

— at the — TONE TOP[®]

Providing senior management, boards of directors, and audit committees with concise information on governance-related topics.

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Diversity: An Accepted Business Value

Diversity, equity, and inclusion (DEI) have become pressing issues for organizations in recent years. The #MeToo and Black Lives Matter movements have spotlighted abuses and inequities that cascade across every aspect of American life and revealed long-standing failures to address them.

For directors seeking to promote DEI in their organizations, it's a good idea to start at the top.

"Diversifying the board is not only possible but also a business and moral imperative," according to the 2020 update of the National Association of Corporate Directors (NACD) Blue Ribbon Commission report on The Diverse Board. "Diversity of human capital is an accepted business value today."¹

Strong evidence exists that promoting diversity is a worthwhile effort because a diversified organization offers numerous business benefits. Studies have established that a wider talent pool brings additional skills, perspectives, and connections, as well as measurable performance improvements. For example, there is a 53% rise in return on equity for Fortune 500 companies with at least three female directors and a 19% boost in innovation at companies with above-average diversity in their leadership teams, according to Boston Consulting Group.²

Beyond data that makes a strong business case for DEI, boards that don't proactively diversify may find



themselves compelled to do so, because regulators, state governments, and other stakeholders are calling for greater corporate board diversity (see "External Expectations" on [page 3](#)). To get started, it's important to understand the current state of board diversity, follow a few key guidelines to improve diversity, and recognize that independent assurance on the effectiveness of those efforts is vital.

"Internal auditors, with their broad perspective on enterprise risk and their collaborative relationships with a wide variety of stakeholders, including boards and senior management, have a role to play in helping organizations assess their current approaches to D&I and consider a path forward," according to Deloitte.³

Mixed Progress

The good news is that the number of women being added to boards is rising. In the last 10 years, the percentage of new women directors at S&P 500 companies rose from 21% to 47%, according to the

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2020 U.S. Spencer Stuart Board Index⁴, and all S&P 500 companies have at least one woman on their board. Their overall representation on boards remained low, however. In 2020, 28% of S&P 500 directors were women, up two percentage points from the previous year. Their participation on Russell 3000 public company boards was lower, at about 23%, based on a study by advocacy organization 2020 Women on Boards.⁵ While this was a historic high, among Russell 3000 companies nationwide, only 5% had gender-balanced boards and one-third had one or no women on their boards. Part of the problem may be varying perceptions of why diversification has been so slow. As the chart on [page 4](#) shows, female directors are far more likely than male directors to identify a lack of commitment to diversity in the board or the CEO.

The percentage of new minority directors on boards was 22%, Spencer Stuart said, up 10 percentage points in a decade, but down from 23% in 2019. “Racial or ethnic, nationality, and age diversity improvements have been disappointing, with little progress to report anywhere in the world,” according to the Heidrick & Struggles Board Monitor US 2020.⁶

The Path to Enhanced Diversity

There are a few guidelines that boards can follow in their efforts to enhance diversity. Keep in mind that internal audit can impart value throughout the process as the sole source of independent assurance within the company by providing holistic and objective views of the effectiveness of board and organization DEI efforts.

Have a conversation. The NACD report lists discussion as the first step in any strategy of inclusion. In the annual board evaluation, including a question on whether the board meets the organization's expectations for diversity can open a conversation on what new skills and perspectives may be needed.

Don't overlook the risks. The business imperative of DEI will be clearer—and potential problems will be easier to avoid—if directors understand the consequences of doing too little or nothing at all. “A lack of diversity is an organizational risk as relevant as any other risk worth being recognized by an internal audit activity,” according to The Institute of Internal Auditors, and that's true at the board level as well as throughout the organization.⁷ Unlawful or unfair employment practices, shareholder lawsuits for failure to adhere to company DEI standards, and reputational risks are all risk areas for boards as well as organizations, and internal audit can support efforts to manage such risks. As Deloitte noted, for internal audit, “the approach to auditing D&I leverages many of the same audit practices as traditional assurance projects.”⁸

QUESTIONS FOR DIRECTORS

- » Is DEI a regular agenda item for the board?
- » What percentage of current board members fall within the organization's definition of diversity?
- » What percentage of committee chairs fall within the organization's definition of diversity?
- » Has the board considered how the current level of diversity benefits it?
- » Is the board missing strategic opportunities to leverage the perspectives and experience of all its members?



