to overcome these limitations, a developing stream of research uses field study methods to obtain the perspectives of board members and external auditors (Cohen et al. 2002; Van den Berghe and Levrau 2004; Gendron et al. 2004; Gendron and Bédard 2006; Beasley et al. 2009; Cohen et al. 2010; Hermanson et al. 2012; Clune et al. 2014, 2019; Boivie et al. 2021; Free et al. 2021; Obermire et al. 2021).

## **2.2. Theoretical Lens**

The large corporate failures that occurred in the early 2000's (e.g., Enron, WorldCom) placed an increased emphasis on improving corporate governance. Following these events, publicly traded companies faced significant pressure from regulators, exchange listings, and external stakeholders for greater transparency and accountability of their governance systems. This created an incentive for companies to show that they have "good" governance to secure legitimacy in the marketplace, and they often did so through public disclosure of required or recommended policies in SOX or from the exchange listings (e.g., certain independence and expertise in board directors; charters and corporate governance guidelines on their website or in proxy filings; audits of internal control over financial reporting). More recently, governance policies continue to evolve as a result of stakeholder requests and social movements (e.g., diversity and sustainability initiatives discussed in Katz and McIntosh [2021] and Silk et al. [2021]). Thus, while companies publicly disclose adoption of formal structures related to various aspects of governance, the question remains how and to what extent companies monitor and evaluate their governance systems to proactively assess their adequacy and make improvements when needed. In the subsections below, we highlight how accountability and institutional theory provide contrasting expectations for what we might see in the field related to companies' governance evaluations.

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<sup>7</sup> Carcello et al. (2011) provide a comprehensive review of corporate governance research in accounting and auditing. More recent research explores evolving needs in board expertise, refreshment, and networking, as well as newer issues in governance arising from the Dodd-Frank Act, proxy disclosures, and shareholders' renewed interest in governance issues (e.g., Masulis et al. 2012; Armstrong et al. 2013; Ertimur et al. 2013; Cohen et al. 2014; Gow et al. 2018; Huang and Hilary 2018; Kroos et al. 2018; Hayne and Vance 2019; Lehmann 2019).

**2.2.1. Accountability Theory.** Organizational accountability refers to an organization’s ability to explain and justify decision-making and behavior to relevant stakeholders when called upon (Crane and Matten 2004; Frink et al. 2008). In particular, the organization is the focal party subject to evaluation, an audience is expected to observe and evaluate, the organization has a perception that a defense of its actions may be required, and the potential for consequences exists (Lerner and Tetlock 1999; Hayne and Salterio 2014). An organization is typically motivated to behave in ways for which acceptable accounts are possible so as to protect/enhance its image or identity, to earn/maintain approval or respect from other stakeholders, or to gain control of desired resources (Tetlock 1985). In general, the presence of accountability has been shown to improve decision-making and behavior. For example, research documents that accountability stimulates more comprehensive and analytical processing of information, leading to reduced bias and improved decision making (Tetlock 1983a, 1983b, 1985; Tetlock and Kim 1987).

Organizations are replete with processes and systems intended to drive accountability. Organizations enact both formal and informal accountability mechanisms including, for example, codes of conduct, job responsibilities, and performance evaluation systems. Such mechanisms are seen as a “vehicle for helping establish goals, norms, roles, conformity, expectations, culture ..., and a host of other desiderata” (Frink et al. 2008, 203). We conceptualize the task of evaluating a company’s governance system as a key accountability mechanism that brings together agency and answerability (Frink et al. 2008). The existence of several frameworks offering guidance on how to conduct an evaluation (e.g., from the IIA, COSO, ISACA), and the possibility that organizations may be held to account by regulators or other stakeholders supports our prediction that organizations will have formal and thorough processes in place.<sup>8</sup>

Prior theory and research have developed two types of accountability: process and outcome (Lerner

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<sup>8</sup> Investors are taking an increasing interest in governance processes (e.g., Orowitz et al. 2021; Fink 2022) and the SEC is currently evaluating new disclosure requirements for ESG risks. Depending on which disclosure frameworks are ultimately adopted, reporting on a formal evaluation of governance may be required. For example, Global Reporting Initiative (GRI 2021) General Disclosure 2-18 requires organizations to “describe the processes for evaluating the performance of the highest governance body in overseeing the management of the organization’s impacts on the economy, environment, and people; report whether the evaluations are independent or not, and the frequency of the evaluations; describe actions taken in response to the evaluations, including changes to the composition of the highest governance body and organizational practices.” Because boards of directors regularly rely on internal audit to assist with evaluating controls and processes within the company (e.g., Trotman and Trotman 2015; Free et al. 2021), the results of our study are directly relevant to regulatory bodies seeking to adopt disclosure requirements surrounding various aspects of governance evaluations.

and Tetlock 1999). Process accountability arises when accountability is demanded for the process employed to arrive at a decision rather than the outcome of this process. In contrast, outcome accountability arises when the focus is on justifying only final judgments or outcomes and not the process through which they are derived. Prior research considers process accountability as more effective since it is more likely to reduce bias, improve analytical processing, and lead to more complex evaluations (Kadous and Sedor 2004; Libby et al. 2004; Chang et al. 2013; Peecher et al. 2013; Kim and Trotman 2015). Given the critical importance of corporate governance, various stakeholders are calling for organizations to invest in monitoring their governance systems. That is, based on theory, we would expect a focus on *how* the company is evaluating its governance systems, which would render more comprehensive and systematic evaluations (i.e., process accountability), rather than simply be satisfied with a report that governance is operating as intended (i.e., outcome accountability).<sup>9</sup> If we find that companies' governance evaluation practices are comprehensive and analytic—including a commitment to improve identified deficiencies—then process accountability will be the relevant lens for our field study.

**2.2.2. Institutional Theory.** Ideally, the policies, practices, and outcomes of an organization are aligned to achieve organizational effectiveness. However, institutional theory suggests that organizational structure and policies are influenced not just by technical and production needs, but also by external pressures (Meyer and Rowan 1977; Scott 2008). Peripheral structures in an organization—such as managerial and governance systems—are more likely to be affected by these institutional forces than other core functions of the organization (Scott 2005). External pressures can arise from rules and law (e.g., accounting standards) as well as from “soft” rules (e.g., ratings, professional norms, or social movements). Organizations have incentives to respond to such pressures by adopting formal structures to gain legitimacy, avoid legal sanctions, or evade public scrutiny (Bromley and Powell 2012). However, these formal structures are often

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<sup>9</sup> For example, a report that indicates governance is operating as intended might be based on observable outputs such as the achievement of a corporate goal (e.g., beating a performance target). While beating a performance target may indicate that the governance system was effective, it could also reflect an outcome that was achieved after failing to follow the company's policies or ethical guidelines. Therefore, the latter would not be identified without evaluating the governance processes during the period. If outcome accountability holds in our data, then the theory we present next—institutional theory—is a richer lens for examining the deterioration of due process through decoupling.

decoupled from actual internal practices, including internal evaluations that are “rendered so vague” to avoid scrutiny (Meyer and Rowan 1977, 343). Thus, institutional theory suggests that decoupling can occur through reduced formal evaluation of the entity’s governance system such that evaluation procedures are either non-existent or ceremonial.

Bromley and Powell (2012) extend existing institutional theory to distinguish between two types of decoupling: policy-practice (“symbolic adoption”) and means-end (“symbolic implementation”). Symbolic adoption refers to formal structures and policies that are “evaluated and monitored so weakly that they do little to alter daily work routines” (page 489). Bromley and Powell (2012) highlight that symbolic adoption is more likely in settings where adoption of formal structures is motivated by legitimacy, the organization does not have sufficient capacity to implement the policies or related evaluations, and when internal parties do not necessarily agree with the external pressures (see, for example, Heese et al. 2016). In contrast, symbolic implementation occurs when “formal structures have real organizational consequences, work activities are altered, and policies are implemented and evaluated, but where scant evidence exists to show that these activities are linked to organizational effectiveness or outcomes” (Bromley and Powell 2012, 496). This form of decoupling is likely more prevalent when the effects of actions are difficult to measure, when internal parties champion an external cause, and when the environment is fragmented (e.g., when accountability is required to a larger number of stakeholders, the organization is decentralized, or there is greater public interest).<sup>10</sup>

As noted above, corporate frauds and social movements have created external pressures for companies to assess and improve their governance systems.<sup>11</sup> However, while institutionalized rules

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<sup>10</sup> Prior research has identified several examples of symbolic adoption in organizations such as the adoption of formal initiatives for CEO long-term incentive plans or stock repurchase programs that were not actually implemented (Westphal and Zajac 1994, 2001). In contrast, research that specifically identifies symbolic implementation is less common; however, it appears to exist in examples such as when organizations dedicate resources to diversity initiatives or compliance programs, but these practices have little known relationship to intended outcomes (e.g., Edelman 1992; Kalev et al. 2006; MacLean and Behnam 2010). Further, compartmentalization can be an indication of symbolic implementation (Bromley and Powell 2012); in other words, an organization could adopt diversity or compliance policies but isolate sole responsibility and resources within a separate group that is not tied into corporate goals—and then no action is taken in response to the activities performed in this separate group.

<sup>11</sup> Pressures related to corporate governance reform span many decades, not just following the corporate failures and adoption of SOX in the early 2000s. For example, Westphal and Zajac (1994, 1998) examine the consequences of symbolic adoption of long-term incentive plans in the 1980s and 1990s that were intended to better align shareholder and CEO interests. However, as noted in Holder-Webb and Cohen (2012, 485), SOX represented an “assertive action to reestablish legitimacy” and includes many provisions intended to increase governance quality.

surrounding governance evaluations—whether through SOX and exchange listing mandates or from social pressures—can bring legitimacy to organizations, they often include a high level of generality that do not address the specific conditions within unique companies (Meyer and Rowan 1977). Companies can suppress these inconsistencies by not rigorously evaluating their governance systems. Thus, if we find that companies’ evaluation practices are weak, have little focus but to confirm data in required governance disclosures, and have few resources devoted to them, then we expect that institutional forces are likely at play that result in decoupling through symbolic adoption. Alternatively, if we find that companies devote resources to internal governance evaluations but these evaluations have little relationship with the organization’s goals, then it is more likely that these evaluations reflect decoupling through symbolic implementation. In either case, institutional theory will be the more relevant lens for our field study.

### **3. Research Method**

To conduct our research, we followed the emerging norms of recently published interview-based field studies (e.g., Hayne and Vance 2019; Bills et al. 2021) in addition to methodological guidance on the design and execution of a field study (e.g., Yin 2013; Evans et al. 2015; Dai et al. 2019).

#### **3.1. Sampling Strategy**

CAEs are in a unique position to shed light on current practices for how corporate governance is evaluated and reported. Moreover, internal audit’s role in governance is considered “vital” because it provides “objective assurance and insight on the effectiveness and efficiency of risk management, internal control, and governance processes” (IIA 2018, 1). Accordingly, we sought interview participants that currently hold (or recently held) a CAE position at a public company listed on either the Nasdaq or NYSE.<sup>12</sup> We intentionally focused on public companies because the minimum requirements for corporate governance are regulated and defined for these entities whereas private companies would exhibit significant variation in governance policies and structures. Otherwise, our sample includes representation from a range of organization sizes (e.g., market capitalization; employee headcount), industries, and corporate governance

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<sup>12</sup> We note that titles for the CAE can vary; however, we confirm with each participant that they hold the internal audit role in their company that includes the functional reporting line to the AC. Other representative job titles include Vice President of Internal Audit, Director of Internal Audit, and Chief Internal Audit and Risk Officer.

features (e.g., governance risk rating using ISS’s QualityScore; apparent governance maturity level).

We recruited participants using various strategies. The IIA announced this project to their CAE membership base, and CAEs volunteered to participate.<sup>13</sup> We also leveraged our own personal and professional networks to recruit additional participants. Many of these participants were recruited to fill a certain gap in our sampling strategy (e.g., to better represent a certain industry or company size). We invited all participants to identify individuals they believed would be good candidates for our research. After carefully screening them, we invited several of these individuals to participate in an interview. Table 1 summarizes information regarding each participant but remains at a high level to protect their anonymity. We stopped recruiting participants at the point of saturation—that is, when participants stopped providing new insights and this occurred for several interviews in succession (Dai et al. 2019).

