TOWARDS MORE IT GOVERNANCE TRANSPARENCY

The current white paper reports on one of the investigations being done in the co-created research project concerning the role of the board in enterprise governance of IT, specifically on how non-executive boards are reporting on their accountability towards IT in their yearly report.

It appears that, notwithstanding the pervasive role of IT, the disclosure on IT governance is still limited and rather focused on reactive elements, for example when IT related risk events happened. During the research more reporting was observed in high IT intense sectors as well as in public listed companies, the latter probably to be explained by the fact that investors might be willing to invest more in organizations that have their digitized assets under control.

We believe that as the dependency on IT will continue to grow within all industries, IT governance disclosure might well become a critical piece of the non-financial information on most annual reports. As such, boards will become increasingly incentivized to disclose on the matter, with them increasing their own expectations towards executive management. Our research will supply examples from the field for boards and executive management to set up and operate an adequate disclosure strategy.

WHY GOVERNING BOARDS SHOULD REPORT ON IT GOVERNANCE

In their 2014 empirical study, Turel and Bart (2014) concluded that “High levels of board-level IT governance, regardless of existing IT needs, increased organizational performance”, clearly demonstrating the importance of board taking up their accountability around IT. They concluded that boards should not shy away from governing and controlling the IT assets for their organizations to approach IT more strategically, identify overlooked opportunities, and ultimately achieve superior performance in the digitized economy.

Next to such empirical findings, also more theoretical research in IT governance has clearly advocated the importance of IT governance communications to external stakeholders of the firm (Gordon, et al., 2006; Raghupathi, 2007). This theoretical underpinning, rooted in voluntary disclosure theory and agency theory predicts that firms can improve their liquidity and firm valuation through better information intermediation, enhance market reputation, reduce litigation costs, and the cost of capital (Healy & Palepu, 2001).

Notwithstanding both the empirically and theoretically demonstrated importance of IT Governance disclosure, other studies point out that on average the involvement of boards in enterprise governance of IT is low and that boards should become more IT savvy to be able to govern the digitized organization. Andriole published an article in this context in 2009 and titled his work “The Surprising State of Practice”, which reported on the “surprising” low maturity of boards in this area. Valentine concluded that less than 20 percent of corporate boards worldwide report having enterprise technology capable directors. (Valentine, 2015).

In conclusion, boards need to extend their governance accountability, from a mono-focus on finance and legal as proxy to corporate governance, to include technology and provide digital leadership and organizational capabilities to ensure that the enterprise’s IT sustains and extends the enterprise’s strategies and objectives. To better understand this challenge, this research aims to provide an insight on how current non-executive boards are reporting on the IT assets in their yearly report. In doing so, we were able to offer a first benchmark for other companies, together with concrete, potential reporting strategies, drawn directly from the field.

RESEARCH ON IT GOVERNANCE DISCLOSURE IN BELGIUM

In order to gain insight in current IT governance disclosure practices, we analyzed the publicly available annual reports of 12 Belgian companies. We expected the non-financial information on these reports to contain information on IT governance practices as part of the overall corporate governance measures. The framework used to determine the rate and content of the IT governance disclosure is the one recently proposed in academic literature by Joshi et al (2013). This disclosure framework proposed that non-executive boards can report on four areas of concern, more specifically IT Strategic Alignment, IT Value Delivery, IT Risk Management and IT Performance Management.

As the IT governance disclosure rate will unavoidably vary among the companies selected, we clustered the companies (see Figure 1) to deduct whether organization within transform industries, where IT profoundly alters traditional ways of doing business by redefining business processes and relationships, disclose more on IT governance as opposed to organization in non-transform industries.1 Secondly, we observed whether those that are publicly listed disclose more than those that are not, because they are incentivized to do so by the market. While testing both propositions, we captured examples of language and narratives that could be considered as a good practice of IT governance disclosure.

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1 Firms in the transform category presents very dynamic industries whose business processes and product/service offerings are highly digitizable are likely to engage in seemingly continuous streams of IT deployments. (Anderson, Blanker, & Ravindran, 2006; Zmud, Shaft, Zheng, & Croes, 2016).
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We are aware that the proposed solution is only a first contribution to the knowledge base, as it only identifies disclosed information, and is based on a relatively small sample size. In order to come to a real benchmark for organizations and allow for a comprehensive IT governance framework that ties in with existing corporate governance code, further in-depth research will be needed.

