UNIVERSITY OF TOLEDO INTERNAL AUDIT DEPARTMENT
MANAGE RELATIONS WITH BOARD OF DIRECTORS

Control practices

The following control objectives provide a basis for strengthening your control environment for the process of managing relations with board of directors. When you select an objective, you will access a list of the associated business risks and control practices. That information can serve as a checklist when you begin reviewing the strength of your current process controls.

This business risk and control information can help you assess your internal control environment and assist with the design and implementation of internal controls. Please note that this information is at the generic business process level and many companies will need to go beyond generic models to address the specific business processes that support the financial and nonfinancial disclosures being made. You can combine the insight of this business risk and control information with your industry-specific knowledge and understanding of your company's environment when conducting internal control assessments and designing and implementing recommendations.

Effectiveness and efficiency of operations

A. The non-management members of the board of directors or audit committee are independent from management, possess sufficient knowledge and experience, and ask the necessary questions.
B. Board or audit committee members receive sufficient and timely information to allow input to and oversight of management's objectives and strategies, forecasting and budgeting, financial reporting, and terms of significant agreements.
C. Directors meet frequently with executive management, chief financial and accounting officers, internal auditors, and external auditors.
D. The board of directors or audit committee receives sufficient and timely notification about sensitive information, investigations, or improper acts affecting the company. (Examples include significant litigation, investigations by regulatory agencies, misappropriation of corporate assets, violations of insider trading rules, political payments, or other illegal payment.)
E. The board of directors or audit committee plays a significant role in establishing the appropriate "tone at the top."
F. Board oversight plays an appropriate role in appointing and terminating executive officers and the head of internal audit, in determining their compensation, and in reviewing their performance.

Effectiveness and efficiency of operations

A. The non-management members of the board of directors or audit committee are independent from management, possess sufficient knowledge and experience, and ask the necessary questions.

Business risks

- The board of directors will be made up of or dominated by management.

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1. Ensure non-executive directors on the board have sufficient independence, knowledge, experience, and qualifications to command credibility with investors, outside commentators, and other external parties.
2. Ensure non-executive directors can devote sufficient time to fulfilling their responsibilities.
3. Ensure a majority of the board of directors is independent of management in substance as well as form.
4. Ensure the majority of the board of directors is free of any business or other relationships that could interfere with the exercise of independent judgment apart from fees and shareholdings.
5. Set a fee structure for directors that reasonably reflect the time they commit to the company.
6. Prohibit non-executive directors from participating in stock option programs.
7. Provide newly appointed directors with a schedule of matters that should be specifically reserved for decision by the full board of directors and keep the schedule current and up-to-date.
8. Require board approval of the criteria for determining the significance or materiality of any transaction.
9. Require the board to agree on the process for making decisions on an exception basis between board meetings so that it will not be put into a position of "rubber stamping" decisions of management.
10. Ensure the board periodically reviews management's forecasts and budgets and requests explanations of historical trends and results.
11. Require the board to meet frequently enough to minimize the number of "board of directors-level decisions" between board meetings.
12. Ensure directors receive minutes of the meetings.
13. Require the board to periodically review the adequacy and reliability of information provided to it and to provide feedback to management.
14. Ensure the chairman is sufficiently distanced from the day-to-day running of the business so that the board of directors as a whole, rather than the chairman as an individual, provides sufficient oversight of company affairs.
15. Appoint a sufficient number of experienced outside directors to the board to develop and assert a strong independent view on the issues.
16. Appoint non-executive directors for specified terms and don't guarantee automatic reappointment.
17. Assign a nomination committee to conduct the selection process and make proposals to the board of directors.
18. Ensure candidates approved by the board are submitted for shareholder approval.

B. Board or audit committee members receive sufficient and timely information to allow input to and oversight of management's objectives and strategies, forecasting and budgeting, financial reporting, and terms of significant agreements.

Business risks

- Board or audit committee members will be unprepared for scheduled meetings.
- Board or audit committee members will not receive information sufficiently focused on their needs.

Control practices

1. Ensure the board regularly receives key information such as forecasts and budgets, financial statements, competitive intelligence, major marketing initiatives, new product development, new product or service lines, significant contracts or status of current negotiations, proposed financings and acquisitions, and management's thinking on strategic direction.
2. Establish a process for directors to seek independent professional advice in discharging their duties, if necessary, at the company's expense.
3. Ensure directors always have free access to the company's advisors.

C. Directors meet frequently with executive management, chief financial and accounting officers, internal auditors, and external auditors.

Business risks

- The board of directors will meet irregularly or infrequently and act only on matters brought to its attention by management.
- The audit committee will not function effectively because of insufficient time.

Control practices

1. Require the board of directors to establish an audit committee of at least three non-executive directors.
2. Develop a written charter that clearly outlines the audit committee's authority, duties, and responsibilities.
3. Assign the audit committee with the key task of examining management plans for engaging external auditors, reviewing their independence and performance, and approving selection and retention of auditors.
4. Engage the audit committee to review and approve the internal auditors' charter and mission, qualifications, plans, and reports of findings.
5. Engage the audit committee to monitor management's response and action plans resulting from the recommendations of internal and external auditors.
6. Require the audit committee to report regularly to the board of directors.
7. Require the audit committee to meet periodically with the CFO and internal and external auditors to discuss the effectiveness of the financial reporting processes, internal control systems, significant comments and recommendations, and management's performance.
8. Ensure the audit committee reviews the scope of activities of the internal and external auditors each year, focusing on risks deserving specific attention, EDP and other controls, and locations visited.
9. Ensure the audit committee reviews audit results, paying special attention to significant issues and their resolution, scope limitations, and client cooperation.

D. The board of directors or audit committee receives sufficient and timely notification about sensitive information, investigations, or improper acts affecting the company. (Examples include significant litigation, investigations by regulatory agencies, misappropriation of corporate assets, violations of insider trading rules, political payments, or other illegal payment.)

Business risks

- The board will be deprived of the opportunity to perform its oversight role because information will be withheld.

Control practices

1. Establish a process to inform the board about significant issues.
2. Communicate sensitive and significant information to the board on a timely basis.

E. The board of directors or audit committee plays a significant role in establishing the appropriate "tone at the top."

Business risks

- Management will not be accountable for establishing an appropriate control environment.

Control practices

1. Require the board of directors or audit committee to monitor management's support of the structure for control within the business.
2. Ensure the board of directors periodically evaluates how management monitors and enforces the code of conduct.
3. Require the board of directors to issue directives to management identifying specific actions to be taken as a result of the board's evaluations and findings.
4. Ensure the board of directors follows up on its directives and management's response as appropriate.

F. Board oversight plays an appropriate role in appointing and terminating executive officers and the head of internal audit, in determining their compensation, and in reviewing their performance.

Business risks

- Compensation practices will not be competitive or will be excessive.
- Compensation will not be fair and equitable.

Control practices

1. Require the compensation committee of the board to approve all performance-based management incentive plans.
2. Ensure the compensation committee includes a sufficient number of directors with access to adequate supporting resources to fulfill the committee's responsibilities.
3. Ensure the compensation committee evaluates compensation and retention issues regarding the internal audit function.