Our sample includes participants from each industry sector; our industry composition is fairly representative of the total population of Nasdaq- and NYSE-listed companies. We include representation from eight small-cap, nine mid-cap, nine large-cap, and three mega-cap companies, ranging from as few as 350 to as many as 300,000 fulltime employees (untabulated). The companies have been listed on the Nasdaq or NYSE for between 2.5 and 90 years, providing the opportunity to observe both newer and more mature organizations. Our sample includes 20 male and 9 female participants with an average of 8 years at their current company and 27 years of professional experience. All participants have a functional reporting line to the AC (and have had such access for an average of 12 years) while their administrative reporting line varies between the CEO, CFO, GC, Chief Compliance Officer (CCO), and Chief Risk Officer (CRO).

### **3.2. Interviews**

Interviews with the 29 CAEs followed a semi-structured format and averaged 70 minutes.<sup>14</sup> Eleven participants were interviewed in person, and the remaining 18 were interviewed by phone.<sup>15</sup> All four

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<sup>13</sup> The IIA provided introductions to interested CAEs in their membership and also distributed our information for CAEs to contact us directly and retain their anonymity. We screened all CAEs based on our sampling strategy.

<sup>14</sup> We also conducted two interviews with representatives from professional/regulatory organizations to help us better understand the corporate governance landscape as well as the roles and responsibilities of CAEs.

<sup>15</sup> The logistical choice of conducting interviews in person or by phone was mainly for convenience. The IIA provided introductions to some of our participants such that interviewing these individuals at the IIA’s annual conference was convenient and facilitated additional recruitment efforts. More broadly, our participants are located across the U.S. making travel to them cost-prohibitive. There does not appear to be any differences in the quality or content of the data we elicited in person contrasted with by phone.

coauthors were present for a third of the interviews; the remaining two-thirds were split equally between having two or three coauthors present. All but one participant permitted a recording of the interview; for this sole exception, three coauthors were present and took detailed notes. We obtained professional transcriptions for the recorded interviews and carefully reviewed each transcript for accuracy and completeness.

We developed our interview script (see Appendix B) according to extant research, recent practitioner publications, key tenets from potential theoretical lenses, and insights emerging from interviews. To prepare for an interview, we reviewed the participant's online profile as well as any relevant publications he or she either had authored or was cited in. We also reviewed the history of the company for which they serve as CAE, the most recent proxy statement, and the corporate governance guidelines or charter. We customized each script based on this collection of information. Our strategy during interviews was to gain participants' trust such that they would speak candidly and at length. As needed, we used our interview script and follow-up prompts to guide participants and delve more deeply into topics aligning with our research goals. We also honed our script in the early stages, including having two interviews with a couple of participants to flesh out several topics (refer to Table 1).

### **3.3. Data Analysis**

Following a positivist approach (Malsch and Salterio 2016), we relied on theory to help us understand the field. Accordingly, we began our field study with a general understanding of several theories that could become helpful during interviews.<sup>16</sup> After each interview, we debriefed and discussed what theories would help us explain the data. Based on guidance from Yin (2013) and Miles et al. (2014), we began with an initial set of codes drawn from potential theories and what our preparations suggested participants might say (e.g., various possible "steps" for evaluating governance); additional codes also emerged from the data (e.g., various strategies employed to report to the AC/board). Next, we revisited our broad codes to achieve

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<sup>16</sup> We had several theories in mind when we entered the field that were later rejected as relevant lenses (e.g., "web" of accountability, comfort theory, agency theory). As detailed in Section 5, accountability theory does not end up offering much explanatory power but we retain it in our lens because it was foundational for informing what we expected to observe in the field, important for updating our interview script to incorporate the "fresh start" question (see Footnote 21), and a helpful counterpoint throughout our theoretical discussion in Section 5.

a more fine-grained analysis (e.g., detailing participants' "current" and "fresh start" descriptions into specific practices and identifying when practices appeared to be decoupled).

All coauthors were involved in the formal data analysis using NVivo. The first six interview transcripts were coded individually by three coauthors, and, thereafter, any differences in approach were discussed and reconciled. Once these coauthors established a reasonable level of inter-rater reliability, they divided and coded the balance of the transcripts. Two coauthors independently coded each transcript and a third coauthor led the reconciliation process. A code book was helpful for facilitating the data analysis as was regular communication regarding any surprising or outlying data points. Our average measure of coder agreement using Cohen's kappa was 66.5, indicating a "good" level of initial agreement (Cicchetti 1994; Cohen 1960).<sup>17</sup> After coding each transcript, the coder prepared a summary of key factors relating to the participant and important insights from the interview. These summaries were helpful for facilitating our patternmaking and data analysis. Our overriding objective was to find a fit between theory and data but also to remain alert to anomalous data (Yin 2013).

#### **4. Analysis**

Our overarching research question in this study is as follows: How and to what extent do companies evaluate their governance systems? We begin this section by discussing what respondents view as the key objectives of corporate governance. Next, we detail how respondents describe their company's process of evaluating governance, their approach the evaluation of a different company's governance system, and the "top three" challenges to evaluating governance. Finally, related to completing the evaluation process by reporting issues to the board, we provide respondents' descriptions of difficult issues that they report to the board, including the related reporting challenges. We conclude our analysis in Section 5 with a discussion that interprets our findings through our theoretical lens.<sup>18</sup>

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<sup>17</sup> Across the 35 categories that were coded by two different coauthors, 31 had a p-value < 0.01, two had a p-value < 0.05, one had a p-value < 0.10, and only one had a p-value > 0.10 (p=0.167) for Cohen's kappa.

<sup>18</sup> We present our empirical data in Section 4 before using our theoretical lens in Section 5 to help us understand and analyze the data. Our rationale is that we need to show exactly what is happening within the companies represented in our sample (their approach to governance evaluations and the related challenges) before relying on theory to help us diagnose why the types of evaluation processes (or lack thereof) exist.

#### **4.1. Understanding Governance Systems**

Effective corporate governance has a pervasive impact throughout an organization and is reflected in a variety of ways. To better understand their perspective on corporate governance for the purpose of evaluating it, we asked respondents to identify the key objectives of a company's governance system. In particular, we found that respondents focused heavily on the issue of oversight (28 of 29 respondents). Approximately two-thirds (19 of 29) discussed oversight related to ensuring a system of checks and balances that would hold decision-makers accountable. As one participant stated, governance is "supposed to be that check and balance and ultimately come up with what you think is the best answer for the company, not just the CEO's answer or the board's answer" (P-1). They pointed out the importance of holding individuals accountable whenever there are deviations from the company's governance policies; for example, a CAE noted that it is vital "in those instances where there are exceptions to ensure appropriate escalation and reporting of those through the various governance levels" (P-20).

While the most frequently noted reference to oversight discussed by respondents related to a system of checks and balances, the remaining references to oversight define the goals and boundaries through which decision-makers will be held accountable. Specifically, they cited the need for policies and procedures (14 of 29) and ensuring company objectives were met (11 of 29). Summarizing the need for policies and procedures, a respondent highlighted that "you need the policies, you need the structures so that people know where the guardrails are" (P-5). Another respondent illustrated oversight by ensuring company objectives were met when they stated the following: "I think that governance really sets that overarching 'What do we want for the business, and then how are we going to get there ethically? What is acceptable or not acceptable to get to our business objectives?'" (P-12). Participants also cited needing board members who are willing to challenge management (7 of 29). They discussed the importance of having a board that "takes their job seriously—that they're there to not just be cheerleaders, but they're there to challenge, question, direct, guide, mentor, and advise" (P-5). Finally, respondents pointed to the mechanism for providing guidance to decision makers (5 of 29) and keeping the company focused on long-term objectives (3 of 29).

Alongside a focus on oversight, respondents also noted other key objectives of corporate governance including risk management (15 of 29). For example, two participants noted the importance of managing risks so that the company could “avoid surprises” (P-1, P-29) while another discussed the oversight of a company’s activities in accordance with its “risk appetite” (P-20). Interestingly, a respondent noted that board efforts related to risk management cannot just be about protecting the company from bad outcomes, but boards must also ensure that companies are doing what they need to do to be innovative and responsive. They stated, “It’s important to not just think about what could go wrong but what needs to go right” (P-2). Emphasizing the significance of mitigating risks related to compliance with regulations and laws, another respondent indicated, “You also want to ensure regulatory and legal compliance. From a strict perspective, those are the things that could bring you down if you don’t get those things right” (P-16).

Another objective of governance relates to the company’s stakeholders (13 of 29). When discussing this objective, a respondent noted the importance of ensuring that the company can “excel at delivering both to our customers and our shareholders” (P-1) while another highlighted that it is important to make sure that “all relevant stakeholders, whether it’s shareholders or regulators, have their interests being considered” (P-2). Several respondents also mentioned the need to balance the interests of a growing list of stakeholders. For example, one of them indicated:

*I believe more and more there’s a realization in the corporate world that it’s not just your shareholders or your major stakeholders; it’s across the board, it’s your shareholders, the community you function in and their employees, your vendors, and your customers. (P-15)*

Finally, several respondents discussed the important role of corporate governance in setting the foundation for the company’s culture (12 of 29). Speaking to this issue, a respondent stated:

*How do we [know] that what is directed at the top is really communicated and adhered to in the middle of the organization, because that will ultimately trickle down into all the other parts of the organization? How do you make sure that the tone at the middle matches the tone at the top? (P-6)*

Referring to governance as the “essence of the company,” another participant expressed that “good governance is like a good conscience. There’s a culture, there’s a conscience that says, ‘no, you don’t do that’—to make sure that the company is doing the right thing all the time” (P-1). Collectively, respondents

appeared to exhibit broad agreement with respect to the overall objectives of a governance system and confirmed its broad application beyond just the boardroom.

## **4.2. Evaluating Governance Processes**

**4.2.1. Current Practices in Evaluating Corporate Governance.** As reported in Table 2, respondents described their current governance evaluation process using one or more of five key processes. Most notably, they rarely described a cohesive evaluation of corporate governance. One respondent went so far as to suggest that corporate governance evaluations at their Fortune 500 company had a “mom ‘n’ pop” feel (P-18). They elaborated:

*If you were talking to the CEO, he would tell you, “I’m not in trouble, so I’m okay.” ... Legal will tell you we’re doing the minimum, which is normal [for us] because we like to run lean. We don’t want any excess unless it’s absolutely necessary. (P-18)*

This example highlights the mentality that, although the organization is not conducting a formal assessment, governance systems must be working given the lack of surprises or other obvious issues. Despite mentioning a few approaches that they use haphazardly, four additional respondents admitted that their organization has weak or suboptimal governance evaluation processes (P-1, P-6, P-21, P-24).

The remaining respondents frequently described piecemeal approaches that focused on specific areas of governance. The most common practices relate to components of the annual internal audit plan (24 of 28 asked), which are further disaggregated in the bottom half of Table 2. For example, on the more objective side, CAEs described approaches where internal audit compares the contents of meeting minutes to charters to verify that committees are completing all of their mandatory tasks, or where internal audit verifies that a certain percentage of employees completed a mandatory training (i.e., a clear “yes” or “no” evaluation). In contrast, respondents also described more subjective tasks in which internal audit evaluates the *effectiveness* of a given area, such as assessing whether risks are adequately identified and managed in the enterprise risk management process or whether hotline calls are investigated and remedied in a timely and thorough manner.

The second most cited process is board and/or committee self-evaluations (20 of 28). While some CAEs have access to the board and/or committee evaluation process, they often reported that the process is

managed by legal (including the GC) or the governance committee.<sup>19</sup> A respondent described the process as follows:

*There's a list of questions that they [the board] all sit down and talk through, so they go one by one and answer them yes/no, rate them one through five, just to see how they're doing. Then, if they need to change anything, they make note of it. (P-24)*

Another respondent provided the following additional detail to illustrate issues that arise when there is a lack of visibility into the board's self-assessment process:

*Our independent board chair is responsible for looking at those self-assessments and making decisions about actions that should be taken based on the self-evaluation. It's not an independent assessment. That, to me, is the part that's challenging. It stays within the board. The leadership team of [Company Name], including corporate counsel, general counsel, and our CEO, they get a summary from the independent chair of the board—on what the evaluation resulted in and what their actions were going to be or what they were requesting from management to address those actions. ... The challenge for me is that it's done within the board by the board for themselves. (P-26)*

Similarly, a respondent admitted, “I do know the audit committee does a self-evaluation, and the board does, but I have never seen the results or asked for them” (P-21). Therefore, board self-evaluations often lack transparency. Consistent with Clune et al. (2019), the absence of involvement by objective parties outside the board can be problematic when the board does not have a culture that welcomes feedback and continuous improvement.