Carefully consider your definition of diversity. A mix of men and women who have similar values, experience, and knowledge may not specifically enhance the group's perspective, noted activist investment firm Barington Capital Group LP.⁹ To strengthen the ability to make "wise and informed decisions" will require "racial, ethnic, gender identity, sexual orientation, age, and experience diversity among the board to broaden the viewpoints, skills, and backgrounds of the individual board members," according to the NACD Blue Ribbon Commission. "This is the essence of board diversity."

Ask the right questions. Gathering key metrics and related recommendations is a critical part of the process. In addressing board diversity, for example, questions can include: What is the composition of the board and other leadership positions? Is there diversity among board committee chairs? Has the diversity of newly added board members increased in recent years? Are the policies on succession or term limits preventing efforts to bring in new voices? What steps has the board taken to find diverse new members, and how effective have they been? Internal audit can work with the board to determine the best questions to ask and gather the most useful metrics.

Measure effectiveness. This will include assessing how well DEI actions, goals, and strategies for the board or the entire organization align with its mission and values. If the organization chooses or is required to report DEI metrics, internal audit can verify the accuracy of any required or voluntary reports on the organization's diversity efforts.

Don't just check a box. In their efforts to enhance diversity, boards should consider the full range of what each board candidate has to offer. When she realized the board members who were interviewing her knew little about her expertise, a woman quoted in a *Harvard Business Review* article told them, "If you think my only value is that I'm a female, then I can't add value to your board."¹⁰ Boards may not pick the right new directors if they see them only as potential diversity statistics.

Don't add diversity then stifle it. Barington Capital Group called the homogeneity of boards a common corporate governance weakness, but directors who are demographically different from all other board members can't make a contribution if their insights or opinions are not heard. Because fresh viewpoints are one of the great benefits of diversity, boards should make a conscious effort to encourage candid and inclusive discussion. "Achieving board diversity but not actively leveraging these diverse perspectives will miss the benefits that a diverse board can bring to benefit the organization," according to the NACD report.

EXTERNAL EXPECTATIONS

When it comes to DEI, a number of regulators and stakeholders have set rules or expectations for organizations.

U.S. SECURITIES AND EXCHANGE COMMISSION

SEC rules require companies to disclose whether and how nominating committees consider diversity when identifying director nominees. If the nominating committee or board has a policy on identifying diverse nominees, it must disclose how it is implemented and how its effectiveness is assessed.

NASDAQ

Last December, Nasdaq filed a proposal with the SEC to require all companies listed on Nasdaq's U.S. exchange to disclose "consistent, transparent diversity statistics regarding their board of directors." Listed companies would also be required to have at least two diverse directors, including one who self-identifies as a female and one who self-identifies as either an underrepresented minority or LGBTQ+, or explain why they do not.

STATE LAWS

A 2018 California law required state-based, publicly held companies to have at least one female director by the end of 2019 and to increase the number of female directors by the end of 2021. A 2020 law required boards to add members of other underrepresented groups, including people who self-identify as Black, African-American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, Alaska Native, or as gay, lesbian, bisexual, or transgender.

A 2020 Washington law requires public companies to have gender-diverse boards by Jan. 1, 2022. A "gender-diverse" board is defined as one in which at least 25% of the directors self-identify as women.

A number of other states are considering or have passed legislation to encourage diversity in the boardroom, according to a Bloomberg article.

INSTITUTIONAL INVESTORS AND OTHERS

Proxy advisory services Institutional Shareholder Services and Glass Lewis have enhanced their recommendations for board diversity in the near term.