**HOW ARE BELGIAN BOARDS REPORTING ON IT GOVERNANCE?**

With regard to the rate and content of IT governance disclosure, we were interested to know which topics make it into the annual reports and which don’t. To have a canvas to score the reports against, we used the previously mentioned IT governance disclosure framework. This framework identified four domains on which can be reported in the annual statement: IT strategic alignment, IT value delivery, IT risk management and IT performance measurement. In each of these domains, expected reporting item were derived from literature. For example, in the domain of IT risk management, items on eg. the “information security plan and policy” were expected, in IT Performance management explicit information in eg. IT expenditure was captured, for IT value management elements on eg. IT project updates were sought and for IT strategic alignment information was searched regarding eg. the position of the CIO and existence of an IT steering committee. We looked at reporting rates, hence these results are by no means an indication of what really was present in the organization, only what was reported upon. In what follows we will explain the main observations from the research.

In general, we observed a low average reporting rate on IT governance. Firms report most in the domains of ‘IT risk management’ and their ‘IT performance measurement’ (see Figure 2). Surprisingly, ‘IT strategic alignment’ is the least disclosed category among the organizations in the sample. Overall, these results indicate that there is room for improvement in overall IT governance transparency in annual reports. Academic literature clearly suggests potential benefits of disclosure on non-financial aspects in general and IT-governance related aspects in specific, providing firms with a clear incentive to consider increasing their IT governance disclosure.
‘IT strategic alignment’ deals with the fact that IT investments need to support the strategic goals and objectives of an organization in order to enable the creation of current and future business value. For IT strategic alignment topics, we observed an 8% average reporting rate. In one out of three cases there was a CIO or equivalent position in the firm, in 8% this position is on the executive board. In one out of four cases, we observed that IT risk is addressed at the audit or risk committee. If an IT committee was present, it was always established at the executive level.

This surprisingly low result on IT strategic alignment disclosure is supported by Nolan & McFarlan (2005) who stated that boards are often not aware of the importance of IT when it comes to supporting corporate objectives and the need for alignment between the overall corporate strategy and the IT strategy.

“The ICT Board is the risk committee on IT matters. It comprises managing directors, two members of the Executive Board and the Chief Information Officer of Delta Lloyd Group.” – Delta Lloyd

‘IT value delivery’ is concerned with the optimization of IT-enabled value creation, where value is broader than strictly monetary (e.g. competitive advantage, higher employee productivity, etc.). These topics received attention in 24% of the reports. In half of the observed cases, IT was explicitly projected as a strength for the enterprise in achieving business objectives. In 42% of cases, the report stipulated that IT still is an opportunity for the enterprise, which might be an underestimation in this digital era.

“The new strategy is in line with ING’s vision that technology and innovation play a crucial role in the future of ING Bank.” - ING

With regard to IT projects, 33% of the reports gave an update on the status of projects (with 25% in a dedicated section). Green IT and IT sourcing decisions received attention in only 17% of cases, of which the latter can be explained because of a reluctance to disclose outsourcing to stakeholders. Absent from the equation are any suggestions made by the board on IT or any kind of framework by which IT is operating such as ITIL, COBIT or an ISO standard. This could indicate that the board is not shaping how value is delivered through IT, even though certainly at an operational level the best practices are set out by a variety of frameworks.
IT RISK MANAGEMENT

‘IT risk management’ is concerned with the protection of IT assets and recovery from IT-related disasters. From the four categories, IT risk management scores the best at an average 35%. IT is established as part of the operational risk in 58% of cases, although only 25% mentions a special IT risk management program. An information security plan is present in 67% of cases, but the business continuity aspects are only mentioned in one out of four reports. With regard to auditing, IT is covered in 25% of cases. Towards general regulation and compliance, IT is used in only 17% of cases.

“There seems to be an underestimation of the business risk an IT incident might imply in terms of business continuity or compliance. As IT brings similar risks to all enterprises and might seriously impact the value of the firm, the overall rating of 35% on the IT risk management domain can be considered as too low. We know investors are concerned with IT security and as such this will influence their decision-making.” – Saint-Gobain

IT PERFORMANCE MEASUREMENT

‘IT performance measurement’ is related to the IT budget and IT investments. It is specifically concerned with the expenditure on IT resources and its association to business value. The average disclosure rate of 32% is mainly due to the fact IT related assets are mentioned under intangible assets in 83% of cases, as imposed by IAS for listed companies.