Third, respondents reported using informal or ongoing benchmarking to incorporate best practices into their governance systems (17 of 28), suggesting that evaluation processes typically combine formalized audit plans with *ad hoc* observations. For example:

*We were comparing ourselves to our peers through networking and general business knowledge, knowing what others were doing and benchmarking with them. I think that's probably how we build the [corporate governance] framework generally—knowing what the industry expectations are and relying on past business success and failures of the collective management team to build and monitor it. So, I think that is part of the evaluation—how we're stacking up against peers, how we're stacking up against past experiences. ... It's continuous and informal. I don't recall us ever having a set time where we would sit down and say, “This is what we're doing.” (P-28)*

Fourth, respondents reported evaluating culture, ethics, and tone at the top indirectly as part of typical internal audit programs (15 of 28). For example, one respondent indicated that an important part of reporting

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<sup>19</sup> Respondents rarely (2 of 20 asked) reported using outside firms or consultants but, even then, the external assessment was on a rotating basis with self-evaluations occurring annually.

on routine travel and expense audits is watching the way that a manager reacts to exceptions identified in their area: “How are you going to address that [exceptions] within your teams, and how are you going to make sure that, after you address it, the trend keeps on moving in the right direction?” (P-6). Notably fewer respondents (7 of 28) reported that their company uses formal surveys or interviews to directly evaluate corporate culture, ethics, or tone at the top on a standalone basis. Finally, half of the respondents (14 of 28) referenced entity-level control testing under SOX 404(A) as part of the internal evaluation process for governance.<sup>20</sup>

Collectively, the evidence in Table 2 suggests wide variation in how companies currently evaluate corporate governance. As one respondent noted, evaluating and benchmarking corporate governance “isn’t like ‘here’s governance in total’ but ‘here’s an aspect of governance’” (P-1). When considering potential cross-sectional variation in our results based on different characteristics (e.g., industry regulation, company size, publicly observable governance features, and administrative reporting line), a key trend is that respondents from highly regulated industries (i.e., banking, healthcare, and utilities) recounted a higher number of governance evaluation tasks (5.00) compared to their non-regulated peers (3.63). Relatedly, the five respondents that admitted to having weak or suboptimal governance evaluation processes are all employed by companies in non-regulated industries. No other patterns were identified across our sample.

**4.2.2. Fresh Start: Designing a Governance Evaluation with Unlimited Resources.** Early in the data collection process, two themes became apparent related to corporate governance evaluations: first, respondents described piecemeal approaches (refer to Table 2), and second, a common challenge to evaluating corporate governance was the perception of insufficient resources (refer to Table 3, discussed further below). Thus, we wanted to assess whether the lack of cohesively structured current processes is due to the CAE’s inability to understand and design a comprehensive governance evaluation or due to the commonly mentioned resource limitations. To do so, we asked participants to “start fresh” and describe

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<sup>20</sup> We recognize that entity-level control testing is required for all public companies complying with SOX Section 404(A), and that some of the specific areas of corporate governance in the internal audit plan would reasonably be a part of that evaluation process. We believe that this data is helpful in understanding the extent to which CAEs consciously link their SOX testing with questions about evaluating “corporate governance,” which has a broader scope than financial reporting controls.

how they would evaluate corporate governance through a “peer review” lens with access to “unlimited time and resources.”<sup>21</sup>

In contrast to the processes described at their own companies, respondents described a more holistic approach to governance evaluations when responding to the peer review task. Whereas participants’ responses describing current practices generally lacked a cohesive train of thought, they often approached the “fresh start” question with a linear top-down, risk-based approach.<sup>22</sup> They often provided long lists of potential data sources, collection methods, objectives, and evaluation benchmarks, starting with the board and moving through the organization. As expected, CAEs often approached the task with an “internal audit lens,” which is “figuring out what should be in place, then evaluating whether it’s there or not” (P-26). While respondents provided complementary approaches to one another, there was no singular approach to this process, which respondents attribute to the absence of comprehensive guidance or frameworks for governance evaluations.<sup>23</sup> As one participant noted, “there’s not a single model or a single set of principles we go by. We actually have a lot of different guidance and documents to look at for what we need to be doing” (P-9).

In Appendix C, we synthesize respondents’ recommendations into a compendium of processes based on four steps. First, the general consensus is that corporate governance is “not one size fits all” (P-11), so any successful evaluation process will begin by defining expectations for each company. Respondents pointed to the importance of benchmarking data for the subjective elements and provided recommendations for where to gather comparison data (see section C.1). Second, respondents often described beginning with publicly or privately available data to understand how decisions are made, how

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<sup>21</sup> We did not anticipate hearing these piecemeal approaches in companies’ current evaluation practices; however, it became clear after the first few interviews such that we adjusted our script to incorporate this “fresh start” question for subsequent interviews. We intentionally asked for this alternative perspective after respondents described their current processes but before prompting them to identify challenges related to governance evaluation to avoid the potential bias of having reflected on their own challenges.

<sup>22</sup> To illustrate the lack of linear or logical focus when asked about current practices, one participant’s initial response to the current practices question was: “I’m trying to think through if I could point to exactly what we’re doing to gauge that, as well as what things just kind of give you a read on whether or not it [governance] is working” (P-25).

<sup>23</sup> The most commonly cited frameworks were COSO’s internal control and/or ERM frameworks (11 of 28 asked), the IIA professional standards (4 of 28), adaptations of Information Systems Audit and Control Association (ISACA) or National Institute of Standards and Technology (NIST) maturity/governance frameworks (4 of 28), and guidelines issued by the National Association of Corporate Directors (NACD) (2 of 28).

management and the board interact, and any “red flags” for potential governance issues. They further cautioned that professional skepticism is needed to separate “substance over form” (P-17) when evaluating existing documentation (see C.2). Third, respondents recommended complementing data with interviews or surveys throughout the company. The goal of these interviews and surveys is to “get into the guts” (P-14) of governance, but participants cautioned that professional skepticism is still needed in evaluating the evidence since, for example, just by being in the room, “your presence changes the atmosphere” (P-7). Examples of the types of questions to ask and what to look for in responses were also provided (see C.3). Fourth, respondents provided lists of what they would evaluate to make an overall conclusion on the effectiveness of corporate governance. Notably, their lists were complementary to one another and provided a comprehensive view of governance, starting with leadership on the board and in the C-suite, down to middle management, and then to rank-and-file employees (see C.4). After describing these four steps in detail in Appendix C, we synthesize concerns about putting too much reliance on the objective or quantifiable elements of governance (see C.5).

Collectively, our evidence suggests that CAEs are capable of designing evaluation processes with careful consideration of the pros and cons of different methods of collecting and evaluating evidence. However, in general, they do not perform these comprehensive evaluations at their own companies. Accordingly, we asked respondents to identify the “top three” challenges to evaluating governance to better understand this gap between potential and current processes.

**4.2.3. Challenges to Evaluating Corporate Governance.** As reported in Table 3, our data analysis revealed two types of challenges: (1) those related to resources available for executing an evaluation (i.e., the people involved as well as the time and budget required) and (2) those related to the testing and documentation of an evaluation. Though we did not necessarily prompt respondents to indicate how they would overcome these challenges, a few respondents provided relevant insights that we discuss below.

**4.2.3.1. Challenges Related to Resources.** Nearly half of respondents (13 of 29 respondents) reported that a resource-related challenge is obtaining support from the board and management for such an evaluation. Referring to the president, board, and AC chair, a respondent indicated that, “without their buy-in on

[evaluating governance], you won't have access to what you need" (P-17), such as interview time with management and the board as well as access to board materials.<sup>24</sup> Further, even if an evaluator is granted access to the necessary information, respondents perceive challenges related to getting transparent and honest responses from leaders unless they truly support the idea of being evaluated. For example, one respondent stated that "you can't ram this down their throat" (P-8) while another noted that "there might be a lot of boards and CEOs that don't really want anybody looking over their shoulder and second-guessing what they're doing" (P-9). The reason for this perceived hesitation from management and the board was described as follows:

*I think people have preconceived notions of what governance should be, and, especially at the level of directors or senior executives, they just have a view that, unless the SEC or somebody mandates that we structure our board in this way, why would we do it? (P-14)*

Further detailing the resource-related challenges, constraints in terms of time and budget were often highlighted as a challenge to evaluating governance (7 of 29). For example:

*A very good governance program is very layered and has multiple facets. To evaluate all of [the layers and facets] and do it in a comprehensive manner, it takes a lot of effort. ... Resources are scarce. I mean, if you're asking internal audit to look at corporate governance and give a comprehensive evaluation, it takes resources. (P-11)*

Respondents also reported concerns about finding an evaluator with the requisite professional experience and governance-specific expertise (7 of 29). For example, when describing challenges specific to evaluating the board, a CAE noted, "You can't just throw anyone on that. It needs to be someone that has experience interacting with multiple boards so that they would be able to evaluate the content of what the board is doing" (P-17). A more minor but related challenge was that some respondents felt that there was a general lack of consensus within the company as to who should own corporate governance (3 of 29). A respondent summarized this concern pointedly: "You can evaluate it, but, if there are problems or a lot of recommendations for change or things that need to be done differently, who owns that change?" (P-26).<sup>25</sup>

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<sup>24</sup> Recall, that in the "fresh start" task, interviews and surveys were deemed an expected part of the evaluation process and most CAEs described interviewing board members and executives directly. However, we did not have any CAEs list interviews of board members or executives in their current practices.

<sup>25</sup> With regard to potential cross-sectional variation, two related patterns emerge. First, we observe that CAEs who report directly to the CEO identified fewer resource-related challenges compared to those who report to another executive. Specifically, these individuals are less concerned about management and the board's willingness to participate, time and budget constraints, and clear ownership over corporate governance. Second, CAEs promoted from within the organization also report fewer resource-related

Regarding opportunities to overcome resource-related challenges, a couple respondents mentioned using a “back door” approach to informally “embed governance throughout all of your audits” (P-8). One of them elaborated:

*Do the same rules apply to the executives that apply to the rest of the employees? If you were to go up to the CEO, and say, “Okay, we’re going to do a governance audit and we want to see executive compensation, incentive plans, and performance reviews,” I think that the CEO would believe it’s a little too personal, and you’d get push back on [it]. But if you’re doing it as part of the HR audit...it’s not as directly confrontational when you do it continuously throughout the year, and as part of all the other audits... It [governance] is easier to audit when you don’t say you’re auditing it. (P-9)*

A couple other respondents also discussed opportunities to use their own current knowledge<sup>26</sup> or to tailor their approach depending on the organization. For example, a CAE discussed how they work for a smaller company that cannot devote resources to a formal, defined evaluation process. Instead, they highlighted:

*[I only focus on] making sure that management follows through on what they say they’re going to do, and at the end of the day, whether there’s a good process to monitor and make sure that what people are agreeing to actually gets delivered. ... That may not be exactly practical in a larger organization, but here at a smaller organization, it’s bringing these things directly in front of the entire leadership team and then keeping a pulse on it. (P-6)*

Further, respondents mentioned that they sometimes considered outsourcing specific aspects of a governance evaluation to overcome challenges. For example, outsourcing may be a way to overcome challenges in certain circumstances when a specific “skillset” (P-13) or “more credibility” (P-8) may be required in management’s eyes for a portion of the evaluation. One respondent pointed to outsourcing employee surveys “so that our participants feel comfortable with the anonymous nature of it,” and also because third parties who execute similar surveys across multiple companies provide benchmarking data with company-specific results (P-25). However, outsourcing the entire governance evaluation was not considered a solution because consultants cannot grasp ongoing governance since they do not belong to the organization. Importantly, across interviews, respondents suggested adopting a systematic approach to

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challenges compared to CAEs who were external hires. These cross-sectional patterns are consistent with respondents overcoming resource constraints because they feel more comfortable asking for the resources needed to evaluate governance.

<sup>26</sup> For example, one CAE provided an example of “good” governance inferred from normal interactions with the CEO:

*...When something hits the Wall Street Journal, does the CEO turn to the head of internal audit or someone and say, “I want you to come to the next board meeting, and I want you to discuss [the issue noted in the WSJ] at length with the board. I want them to understand what happened, why it happened, and could it happen here at our company. And if it could, what are we going to do differently? And if it couldn’t, why do we believe it wouldn’t happen? What controls do we have in place, and what independent assessments do we have?” (P-1)*

auditing governance over multiple periods, thus reducing the burden of evaluating the entire governance system each year and providing a better approach to integrating evaluations into the organization's core practices.