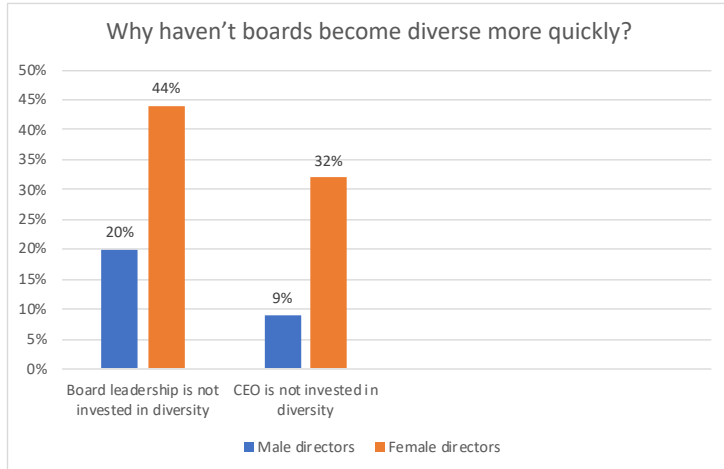
Separately, according to the Investor Stewardship Group's *Corporate Governance Principles for US Listed Companies*, "a well-composed board should also embody and encourage diversity, including diversity of thought and background." State Street Global Advisors and BlackRock are among those who have pressed for holding boards to account, a Russell Reynolds report said.

Goldman Sachs last year announced that it would require companies that the firm is taking public to have at least one diverse board member.

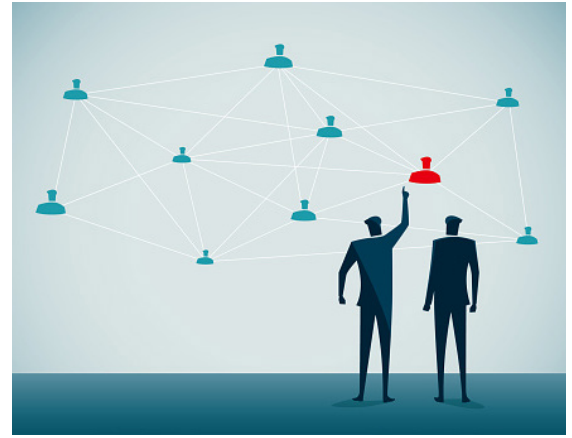


A Clear Choice

“Boards now have a choice: maintain the current course and risk being left behind, or restructure board composition and operate at peak performance,” according to the NACD report. By consulting with the C-suite, their chief audit executives, and others, boards can begin to make meaningful change in their own ranks and their organization’s DEI.



Source: PwC, [Annual Corporate Directors Survey](#), September 2020



Quick Poll Question

Does your board (or equivalent) have a defined DEI strategy?

- Yes
- No
- Not sure/Not applicable

Visit www.theiia.org/Tone to answer the question and learn how others are responding.

¹ “2020 Update of the Diverse Board: Moving from Interest to Action,” NACD Blue Ribbon Commission on Board Diversity, 2020

² “Embrace the Business Imperative of Diversity,” Boston Consulting Group, 2021

³ “Internal Audit’s Role in Driving Diversity, Inclusion,” August 3, 2020, Deloitte, The Wall Street Journal Risk & Compliance Journal

⁴ 2020 U.S. Spencer Stuart Board Index

⁵ 2020 Women on Boards Gender Diversity Index

⁶ Board Monitor US 2020, Heidrick & Struggles

⁷ Global Perspectives and Insights: Understanding the Effects of Diversity and Inclusion on Organizations, The Institute of Internal Auditors, 2020

⁸ “Internal Audit’s Role in Driving Diversity, Inclusion,” Deloitte, The Wall Street Journal Risk & Compliance Journal

⁹ “Maximizing the Benefits of Board Diversity: Lessons Learned From Activist Investing,” Jared Landaw, Barington Capital Group LP, July 14, 2020, Harvard Law School Forum on Corporate Governance

¹⁰ “When and Why Diversity Improves Your Board’s Performance,” March 27, 2019, Stephanie J. Creary et al., Harvard Business Review

QUICK POLL RESULTS

In what way is your board most likely to respond to information from management?



Source: Tone at the Top February 2021 survey.

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