“Both purchased and internally-developed software are recognized as other intangible assets, but the latter only qualifies if it is identifiable that Delta Lloyd Group has the power to exercise control over the software and if the software will generate positive future cash flows.” – Delta Lloyd

There is also explicit information on IT expenditure in 67% of cases. Research by the IT Governance Institute (2011) showed that increasing IT expenditure is a point of attention for IT management, as was confirmed by 38.7% of our respondents. Interestingly enough, the IT budget is never disclosed, nor is the direct cost on IT ever mentioned in currency or percentage.

“The security of online transactions is something to which Keytrade Bank pays a great deal of attention. It continues to invest in this aspect and seeks to offer its clients guaranteed security without compromising the efficiency of the transactions or the user-friendliness of the platform.” – Keytrade Bank

“Other key action points during the year included significantly increasing the number of systematic analyses of the Group’s potential information systems risks in order to assess the effectiveness of the internal control system, and rolling out to the shared service centers an internal control self-assessment method called ‘World Class Administration’.” – Saint-Gobain
ORGANIZATIONS IN TRANSFORM INDUSTRIES DISCLOSE MORE ON IT GOVERNANCE AS OPPOSED TO ORGANIZATIONS IN NON-TRANSFORM INDUSTRIES

As mentioned before, the role of IT within the industry (transform vs. non-tranform) could have an impact on the IT governance disclosure rate. By comparing tranform and non-tranform groups of companies while keeping their reporting context the same (all listed companies in Belgium), we were able to determine a difference in the overall disclosure rate. Tranform listed companies had an average reporting rate of 35% whereas non-tranform listed companies were at 14%.

These tranform companies mainly deal with digital information, leading to the fact that information intensity is greater in these sectors (Zhu, Kraemer & Dedrick, 2004). For these companies, IT was always projected as a strength in the annual reports, and an information security plan was always mentioned. In 75% of cases, IT was mentioned as a strategic business issue, but also explicitly mentioned for achieving business objectives. Both the opportunity and risk perspective of IT are therefore clearly addressed for transform companies.

LISTED COMPANIES DISCLOSE MORE IT GOVERNANCE INFORMATION AS OPPOSED TO NON-LISTED COMPANIES

With an overall disclosure rate of 35% to 26% (all transform industries Belgian companies), listed companies have an overall better disclosure rate than non-listed. Reasons can be found in prior research which states that disclosing non-financial information can improve a firm’s valuation on the stock market. This incentivizes companies to explicitly mention practices with a known valuation impact such as having a dedicated CIO (Chatterjee, Richardson, & Zmud, 2001) or investing in IT (when in a transform industry) (Dehning et al., 2003).

A CALL TO ACTION FOR GOVERNING BOARDS

When considering the potential valuation impact of IT and the relatively unexplored nature of IT governance at this corporate level, this type of research can be valuable to governing boards and executive committees to establish the right questions towards their direct reports. Chances are high that more practices are in place, but not reported on, which is a missed opportunity to convince stakeholders of the governance system. Formalized practices will enable boards and executive committees to take preventive action, as well as to detect deficiencies and take mitigating action, enabling them to show they are indeed in control of IT at a strategic level.

Our research on the annual reports of Belgian companies showed that IT governance disclosure is generally rather low, and might be indicative of the IT governance maturity at executive and/or non-executive level. As IT risks and IT opportunities are ever increasing and stakeholders rely on the non-financial information given to them to value the firm, boards and executive committees are incentivized to take up their IT governance role to be able to report on it.

A high degree of board involvement in IT governance has a positive effect on organizational performance (internal perspective) and the general principle of reporting non-financial information as well as certain IT governance practices are known to have a positive effect on the valuation of a firm (external perspective). We are convinced that further research will enable us to detect more good practices, provide benchmarking information to determine an ambition level suitable to the individual context of each firm, and establish a formal set of practices which can be implemented towards better organizational performance, and reported upon to satisfy stakeholder needs.
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REFERENCES