**4.2.3.2. Challenges Related to Testing and Documentation.** The second type of challenge relates to issues with testing and documentation. Roughly half of respondents (15 of 29) identified this challenge in the context of governance being subjective and hard to measure. For example, a respondent noted, "There's a qualitative component to this [evaluation], which, by nature, can't really be defined concretely, so the fact that this is a qualitative assessment makes it hard, and it's just an uncomfortable thing to do" (P-6). Similarly, it was noted that not only is corporate governance "squishy-soft subjective," but expectations for governance are "an ever-shifting target" (P-12). Another common documentation-related issue was the collection of evidence to support an evaluation (10 of 29). As noted, "the main challenge goes back to documentation and making sure there's evidence that what's in place is actually effective. ... It's not always clear, not always easily documented as to whether you have good corporate governance or not" (P-22).

Another challenge that participants (8 of 29) identified involves communicating issues to management and the board, which can be uncomfortable. For example:

*In our professional standards for the practice of internal auditing, internal auditors should be auditing governance on a regular basis. In most cases, they don't. And why don't they? Well, who wants to tell the board they're not doing what they should do? Who wants to tell management they're not doing what they should do? (P-1)*

The testing/documentation-related challenges include four additional issues that arose less frequently in interviews. In brief, respondents mentioned that (1) it is hard to evaluate and garner support for correcting deficiencies without a specific framework, (2) it is difficult to set expectations for lines of responsibility between management and the board because corporate governance encompasses the entire company, (3) it is human nature to want to keep issues hidden for fear of retribution (i.e., employees may try to hide governance issues prior to testing; board members may not want to speak up in self-evaluations), and (4) significant judgment is required in the evaluation process since there is not a "one-size-fits-all" approach to corporate governance.

In trying to overcome the challenges related to testing and documentation, a few respondents emphasized needing to fall back on their own judgment due to the subjectivity of many governance aspects.

A respondent explained:

*When we're in there doing the [internal audit] work, what are we seeing? Certain findings can point you to whether you have a cultural issue ... It really comes down to what happens when you start having issues or findings. What is the tone and reaction at that point? That will tell you a lot.*  
(P-14)

Related, a CAE noted, “I’ve actually done a lot of work with my team trying to prep them around more of the emotional intelligence and being able to build rapport with people and how to interview someone to tell when they are not telling the truth” (P-7). As described in Appendix C (section C.5), respondents also provided suggestions to balance the use of quantitative data in the assessment by emphasizing time-series data as well as analyzing *where* and *when* failures are identified within the organization. For example, if violations of company policies are often identified within one or two levels of management from where the failure originated, then that may suggest governance processes are in fact working properly (i.e., efficient identification of an issue). In contrast, situations where violations are undetected for a long time and/or are identified by whistleblowers likely reflect “poor” governance evaluation processes.

In sum, the challenges discussed in this section provide context for the stark differences we observed between current practices in governance evaluation (Table 2) and the “fresh start” peer-review evaluation with unlimited resources (Appendix C). Collectively, this gap and the various challenges discussed by respondents perhaps explain why internal audit is considered a “woefully underutilized vehicle” (P-5) for evaluating governance. While we highlight some respondents’ informal or indirect ways to work around or overcome certain challenges, these alternative approaches do not address all the issues that arise when CAEs do not have the necessary resources and an agreed-upon approach to testing and documentation for conducting a comprehensive governance evaluation.

While we present the challenges in this section as separate types for presentation purposes, we note that respondents often discuss the challenges as interrelated issues. For example, the absence of a commonly accepted framework to use in corporate governance evaluations—a challenge in and of itself—makes it

difficult to justify such an evaluation to the board and seek approval for resources or access to the board and senior management. In turn, these challenges exacerbate the difficulties of communicating deficiencies to the board at the end of the evaluation:

*Until somebody says, “Here are the objectives that we believe meet these requirements for governance and how you can assess them and what we expect you to assess against,” I’m not sure how effective [corporate governance evaluations] can be. The thing that we have to deal with typically as a CAE is, “You did this assessment, but against what? What did you assess us against? Did you assess us against theory? Did you assess us against practice? Why did you choose this thing?” (P-6)*

To better understand the final task of a governance evaluation—reporting to the AC—we asked respondents to share with us the most difficult issue they have taken to the AC as well as the challenges of this reporting process.

### **4.3. Finalizing the Evaluation by Reporting Issues to the Audit Committee**

**4.3.1. Current Practices in Reporting.** As CAEs described their approach for reporting issues to the AC, all respondents (25 of 25 asked) indicated that they generally take such issues to management first. A respondent described their reasoning as follows:

*I am of the mindset that I am never going to catch management off guard with anything in these conversations. No matter how bad the news is or what I’m going to say, I want the CEO to know, and maybe others. ... To be clear, they [the AC] like seeing some tension. They like to see me challenge them [management], but, again, they want a professional response from management, and they expect a professional response from me. (P-14)*

Other respondents made statements such as, “I’m not going to bring something up to the audit committee that I haven’t had a discussion with management. ... Just doesn’t feel right. Then you’re just a tattletale” (P-7), “We generally like to be in sync with management before we go to the audit committee” (P-11), and “The last thing you want to do as a head of internal audit is to embarrass management” (P-10). Usually, their process was to first approach the manager related to the issue followed by their superior, and, if that executive did not support the CAE, then the CAE would approach the executive leadership team and/or the CEO. Departing from this general approach, five respondents recounted specific situations when they preferred or were required to take issues directly to the AC or board (e.g., suspected fraud involving senior executives).

It stands to reason that CAEs should first take issues to management. Doing so provides several desirable outcomes: the CAE is able to confirm that they have all of the pertinent information, relevant parties are provided with advance notice to devise a solution or prepare their response to the board, and management can ensure significant issues are heard by the board while more minor ones are saved from occupying valuable boardroom time. For example:

*It gives that leader an opportunity to hear it from you that you're going to do it [report to the AC] without them being surprised later. And God forbid you're wrong and that you've missed something and that you, for whatever reason, didn't fully appreciate some aspect of the organization or the processes or controls around it—it gives them [management] an opportunity to disagree with you and show you why it's not something that is worthy of the audit committee's attention. (P-6)*

This general strategy of reporting issues to the AC is consistent with the performance standards defined by the IIA and findings in extant research (IIA 2016a; Norman et al. 2010; Roussy 2013).

However, we also learned of undesirable effects of reporting issues to management before the board, including that management could filter the information. Respondents shared examples of issues to be reported to the board for which they were asked to “soften the blow and ... be very careful with the wording” (P-12), “tailor the message or deliver the message over time rather than all at once” (P-11), or “wait and not report to the board [since the solution] is just a few months away” (P-19). One respondent cautioned against succumbing to such pressures:

*The worst thing you can do as an auditor is give in to a powerful executive. Better to hold ground because they won't respect you in subsequent instances. For example, if you do change your report, there will be a short-term sugar rush; they're happy at first, but, in the long run, they will not respect you. You have to be willing to say that you will not change a report if it is an important issue. They will respect that. They won't like it, but they'll respect you for it. It's a catch 22. (P-13)*

Although this respondent cautioned against succumbing to management, other respondents were less certain about how to manage this tension. For example, a CAE stated the “ethical dilemma of ‘I know this might be wrong, but how far do I push it? I don't want to lose my job; my family is depending on me’” (P-12).

**4.3.2. Challenges of Reporting.** In our interviews, while many respondents *presented* themselves as being comfortable taking issues to the board and AC, these same individuals acknowledged the discomfort of doing so. For example, a respondent described coaching oneself prior to communicating with the board: “This is a confrontation and it's going to be uncomfortable, but you will not shy away from it” (P-28). They

even shared candid examples that demonstrated they were personally uncomfortable with this role:

*Those five minutes in private session are always the most difficult. It's like, "What do I say, what do I not say?" But I think the most difficult thing to bring up is if you feel, based upon your audits, based upon what you see, based upon what you hear, there are areas of improvement at the very top, at the senior level, at the CEO level (e.g., tone).... How to communicate that to the board, it's almost the nuclear option button that you push. When does that button need to be pushed? How many red flags do you need to make you have to push that button? And then what happens after you push that button? There's been plenty of times when this was tricky to navigate. (P-8)*

Respondents explained this discomfort in a variety of ways, including management and the board are not always open to feedback, management controlling or suppressing the CAE's message, fear of retribution from management, difficulty communicating subjective issues, concern that the board does not view the CAE as a reputable figure, and complexity navigating boardroom politics and dynamics.<sup>27</sup> A respondent concisely stated that the "single biggest impediment to people standing up and saying what's really on their mind is just that most of us are paid by the company and are hired and fired by the company" (P-6).<sup>28</sup>

To overcome the challenges associated with reporting issues to the board and AC, respondents described various strategies they employ. For example, respondents highlighted that they prefer to share news with the AC chair before the board meeting either by phone or over a private meal. In particular, this was described as a more "comfortable and safe" setting (P-8). Such opportunities allow a CAE to update the AC chair in a timely fashion while providing a means to solicit advice on presenting an issue board-wide and determine if the AC chair views the issue or its severity in a similar way. Another CAE described a more unique way to engage the AC chair:

*If there are things that, for whatever reason, political maybe, I didn't want to be the one to bring them up in the meeting, I can tell the audit committee chair, "Okay, look, we're having an issue here, and I'd be more comfortable if you would raise a question about it that would open the door for me to then discuss it. Unless a question comes up, it would be awkward if I just brought it up in the middle of the meeting, but, if you asked a question, they [other members of management] can't fault me for*

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<sup>27</sup> Many respondents listed the challenge of reporting to the board/AC when we prompted them to describe evaluation challenges in general (see Table 3). After that discussion, we asked them to list any unique challenges that arise when reporting the results of these evaluations to the board/AC. Some respondents indicated that there were no additional challenges, but several others did extend their discussion. Here, we list only the additional challenges that arose.

<sup>28</sup> One respondent—between the time they discussed an issue with management and the first time they had a chance to report it to the AC—lost the CAE position and was reassigned outside of internal audit. The respondent elaborated:

*The problem for the CAE is that, if there's politics or there's gaming going on, or somebody's trying to hide something or trying to cover themselves up, or make them look better, you've given them way too much time to establish their case before you get to the ear of the audit committee. (P-5)*

This example highlights the potential for extreme consequences when issues are raised in an environment in which individuals are not willing to listen and illustrates why several respondents specifically mentioned a fear of retribution when reporting to the board.

*answering a question.” I have to do that. (P-9)*

Likewise, a respondent described learning the night before the board meeting that an issue had been withheld from the preparation materials and, as a result, they placed an envelope at the AC chair’s seat prior to the start of the meeting with the relevant details (P-5).<sup>29</sup>

Respondents also overcame some challenges of reporting issues to the board by adopting structured approaches based on facts and protocols. For example, CAEs described lengthy processes to research and prepare an issue before reporting to the board:

*I’ll make sure that my facts are completely tight. Bulletproof. Once I’m happy with that, I would approach the board. The board does know you. I know them, the executive chairman, the audit committee obviously. So, through them, I would approach the board and say, “I have something to discuss with you that has come to my notice.” Boy, you better have your facts right before you do that. That’s not something you take lightly. (P-15)*

Closely related, a respondent recounted a time when they delayed reporting an issue to the AC to allow time to first prepare the solution.<sup>30</sup> Other respondents leaned on structured “protocols” (P-19) for reporting since the “process is there to protect you.” (P-23). In particular, CAEs found that it helped to rely on a process where they “just had to lay out the facts” (P-7).

Another strategy expressed by many respondents was to purposely remove emotion from the task:

*I’m kind of clinical on this stuff [reporting issues to the AC]. You can’t really do what I do if you don’t think of it clinically. If you’re going to worry about, “Well, if I report, I’m going to get fired”—you shouldn’t be doing what I do for a living. You just can’t. You see what I’m saying? ... You have to void it from emotion. If I find there’s an error, there’s an error. Of course I care about the company. I love this company, but this is what we found. [Do I worry about] how is management going to fix it? As opposed to worrying “Oh, we found this, how are we going to report it? Is management going to get upset?” Management gets upset, they get upset, life goes on—that’s what I mean by clinical. (P-27)*

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<sup>29</sup> The ability to lever this first strategy toward reducing discomfort with reporting to the board seemed to rely upon respondents’ access to and relationships with the AC chair. Regarding access, CAEs described the ease with which they could contact the AC chair when issues arose. Specifically, respondents mentioned being able to “pick up the phone and talk with [the AC chair] in five minutes” (P-4). CAEs also emphasized the importance of a close relationship with the AC chair:

*It probably depends on the audit committee chair. I think most of the audit committee chairs that I’ve had have fostered that relationship with me and have really wanted it to be open. “Let me know if anything comes up.” But I also have worked for some audit committee chairs that—I don’t want to say they are a little more standoffish, but they are a little more formal. They don’t want to hear about things unless it’s burning hot and on fire. (P-24)*

As respondents reflected on their relationship with the AC chair, references were made to building “a lot of credibility” (P-3) and “a very good rapport” (P-20, P-21).

<sup>30</sup> When pushed to reflect on the time delay before informing the AC, the respondent replied, “Well, that’s a good question. I don’t think that they were upset that we didn’t bring the issue in advance of the solution” (P-17). Though fewer respondents shared such a narrative, there could be implications to not informing the AC in a timely fashion if such an approach is more widespread.

Similarly, respondents felt more comfortable reporting issues to the AC when they believed “it is part of doing the job” (P-17, P-28) and that it is their “corporate responsibility to the company” (P-26). Summing it up, a CAE indicated, “That’s why you sign up for this role—knowing that you’ve got to do it whether it’s uncomfortable or not. We have a very, very unique role in the company” (P-22).

Finally, while not necessarily an actionable strategy for overcoming reporting challenges, the experience and personality of respondents allowed some to feel more comfortable with the task. For example, one CAE described the role of experience and personality as follows:

*To have shown through years—not months—of performance that you know what you’re talking about. You’re not an alarmist. You’re respectful. You’re deferential at the right time, but you’re not going to just back away from the issue.” (P-5)*

Another respondent confirmed that “There’s so much knowledge and confidence that’s gained through experience” (P-22). Similarly, a respondent noted that while CAEs can opt into various types of training, it does not fully replace experience when deriving comfort: “We do all sorts of effective challenge training and scenario training that [should help] people feel more confident, but ... I’m senior enough and have been here long enough that I’m less worried about management getting upset” (P-27). Regarding personality, we further noted that several respondents recognized the need to be willing to walk away from the job (i.e., willing to accept potential retaliation) in order to feel comfortable and empowered in the reporting role.

Interestingly, respondents identified more challenges related to *conducting* an evaluation (resources and testing/documentation) than challenges in the final evaluation task related to *reporting* issues to the board. In contrast, respondents had few strategies for overcoming evaluation challenges but several for overcoming reporting challenges.

## **5. Discussion of Findings**

As discussed in Section 2, the intended effect of organizational accountability is to influence the organization’s perception that a defense of its actions may be required and the potential for consequences exists (Lerner and Tetlock 1999). Consistent with accountability theory and the practical importance of governance, we entered the field with some expectation that public companies would have well-developed internal processes for evaluating their governance systems and making improvements as needed. When

describing the objectives of corporate governance, respondents even highlighted the importance of holding individuals accountable when there are deviations from the company's governance policies, indicating that accountability theory *should* inform our understanding of the field. However, our interviews quickly revealed that there seem to be obstacles preventing organizations from fulfilling this accountability demand, rendering accountability theory unable to explain our data. For this reason, we incorporated into our theoretical lens the concept of decoupling from institutional theory, which we elaborate on below.

Our analysis in Section 4 revealed that five of the 29 respondents in our sample admit to having weak or suboptimal governance evaluation processes in their organizations. As previously highlighted, a respondent from a Fortune 500 company stated that the company's governance evaluations had a "mom 'n' pop" feel; in other words, they cited that the company had retained the same practices of a small, family-owned company even though it had grown into a large, international organization. Through public disclosures, these five companies project the appearance that governance is regularly evaluated; for example, these five companies belong to stock exchange listings that require certain minimum thresholds of governance and make general references in their proxy filings to evaluating their corporate governance policies. In our interviews, however, we learned that none of these companies have meaningful evaluation processes in place. Based on decoupling theory, these five organizations demonstrate symbolic adoption since the formal governance structures are "evaluated so weakly" (Bromley and Powell 2012, 489) and "evaluation systems are subverted" (Meyer and Rowan 1977, 343) such that it would be unlikely for problems or issues to be uncovered and improved on a timely basis.

Aligning with theory, symbolic adoption arises when organizations do not commit resources to a particular task—in our case, the evaluation of governance. Without resources, including dedicated time/budget and support from management, organizations are limited in their ability to identify instances when they do not have "good" corporate governance. Any resources that are dedicated to evaluations seemed to go towards "check-the-box" activities that confirm required governance disclosures, leaving limited resources remaining (or none at all) to support a more thorough evaluation. Accordingly, the respondents of these five organizations tended to refer to more resource challenges relative to other

respondents (refer to Table 3), especially those related to constraints on their time and budget. These organizations also varied in their documentation challenges relative to other organizations; in particular, they were much more likely to cite challenges related to governance being subjective, while none of the five cited challenges related to documenting evidence to support their evaluation. This evidence implies that limited resources and initial subjectivity prevented these respondents from getting far enough into the details of an evaluation to even recognize other possible challenges. A key implication is that if stakeholders are unable to identify instances of symbolic adoption—which they are unlikely able to do based on required disclosures—then they face greater risk in their dealings with that entity. It is important to stress that the lack of a governance evaluation does not necessarily mean poor corporate governance; instead, it implies an increased chance that weak governance practices will go unnoticed and exposes stakeholders to risk if those issues ultimately result in corporate failure (e.g., MacLean and Behnam 2010).

For the remaining organizations in our field study, our analysis revealed that they do attempt or have in place processes and practices intended to evaluate whether corporate governance is functioning as intended. However, we learned of piecemeal approaches that focused on specific areas of governance and did not lead to an *overall* conclusion on the effectiveness of corporate governance. For these organizations, resources were often committed to governance evaluations; however, these companies were still unable to complete a comprehensive evaluation of governance. This occurred despite the fact that CAEs appear to be up to the task (i.e., they were able to describe a comprehensive process for evaluating governance if given a “fresh start”). Accordingly, these organizations illustrate symbolic implementation—certain approaches to evaluate governance appear to be in place but they lack a connection to the objectives that the governance systems were designed to achieve.<sup>31</sup>

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<sup>31</sup> Admittedly, the distinction between symbolic adoption and symbolic implementation is more of a continuum than a dichotomy. For example, the organizations that we characterize as symbolic adopters may not demonstrate a complete absence of formal structure but, rather, may have one or two minor practices in place (e.g., they review whether/how issues reported to their hotline are resolved) but no meaningful set of practices aimed at evaluating governance. Still, even within the set of organizations we indicate are examples of symbolic implementation, there is notable variation in both the resources dedicated to governance evaluations and the number/quality of resulting evaluation practices. Some organizations dedicate substantial resources to governance evaluations while others do not. Some organizations have a few meaningful evaluation practices in place while others have more. Some organizations might even draw conclusions on a limited number of governance aspects, but none derive an *overall* conclusion on the effectiveness of corporate governance. Though our study confirms the value of considering different types of decoupling, future research would help to further refine them.

Decoupling theory is also helpful for diagnosing the possible reasons underlying symbolic implementation of governance evaluations, which was more pervasive in our findings. First, Bromley and Powell (2012) highlight that symbolic implementation often involves compartmentalization of certain practices such that they are disconnected from the organization's core. One reason that directors and executives may not demand a more comprehensive governance evaluation is that they have compartmentalized governance to be viewed only at the board level for regulatory and listing exchange compliance purposes. However, consistent with the definition in Larcker and Tayan (2019), our data from the "fresh start" perspective suggest that governance should be viewed broadly through all levels of the organization. Thus, we end up with symbolic implementation of current practices that reflect a disconnect between evaluation activities that are isolated within either the board or the internal audit plan and have little coordination between the two groups (e.g., boards do self-evaluations for purposes of fulfilling the requirement, but they do not involve CAEs who are typically tasked with process evaluation, risk assessment, etc.).

Second, our data suggest that respondents highlighted a lack of consensus regarding how an evaluation of governance should culminate. Since the organizations in our study rely on piecemeal and narrow approaches, they were not able to describe how evaluation of various governance inputs led to a comprehensive conclusion. As a substitute for a comprehensive conclusion, some respondents indicated that they rely on negative assurance. For example, a respondent highlighted that "if you don't have any quantifiable failures, then you must be doing good. But it is very hard to measure 'doing good,' except for the absence of failures" (P-28). This second reason for symbolic implementation ties into two challenges that respondents identified—that governance is subjective and hard to measure and that no specific framework exists upon which they can rely for evaluating governance. Together, these challenges make it difficult to know what to include in a governance evaluation, how to measure and assess it, and how to derive a meaningful conclusion.

Third, a related but broader issue is that opacity in the field of governance may be another determinant of the absence of *comprehensive* governance evaluations described by respondents. Power

(2021) argues that accounting and auditing are particularly susceptible to symbolic implementation because of the uncertain relationships that can exist between means (i.e., evaluation and assurance) and ends (i.e., corporate governance objectives). Related, Wijen (2014) argues that highly opaque fields are at risk of symbolic implementation. A field is opaque when “observers have difficulty identifying the characteristics of prevailing practices, establishing causal relationships between policies and outcomes, and measuring the exact results of policy implementation” (Wijen 2014, 302). For example, some scholars examine symbolic implementation in the field of sustainability because of the opaque reporting rules and their voluntary nature (e.g., Crilly et al. 2016; Graafland and Smid 2019; Li and Wu 2020). We are not suggesting that decoupling is a deliberate choice made by the organizations in our sample. Decoupling could be due to a lack of capacity and not just a lack of will (Bromley and Powell 2012). For example, poor implementation may arise when there is an absence of consensus between what evaluations could achieve and what organizational members are willing and able to put in practice (Crilly et al. 2016; de Bree and Stoopendaal 2020). Research suggests that fields or organizations that experience symbolic implementation would benefit from concrete rules, strong incentives, and methods of transferring best practices to ensure substantive compliance (Wijen 2014).

Drawing on theory more broadly, we further highlight two key assumptions of decoupling in the context of our setting: (1) that all organization members adhere to the same logic and are willing to protect it, and (2) that organizations are able to avoid external scrutiny (Pache and Santos 2013). While our interviews reveal that CAEs demonstrate an interest in conducting governance evaluations, they face significant challenges that prevent them from pushing the issue (e.g., full workloads, risks to job security). Thus, CAEs conform to the preferences of top executives and the board. Further, it is difficult for outsiders to observe whether governance systems are being evaluated and continuously improved; in other words, public disclosures may show that a company’s governance practices look good in form even though they may lack substance. At present, this is particularly true in the U.S. since few mandatory requirements are in place governing how and the extent to which organizations should conduct evaluations of their governance systems. Corporate failures—a rare event—may be the only public indication that proactive governance evaluations were not being carried out. Evidence also suggests that governance rating agencies (e.g., ISS and

Glass Lewis)—who are supposed to fill a policing role—have become complicit over time such that they are unlikely to expose poor governance processes (Clark and Newell 2013). Notably, the five symbolic adopters in our sample operate in non-regulated industries, suggesting that certain regulators (e.g., banking) that are more likely to delve into company processes may deter decoupling through symbolic adoption. In any case, scholars suggest that organizations may not be able to avoid scrutiny for extended lengths of time and, therefore, decoupling may be difficult to sustain indefinitely (Pache and Santos 2013; Dick 2015). This reaffirms the need for organizations to incorporate governance evaluations in a way that contributes toward a broad, holistic assessment of an organization’s governance.

Our theoretical lens also permits us to offer cautionary notes. In particular, slippage from symbolic implementation to symbolic adoption and vice versa can occur. That is, the solution is not as simple as mandating governance evaluations. For example, organizations that have some evaluation processes and practices in place—even if piecemeal—may retreat to symbolic adoption if they do not believe they can fulfill the mandatory requirements. Alternatively, the current social and regulatory movements toward improved ESG initiatives (e.g., Landaw 2020; Katz and McIntosh 2021) may create added pressure to encourage even further symbolic implementation of evaluations as companies seek credibility for their governance policies. Symbolic implementation has the potential to be even worse for an organization relative to symbolic adoption as it creates unnecessarily complex internal structures and diverts substantial resources away from key goals (Bromley and Powell 2012).

Additionally, a few scholars point to the possibility that accountability may be a way to correct decoupling or, rather, lead organizations to “recouple” practices such that they actually contribute to organizational effectiveness (Dick 2015; de Bree and Stoopendaal 2020). At the beginning of this discussion, we noted that accountability theory did not offer much explanatory power for our data relative to decoupling theory, suggesting that the two theories are disparate. Drawing back to the theoretical lens detailed in Section 2, for organizations to be encouraged to adopt and implement summative and meaningful governance evaluations, accountability over the evaluation processes in place *and* the connection with

desired corporate outcomes seems necessary. This recommendation is aptly summarized in Bromley and Powell (2012, 519) as follows:

*[T]here is a need for more reflective and proactive responses to external pressures. We would encourage leaders to focus thoughtfully on shaping tools, such as systems of reporting, monitoring, and evaluation, in ways that are more directly linked to their organization's core activities, and to search for ways to influence the nature of external standards in the environment.*

In other words, companies need to focus on more than just implementing an evaluation process where data collection is an end in itself; instead, companies should go a step further to connect that process to the core goals of the organization.

## **6. Conclusion**

Collectively, our analyses reveal several interesting findings and areas for future research as well as important factors for organizations to consider if they wish to develop and devote more resources to evaluations of their corporate governance. Although CAEs are able to describe the evaluation process in great detail from the perspective of a peer reviewer, evaluation processes within their own organizations do not have the same level of detail or scope. Moreover, obtaining access to adequate resources to perform such evaluations was noted frequently as a significant challenge. We encourage future research to better understand the potential benefits and costs of a comprehensive evaluation process. Even among those CAEs with more robust governance evaluations, respondents acknowledged that their company lacks a formalized process for systematically concluding on collected evidence across tasks. Thus, research is needed to design methods of aggregating evaluation results across the wide range of corporate governance facets. Regarding reporting governance issues to the board and AC, respondents highlighted additional challenges specific to the task but they also identified several approaches for overcoming these challenges. Here again, research could assess alternatives for the relationship between CAEs and the board such as modifying reporting lines or responsibility over their performance evaluation and compensation. In sum, our study highlights how little is known about companies' governance evaluations. With the rise in governance analysts and advisory services as well as shareholder proposals on governance issues, future research could also explore the extent

to which these evaluation processes should be publicly disclosed.<sup>32</sup>

This field study is not without limitations. In all interview-based research, participants' descriptions of "actual" practice may include some idealized notions of those practices. During interviews, we try to minimize this risk by gaining participants' trust and revisiting important insights several times during an interview to verify their accuracy. Another limitation of our study is that our organizational level of analysis means we forego potentially interesting insights and theoretical applications at the individual level (e.g., Westphal and Park [2020] call for a broadening of decoupling theory to the individual level). We hope that these limitations provide a basis for interesting future research.

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<sup>32</sup> For example, Nielsen Holdings Plc's 2018 proxy statement provides robust and transparent disclosure of the board and committee evaluation process, including areas identified for future improvement. This proxy statement (see page 13) is available at: [www.sec.gov/Archives/edgar/data/1492633/000119312518111657/d529525ddef14a.htm](http://www.sec.gov/Archives/edgar/data/1492633/000119312518111657/d529525ddef14a.htm). Additional best practices are provided by the Council of Institutional Investors (Davis and Whitehill 2019); similar practices could be used to communicate evaluation processes for governance areas *beyond* board evaluations.

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**Table 1. Interview Details**

Interview #	Interview Date	Interview Length (minutes)	Industry	Market Cap	Exchange	Years as Public Company	Governance Risk
1	02/08/2019 02/12/2019	60 55	Aerospace & defense	Large	NYSE	> 50	Low
2	02/11/2019	55	Information technology	Mega	Nasdaq	5-15	High
3	02/15/2019	100	Airlines	Large	Nasdaq	16-50	Moderate
4	02/27/2019	70	Medical care	Large	NYSE	16-50	Moderate
5	02/28/2019 03/25/2019	65 70	Chemicals	Mega	NYSE	> 50	Moderate
6	03/06/2019	105	Communication equipment	Small	Nasdaq	< 5	High
7	03/11/2019	60	Capital markets	Mid	Nasdaq	5-15	Low
8	03/11/2019	50	Medical devices	Small	Nasdaq	5-15	Low
9	03/11/2019	85	Banks – regional	Small	Nasdaq	15-50	Moderate
10	03/11/2019	85	Department stores	Mid	NYSE	< 5	Moderate
11	03/12/2019	60	Aerospace & defense	Mid	NYSE	15-50	Low
12	03/12/2019	45	Restaurants	Mid	Nasdaq	15-50	Low
13	03/12/2019	60	Software – infrastructure	Mid	NYSE	< 5	Moderate
14	03/12/2019	65	Regulated electric	Large	NYSE	> 50	High
15	03/12/2019	70	Business equipment	Small	NYSE	> 50	Low
16	03/13/2019	52	Health care plans	Large	NYSE	15-50	Low
17	03/22/2019	85	Medical devices	Mid	NYSE	15-50	Low
18	03/27/2019	65	Home furnishings & fixtures	Mid	NYSE	15-50	High
19	04/01/2019	75	Telecom services	Small	Nasdaq	> 50	Low
20	04/03/2019	60	Banks – global	Mega	NYSE	15-50	Low
21	04/03/2019	45	Truck manufacturing	Large	Nasdaq	15-50	High
22	04/08/2019	65	Business services	Large	Nasdaq	5-15	High
23	04/24/2019	65	Aerospace & defense	Large	NYSE	> 50	Low
24	04/29/2019	60	Specialty retail	Small	NYSE	< 5	High
25	04/30/2019	65	Discount stores	Small	NYSE	15-50	Low
26	05/03/2019	75	Specialty chemicals	Mid	NYSE	> 50	Moderate
27	05/06/2019	70	Credit services	Large	NYSE	< 5	High
28	05/09/2019	75	Banks – regional	Small	Nasdaq	5-15	Recently delisted
29	05/21/2019	70	Semiconductor equipment & materials	Mid	Nasdaq	15-50	Low
30	02/15/2019	80	Professional/regulatory organization	--	--	--	--
31	03/12/2019	65	Professional/regulatory organization	--	--	--	--

*Notes:*

- For “Market Cap,” we use the following categorizations: small includes companies less than \$2 billion market capitalization, mid includes companies between \$2 and 10 billion market capitalization, large includes companies between \$10 and 100 billion market capitalization, and mega includes companies larger than \$100 billion market capitalization.
- For “Governance Risk,” we access ISS’s QualityScore, described as a “data-driven scoring and screening solution designed to help institutional investors review a company’s quality factors and assess risk.” We include ISS’s overall rating for corporate governance, which is intended to provide an indication of relative quality. Rather than mirror ISS’s rating scale, we recode 1 through 3 as “low” risk, 4 through 7 as “moderate” risk, and 8 through 10 as “high” risk to protect each company’s anonymity.

**Table 2.** Current Practices in Evaluating Corporate Governance

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N = 28 interviews

Evaluating specific areas of corporate governance in internal audit plan (*)	24	85.7%
Conducting annual self-evaluations of the board and/or committees	20	71.4%
Benchmarking to informally suggest changes based on best practices	17	60.7%
Considering culture, ethics, or tone indirectly as part of other internal audit programs	15	53.6%
Evaluating entity-level controls over financial reporting for SOX testing	14	50.0%
(*) Specific areas of corporate governance in internal audit plan are as follows:		
Evaluating board/AC processes: structures, charters, etc.	12	42.9%
Evaluating processes and procedures around risk/ERM	9	32.1%
Evaluating culture, ethics, or tone at the top directly through surveys/interviews	8	28.6%
Evaluating whistleblower hotline: operational and response effectiveness	8	28.6%
Evaluating compliance of trainings on code of conduct and other HR issues	5	17.9%
Evaluating board/management authorization structures and reporting lines	3	10.7%
Evaluating board and/or executive expense reports	2	7.1%
Tracking various reportable “bad” events, KPIs, etc. and comparing to peers	1	3.6%

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*Notes:*

- We asked participants to describe how their company evaluates corporate governance. Due to time constraints, we were not able to ask this question for one of the 29 participants. Thus, the quantification in this table is based on 28 of the 29 interviews.

**Table 3.** Challenges of Evaluating Corporate Governance

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N = 29 interviews	<u>Listed in “Top 3”</u>	
<u>Challenges Related to Resources:</u>		
Management and the board need to be willing participants	13	44.8%
Constraints on time, budget, etc.	7	24.1%
Expertise required to do evaluation	7	24.1%
No clear ownership over corporate governance	3	10.3%
<u>Challenges Related to Testing and Documentation:</u>		
Subjective and hard to measure	15	51.7%
Difficulties with documenting evidence to support evaluation	10	34.5%
Difficulties with communicating deficiencies to management and the board	8	27.6%
Lack of a specific framework	5	17.2%
Corporate governance is very broad; lines of responsibility not always clear	5	17.2%
Human nature to keep issues hidden; fear of retribution	5	17.2%
No “one-size-fits-all” approach; hard to make comparisons	3	10.3%
	<hr/>	81

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*Notes:*

- We asked participants to identify the key challenges to evaluating corporate governance. In doing so, we asked participants to focus on the “top three” challenges. While many participants discussed three (or more) challenges, a few provided only one or two unique challenges which explains why the total number of challenges above does not equal 87 (29 multiplied by 3)

## Appendix A. The Chief Audit Executive's Role

Chief Audit Executives (CAEs) lead internal audit in evaluating various processes and controls throughout the organization, including processes related to compliance or regulatory matters, core operations, corporate culture, cost/expense reduction, cybersecurity, enterprise risk management, fraud, and information technology. A common misperception is that internal auditors primarily focus on financial controls. However, in 2017 and 2018, testing of internal control over financial reporting accounted for less than 15 percent of internal audit's annual budget (IIA 2019), indicating a much broader scope of their responsibilities.

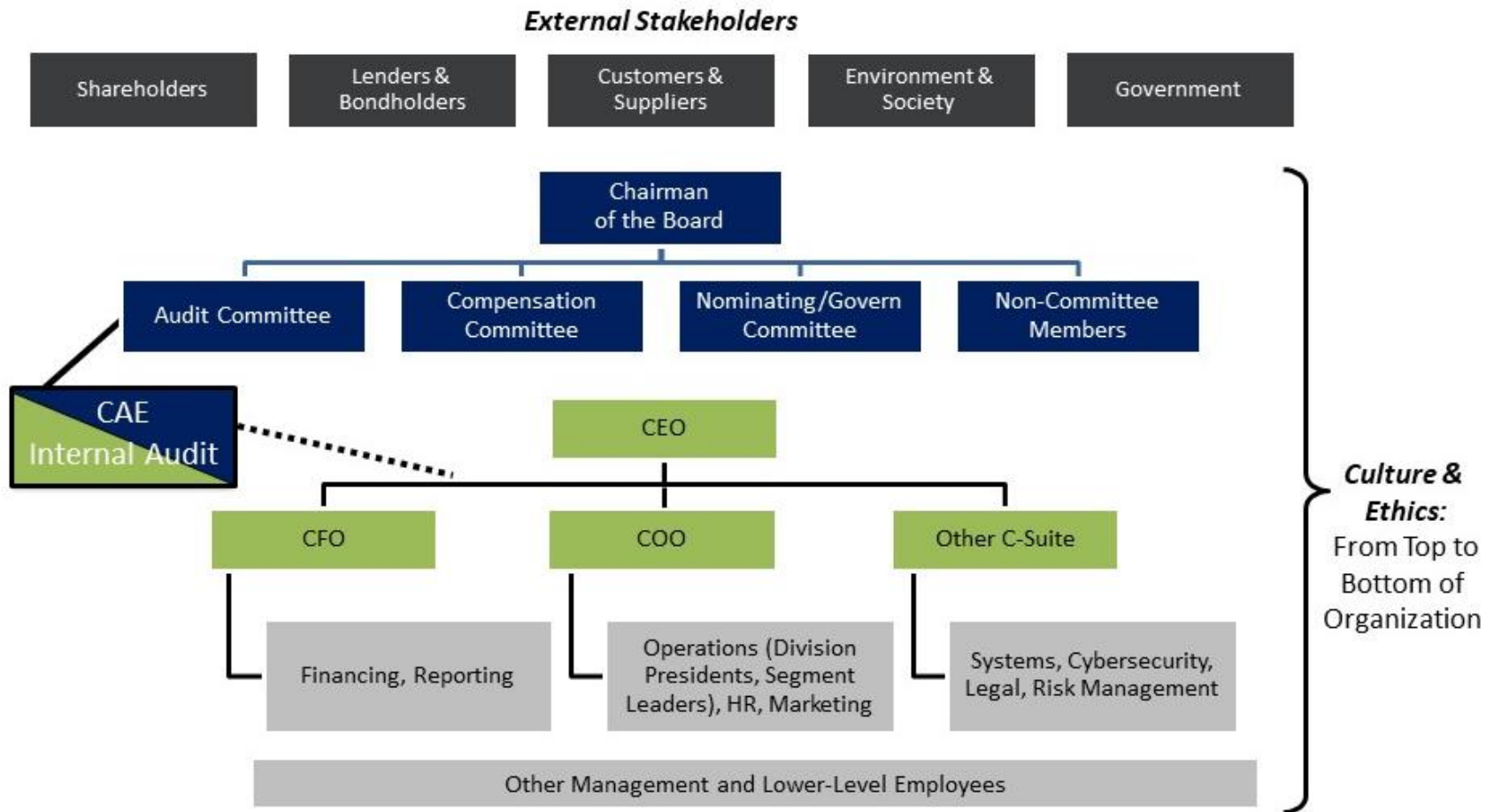
In addition to the breadth of this role, the CAE occupies a unique position in the company as one of the only executives with a functional reporting line directly to the AC. However, the CAE generally reports to senior management (e.g., CEO, CFO) from an administrative perspective (e.g., performance evaluations; approval of travel and expense reports). As a result, the CAE is tasked with being an independent and objective executive who works for the AC despite being evaluated and compensated by senior management (refer to Figure A-1 below). Research highlights how these conflicting priorities affect internal audit's ability to be objective given its need to "serve two masters" (Norman et al. 2010; Roussy 2013; Iyer et al. 2018).

While prior research tends to focus on internal audit's role in financial reporting and internal control (e.g., Prawitt et al. 2009; Christ et al. 2015; Ege 2015; Abbott et al. 2016), our objective is to provide insights into the broader evaluation of governance. In doing so, the CAE's functional reporting line to the AC is critical since the CEO is usually the only other executive that has a direct line to the board. It is important to note that both controllers and risk managers have similar roles and face similar challenges as CAEs. For example, they may be involved in governance (particularly Chief Risk Officers), they often have dual reporting structures, and they generally face resource constraints given they may not work in revenue-generating segments of the organization (e.g., Byrne and Pierce 2007; Maas and Matějka 2009; Mikes 2011; Goretzki et al. 2018). However, the key distinction is that CAEs' expertise in providing assurance over various company processes provides them with a unique and important perspective with which to consider the *evaluation* of corporate governance.

IIA Standard 2110 states that internal auditors' evaluation of corporate governance should consider "organizational performance management and accountability," "ethics and values within the organization," and communication of "risk and control information to appropriate areas of the organization" (IIA 2016a, 13). Further, the IIA recommends that "all governance activities, both board and nonboard, should be considered" (IIA 2012, 1). The IIA provides guidance to assist CAEs in conducting this broad evaluation of governance. As an example, in evaluating the company's values, culture, and philosophy, the IIA recommends that CAEs consider written policies, training manuals, evidence of hotline effectiveness, and employee surveys (IIA 2012). Further, the IIA recommends that CAEs consider written goals and objectives, evidence of board approval and oversight, allocation of resources to execute strategies, and reward systems embedded in compensation structures to assess the alignment of goals, objectives, strategies, risk, and controls (IIA 2012). Despite the importance of corporate governance, existing research does not address companies' *evaluation* of their governance systems nor how CAEs—based on their unique inside perspective—perform this type of comprehensive evaluation. The closest study that we are aware of is Clune et al. (2019) which examines the role of the governance committee in evaluating the board and its committees. In contrast, a comprehensive evaluation of corporate governance requires a broader assessment of processes across the entire company, requiring surveys and interviews throughout all levels.

To conclude the evaluation process, CAEs must communicate issues to the AC. In particular, we view the reporting of issues to the board as the final phase of the governance evaluation process rather than a separate process in and of itself. To provide some guidance for this reporting role, IIA Standard 2060 indicates that a CAE must periodically report to the board on matters related to internal audit and other governance issues (IIA 2016). In particular, IIA Standard 2600 requires a CAE to discuss with management any issues for which an unacceptable level of risk has been accepted and, if unresolved, the CAE must report such issues to the board (IIA 2016). While the standards provide the minimum requirements for CAEs to fulfill their accountability to the AC, significant scope remains for CAEs to navigate this process.

**Figure A-1.** An Illustration of Corporate Governance and the Role of the CAE



*Notes:*

- This figure illustrates the many relationships in a full system of corporate governance. The CAE’s dual reporting role is illustrated with a solid (functional) reporting line to the audit committee and a dotted (administrative) line to the C-suite.

## Appendix B. Sample Interview Script

We noted from our preparations that you have been employed at [Company Name] since \_\_\_\_ as the Chief Audit Executive. Can you describe your role in corporate governance at your company?

What would you identify as the key objectives of a system of corporate governance?

- Who champions/leads corporate governance?

How does [Company Name] evaluate its system of corporate governance?

Example Prompts:

- What processes do you use? Formal or informal?
- How often does this evaluation occur?
- Led by whom?
- Do you follow any frameworks or standards when evaluating corporate governance?

Next, we'd like you to set aside what happens at your company so we can revisit the evaluation of corporate governance with a different perspective in mind. If we were to give you an opportunity to start fresh, with access to unlimited time and resources, if you were on a peer review team going in and looking at another organization, what would you look at to assess corporate governance?

- a) {if response does not touch on specific aspects} We're hoping to tease out real changes in corporate governance over time; what quantitative or qualitative things can be assessed to determine whether an organization has strong vs. weak governance?
- b) So far, you've highlighted several inputs to corporate governance but how do you know these inputs are "good enough"? Can you identify the outputs/outcomes you would hope to see?
- c) What features of either an organization or its industry would cause your evaluation process to vary?

What are the "top three" key challenges to evaluating corporate governance?

- Can be based on current company challenges, prior challenges, or in general
- Are there any additional or specific challenges that arise when the CAE is responsible for evaluating corporate governance?

What are the key challenges of reporting issues to the board that are identified in a company's corporate governance evaluation?

Can you describe for us the most difficult issue that you have had to take to the board to resolve?

- What was the board's initial response?
- How was the issue resolved?
- Is there another example that you can share with us?
- Are there typical or commonly occurring issues? More vs. less uncomfortable issues?
- If you were evaluating corporate governance and found an issue with the audit committee or board itself, how would you handle that?

If we were to compile a list of "best practices" in corporate governance, what practices would you recommend that we add to our list?

Are there any questions you thought we would ask but did not? Or, anything you would like us to know that we didn't ask about?

## **Appendix C. Evaluating Corporate Governance: A Compendium of Perspectives from CAEs**

This appendix is based on a compilation of views from CAEs in response to the following prompt in the interview script provided in Appendix B: *Next, we'd like you to set aside what happens at your company so we can revisit the evaluation of corporate governance with a different perspective in mind. If we were to give you an opportunity to start fresh, with access to unlimited time and resources, if you were on a peer review team going in and looking at another organization, what would you look at to assess corporate governance?* We intervened as little as possible, asking only clarification questions.

### ***C.1. Step #1: Define company-specific expectations for corporate governance***

Evaluators can use the company's listing exchange requirements, regulatory requirements (e.g., Securities and Exchange Commission [SEC], Foreign Corrupt Practices Act [FCPA], industry regulation), corporate objectives, and company-specific policies, procedures and codes of conduct to set expectations for corporate governance.

It was indicated that there is not a "one size fits all" answer to defining "good" or "bad" corporate governance. Significant judgment is involved in deciding whether the company's corporate governance is "good enough" for their specific needs. For example, one respondent stated: "I would make sure that we are all on the same page with the definition of what we are talking about when we say 'assessing the governance'" (P-10). Another CAE reiterated: "I'm not going to go in with a presumption of knowing the business and knowing exactly what should be monitored. I would want their perspective on that. Then I would also evaluate whether there are things that they should be monitoring that they're not" (P-19).

Benchmarking data is particularly helpful for subjective evaluations about corporate governance because "there are varying levels [of corporate governance], and there is that gray area in the middle where you're like, 'Well, I can't say it's necessarily bad or not.'" (P-12). While there is readily available benchmarking data for compensation, board demographics, head counts, sales tactics, and information technology, "there's no database that one can really go to ... that has a lot of good information related to great corporate governance" (P-1). Lacking a central database, CAEs suggest that evaluators can use benchmarks or standards such as:

- Comparison to experiences in prior years at current company
- Comparison to experiences at other companies
- Comparison to leading practices published by corporate governance thought leadership (e.g., the Big 4 or other consulting firms, IIA, Gartner, NACD)
- Comparison to peers based on industry or professional networks
- Compliance with regulatory standards and listing exchange requirements

### ***C.2. Step #2: Collect publicly and privately available data***

Once the scope of the evaluation and set of expectations are defined, CAEs recommend gathering supporting evidence for the evaluation by reviewing existing documentation that is either publicly or privately available. In doing so, they seek to understand how decisions are made at the company, how management and the board interact, how tone at the top disseminates through the organization, and any "red flags" for potential issues related to corporate governance. A variety of sources can be used, including (sorted alphabetically):

- Biographies of board members and executive leadership
- Board and committee meetings (agendas, board materials/packages, and minutes)
- Board and committee self-evaluations
- Code of Conduct, Code of Ethics

- Employee complaints and whistleblower hotline activity (listing of reported incidences and evidence of how they were handled)
- Employee surveys (e.g., culture surveys, “best company to work for” surveys)
- Employee training materials and completion records
- Exit interviews
- External assessments of any aspect of corporate governance
- Internal audit plan and any recent internal audit reports
- Legal matters
- Organization chart
- Policies and procedures
- Publicly available information produced by the company (10-K, DEF 14A, corporate governance guidelines, board and committee charters, investor relations information, press releases and earnings announcements, etc.)
- Social media and press activity, both by the company and others

For each of these pieces of supporting evidence, CAEs emphasize avoiding “check the box” (P-22) evaluations. A respondent suggested that evaluators “look for ways to assess substance over form. Having the meeting just because you have to doesn’t mean anything, but what was actually done and debated at that meeting is a much better way of getting at how good the corporate governance is” (P-17).

CAEs also emphasized that professional skepticism is needed when assessing evidence. For example, as it relates to board self-evaluations, “on a one to five scale, are they giving themselves five on everything they do? And if there are no comments associated with that, then you’ve got to call that out” (P-22). Similarly, CAEs recommend considering the completeness of the supporting evidence. While the majority of CAEs believed that board meeting agendas, materials, and minutes could help assess the quality of board oversight, one CAE suggested that context is important for evaluating the completeness of this information: “Are there so many pre-meetings that, by the time you get to the governance committee, it is a rubber stamp job and all the tough issues have been resolved outside that governance meeting? There’s not the same transparency and the minutes [do not reflect] the same sort of credible challenge that may be happening outside of the [meeting]” (P-20).

### ***C.3. Step #3: Conduct interviews and surveys***

Recognizing that documentation alone does not reveal the full picture, CAEs recommend supplementing the publicly and privately available information with interviews or surveys. “The goal here would be not only to understand the governance practices, but trying to assess that tone, level of appreciation, and level of rigor that they [companies] put into it [their governance systems], because ...they could have a framework in place and they’ll probably say all the right things, but you just gotta get into the guts of that” (P-14). Another respondent described:

*We will do water cooler talks or even specific formal interviews with [employees] just to understand how they go about doing business, but [we will also ask], “Are you familiar with the corporate policies in place?” It’s amazing, what you get from doing those interviews because [employees], they’ll usually just flat out tell you. (P-22)*

While the prospect of sitting in on board meetings as a “fly on the wall” (P-11, P-29) is certainly appealing for gathering evidence, CAEs cautioned to consider whether “your being present changes the atmosphere and the dynamics of the conversation” (P-7). Instead, respondents noted that there are ways to elicit useful information about board-management interactions from interviews or surveys. For example, CAEs recommended interviewing members of the board, executive management, as well as other leaders in the organization. A CAE provided additional context for such an evaluation:

*I would ask them to define for me why they think the governance of the organization is effective or ineffective. What are the strengths and what are the weaknesses? ... What I would be looking for is whether there is a commonality between all these folks. Do they all speak the same language? ... Does management appear to be aligned with the board? Does the board appear to be aligned with management? (P-1)*

CAEs also suggest that the board and CEO be asked to define the culture they are trying to achieve, as well as the types of acceptable and unacceptable behaviors. “Then trickle down into the lower level management and look at [internal audit findings]. Do you see some of the ‘do as I say, but not as I do’ mentality?” (P-12). CAEs recommend asking board members to describe not only the types of challenges that the executive team brings to the board, but also how the executive team presented the information, how it was discussed, and whether it was resolved in a manner that satisfied the board. Finally, members of executive management could be asked to answer the same questions from their perspective, with particular emphasis on looking for whether the board and management are aligned.

Next, CAEs recommend facilitating ‘what-if’ scenario planning with the board and senior leadership. One CAE highlighted the following set of example questions:

*If you have a data breach, how is that going to be handled? How are they going to handle not only the customer relations [but also] public relations? How are they going to interface with any legal or regulatory authorities? What are they going to be able to reconstitute? What are they going to tell the public? (P-23)*

CAEs or other evaluators can then use their experience to interpret the response: “If you have experience, you can listen to answers and know—‘Whoa! Wait a minute. What did you just say?’—that sent shivers up my spine. That’s not a good answer” (P-3).

While interviews allow for follow up questions and can provide a variety of visual and audio cues, surveys are more effective at reaching a broader range of employees. If using surveys, CAEs felt that paying attention to specific wording is key to eliciting genuine responses. For example, a respondent described what a successful survey would incorporate:

*[It would] talk about more situational stuff and how they [various levels of management] would handle items that are reflected within the governance structure without basically saying “Do you think it’s important that employees abide by the code of conduct?” because what person is going to say “no” to that question? The answer is going to be “yes.” It’s going to be 100% of the time, “yes.” You need to ask a different question: “How would you handle a direct report of yours falsifying T&E [travel and expense] submissions?” ... You want to extract that person’s view on governance related issues and matters and see how they respond to it and then use that as an input into, “Well, is the organization aligning to it?” (P-6)*

#### **C.4. Step #4: Conclude on the effectiveness of corporate governance**

The final assessment of overall corporate governance requires the evaluator to look at several types of data together. Only a few respondents suggested a comprehensive process where information is aggregated into a “cauldron” (P-6), risk “dashboard” (P-26), or “color” scheme (P-14) to make a final assessment. Alternatively, most CAEs proposed a process that would separately evaluate a variety of aspects of corporate governance. The remainder of this section describes the various aspects of governance identified by CAEs, organized with a top-down risk-based approach, beginning with evaluating the board:

- How are board members selected?
- Are board members independent in fact and appearance?
- Are the total number and diversity of board members sufficient to oversee the company (diversity

in terms of skills, background, tenure, etc.)?

- Is there clear leadership of the board?
- Are board committee responsibilities clearly structured?
- Do board members receive accurate and timely information, and are they given sufficient time to absorb and formulate questions about that information before board meetings?
- What does board oversight look like? How do management and the board interact? Is the board “rubber stamping” management’s plans or asking “tough” questions?
- What is the “tone at the top” and how far into the organization does it permeate?

The underlying concern here, collectively, is whether the board-management relationship is “overly familiar” (P-11). The board should be comprised of the appropriate number and types of board members to allow appropriate oversight and credible challenges of management. While there is no singular set of committee or management structures that is perfect for all companies, CAEs suggested that evaluators consider whether these structures “enable discussions around areas of risk or areas that should be reviewed” (P-7). Other CAEs described:

*Something bad happens or something good happens. How does that make it through the chain? ... Why did this go wrong and how can we ensure that it won’t happen again here and, more importantly, how can we ensure that it isn’t happening someplace else in the organization? ... Something could be small financially but has huge reputation, regulatory, or strategic risks. Following through on incidents is a really good way to see how it [governance] works in practice.* (P-20)

*I’d also look at the credentials of the board members to understand: do they even have the wherewithal and the experience to be able to ask tough questions around some of these big issues that the company might need to be dealing with?... Is it the same topics [at every meeting] or are there new risks and new items being added to the agenda that match up with the enterprise risk assessments that are being done?”* (P-4)

CAEs also suggest considering whether management and the board are adding agenda items in a cursory requirement to fulfill listing exchange or SEC requirements, or whether there are genuinely robust discussions around each agenda item. As one CAE described:

*Governance actually takes place when there are lengthy, meaty discussions and there are opposing views—really challenging the direction of the company. Somebody has to be there playing devil’s advocate so they can really talk things through instead of having everybody kind of nodding their heads and being in agreement.* (P-22)

Another aspect that must be considered is whether the company has a succession plan for management and the board of directors. A CAE stated: “Every company will have a succession plan but a really good company doesn’t just have a succession plan with names on the org[anization] chart” (P-27). Instead, companies should have a plan that accounts for both planned and unplanned succession needs, at both the board and executive level. For example, one CAE suggested looking for evidence that the board has performed a “stress test” of succession planning (P-27) based on risk-and-response scenarios such as for death or disability. Therefore, another factor to consider is:

- Are there succession plans for key board and leadership team members?

Further, CAEs emphasized that compensation should help align employees with corporate objectives, but it should also encourage employees to be *ethical* in meeting those objectives. For example, instead of basing compensation solely off the number of produced goods, a company could also impose minimum requirements for work safety and health. The company should be saying: “We’re going to do it

ethically by having no violations. If any of these [work safety and health] buckets don't meet their target metrics, everybody's bonus is going to be impacted" (P-8). As such, additional characteristics to evaluate include:

- How aggressive is the company's strategy, and is it aligned with shareholder or industry expectations?
- Does compensation (at all levels) align with the company's strategy *and* the company's code of conduct?

Next, a respondent provided the following description of the importance of assessing risks based on proper information:

*First, I'd look to see whether policies are all written down and all make sense, whether there was proper organization on the board and executive management, and whether there are processes for information to flow to the appropriate decision maker. The second thing I would look for is the quality of their enterprise risk activities, internal audit, and compliance functions. Because those are the ways that you identify, assess, and establish a feedback loop that allows the board to fulfill its fiduciary duty to safeguard shareholders and investors. Are they set up to get the right information? Is there evidence that would confirm that that information is high quality, it's delivered in a timely way, and that a process exists for them [management and the board] to identify, assess, and mitigate risk properly? ... What's important is not that all risks are mitigated, but that risk appetites are set in a very disciplined way. (P-23)*

Given the importance of risk assessment and management in corporate governance, CAEs suggested that evaluators can consider the following factors:

- Is the company effective at identifying and managing risk?
- Is there adequate time and funding assigned to compliance, culture/ethics, internal audit, and risk management? Are the leaders of these areas appropriately qualified and given appropriate access to the board?

Companies need collaboration across the management team to identify and manage risk because no single group is going to have "the overall picture and visibility on all the issues that come up within a corporation" (P-22). This respondent indicated that having the CRO, CAE, CCO, Chief Ethics Officer, and Chief Information Security Officer team all collaborating is important because "that's when you start seeing the bigger picture and you see all of it instead of just a certain piece" (P-22). Another CAE further elaborated that good governance is the responsibility of all employees, not just management or the board:

*Everybody thinks of corporate governance as this sort of esoteric, out there, "Oh that's the board, the board deals with that and maybe senior management or executive management deals with it, but it doesn't really impact me as an employee." I just feel people are dead wrong if that's the way they're thinking about it because all of these things, like truly having a transparent ethics hotline process means that ... an operator of some part of our plant has as much responsibility and opportunity to let the organization know what they're seeing. (P-26)*

Therefore, CAEs emphasized consideration of the following questions:

- Are management reporting structures clearly defined and effective at getting the right information to the right people?
- How does the company communicate with employees? How do they ensure policies and procedures are disseminated, read, and followed?
- Does the company have people that are adequately trained and in possession of the necessary skill sets?

- Are employees at all levels held accountable to their goals and objectives?
- Are employees empowered to report violations of the code of conduct, code of ethics, or policies and procedures?

Finally, the evaluator should determine whether the company is both looking at current issues *and* planning for future needs. For example, a couple of CAEs described:

*Do they [the company] have something like a compliance and operational risk forum where senior managers are being brought together and told, “This is what’s coming down the line. How are we getting ready to address this?” whether it be a change in a regulation or a change in business process. Is there a new product that we’re offering, a new line of business we’re getting into, a new market we’re getting into? Is there a forum to discuss [the future] and to address those risks and implement controls on the front end of that process? (P-28)*

*If they [the company] are set up to succeed at this moment in time, the only guarantee [in corporate governance] is, as time goes forward, they’re going to need to make adjustments. Do they have feedback loops that allow them to consider how their situation is evolving and provide for those changes? (P-23)*

Based on these descriptions, a final factor derived from our interviews with CAEs is as follows:

- Is the company anticipating future needs and proactively assessing risk in anticipation of inevitable changes?

### **C.5. Risks with over-quantifying corporate governance**

Given the inherent difficulty in defining corporate governance as well as the subjective nature of a corporate governance evaluation, CAEs emphasized the need to be cautious when attempting to quantify all aspects of the evaluation. One CAE provided the following interesting insight:

*It is very hard to measure doing “good,” except for the absence of failures. It’s a touchy-feely, intangible type of audit or evaluation. ... So you’re almost giving negative assurance on governance. We weren’t able to find these failures, therefore we’re giving you some negative assurance that you’re doing well ... Ask the chief of police how many crimes he prevented last week because he has a police force out on the streets. He can’t tell you. However, he can tell you, “We increased our patrols in this area and crime went down.” Okay, but how many did you prevent? How many were you preventing in that area to begin with, and how many more did you prevent? “Well, I don’t know. I can tell you how much it went down.” So, it’s negative assurance. (P-28)*

Thus, it is perhaps not surprising that if asked how to quantify or track corporate governance over time, most CAEs responded with “red flags” and suggested that evaluators might conclude that corporate governance is “bad” if they see unusual or unexpected trends in:

- Ethics or culture surveys
- Number and severity of internal audit or external audit findings
- Number and severity of regulator investigations or lawsuits
- Number and severity of whistleblower hotline calls, employee complaints, or workplace safety issues
- Speed and thoroughness in resolving reported issues (from sources above)
- Employee turnover

Ethics or culture surveys are often based on a core set of questions that can be tracked over time or, if partnering with an external firm, they can also be tracked against peer companies. Certain red flags

are inevitable, such as whistleblower hotline calls and employee complaints, and so the severity of issues and resolution process may be the truer measure of corporate governance. One respondent indicated: “To error is human. Things go wrong. In a governance process, hopefully you catch things early enough so they’re small and resolved appropriately and promptly” (P-20). Another CAE reiterated this point: “If you have no activity [on the whistleblower hotline] that’s a telltale sign to me. That means people don’t use it, which is ... I’m very wary when people don’t use [it]. There’s always something [to report]” (P-11).

In addition to looking at the total number of reportable events, CAEs recommended looking at the *source* of reportable events and whether there is adequate staffing and funding to remediate issues. As one respondent explained, ideally, the source of identification is “an upside down triangle” (P-20):

*So the most items and greatest severity are identified by the first line [of defense] ... which is fewer to be identified by the second line, fewer still by the third. The external auditors, regulators don’t have much left.... One of the things that my audit committee chairs and I have looked at in the past is that shift from, external identification and third line of defense identification and seeing that number proportionally go down compared to what is done by the first line and second line respectively. (P-20)*

While quantifiable measures can be helpful for tracking trends in “negative” events that may reveal “bad” corporate governance practices over time, many CAEs cautioned against over-reliance on things that can be objectively quantified. By the time quantifiable “red flags” are found, it is too late: “I think you want to proactively assess [corporate governance] to determine if you have that kind of risk before the SEC comes knocking” (P-7).

Interestingly, CAEs did *not* think that operating performance was a clear indicator of corporate governance quality because “some companies can be very profitable and maybe they’re not always ethical or always doing the right thing. Maybe they don’t even have great corporate governance. Maybe they’re just in a field that makes money” (P-9). A respondent further indicated:

*Your stockholders want you to increase the dividends. Well, if we cut some corners and step outside of our policies, procedures, and regulations, we could probably make more profit. So the stockholders are measuring, “Hey we’ve got a larger dividend,” [but] that doesn’t measure good corporate governance. (P-28)*

## **C.6. Conclusion**

In summary, this appendix was prepared according to respondents’ descriptions of a peer review corporate governance evaluation with unlimited resources. While respondents were not able to attest to the success of this comprehensive approach to evaluating corporate governance—because they were either not leveraging these processes in their companies or applying only parts of these processes, as described in our main paper—the CAEs’ rich backgrounds and lengthy professional experience suggest that they are in a good position to help develop guidance and recommendations. These recommendations and cautionary notes should be helpful to companies, professional organizations, and regulators considering the implementation of a broader, comprehensive corporate governance evaluation process.