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Building a better working world

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Board Matters Quarterly offers thought-provoking perspectives and insights into leadership and governance issues for boards and audit committees, supporting them to navigate the increasingly complex business environment.

COVID-19 exacerbates new and prescient risks that organizations have struggled to contain even before the pandemic. Read more to keep updated on the latest board issues and the strategies to navigate them.

Four megatrends for boards in charting a new course

Some long-term trends will fundamentally shape boardroom conversations on how businesses should operate in the future.

By Max Loh

Responding to the ramifications of the COVID-19 pandemic has dominated many management and boardroom discussions. While the management focuses on addressing how the business can recover and restart operations with the easing of restrictions, boards can steer their organizations toward more future-oriented thinking and planning in response to megatrends that have a long-term impact on the wider environment and business.

Megatrends provide a valuable basis for organizations to generate new planning scenarios, define a relevant purpose for the future and execute with urgency — with the goal of becoming a more resilient and transformative company. In particular, four megatrends will create the most impact across boards: decarbonization, the future of thinking, unbounded work and life, and the behavioral economy.

Decarbonization

Businesses are increasingly expected to step up to the plate in taking action on climate issues as dissatisfaction with government progress continues to grow across the world. Employees, customers and other stakeholders expect CEOs to lead the way in addressing growing global challenges, including climate change. Investors are moving up a gear when it comes to assessing the performance of companies using nonfinancial factors. According to the *2020 EY Climate Change and Sustainability Services fifth global institutional investor survey*, 73% say they will devote considerable time and attention to evaluating the physical risk implications of climate change when they make asset allocation and selection decisions.

> Megatrends provide a valuable basis for organizations to generate new planning scenarios, define a relevant purpose for the future and execute with urgency.

As new carbon-removal solutions emerge for decarbonizing business models, the board's role in demonstrating climate leadership will be imperative. Boards must work with the management to continue to champion climate-related considerations and ensure that they are factored into decision-making processes, including how exponential climate impacts may threaten supply chains and physical infrastructure.

To drive and measure progress, boards should consider if the management is incentivizing innovation in a way that contributes to a decarbonized business model, drive the development of performance metrics that promote sustainable opportunities, and request for more frequent and in-depth reporting on such metrics. This should not stop at the boardroom: when boards are transparent with stakeholders about what the metrics are, and regularly review and share progress on them, this will help to build trust with their stakeholders.

Future of thinking

As technology permeates virtually all domains of the workplace and gains the ability to supplement or substitute human cognition, organizations need to strike the right balance between adopting digital technologies that liberate staff for higher-value activities and preserving human-centricity.

Importantly, organizations need to ensure that the information and technologies they manage are trusted and protect against and mitigate cyber risks, including disinformation, phishing and malware. This responsibility should not lie solely with the IT function but rather, embedded into the enterprise risk management processes and company's risk culture. Together with the management, boards should closely and continually monitor the organization's approach and investment in the digital strategy and cybersecurity to ensure that they are agile, ethical and robust.

Technology is also profoundly changing how we think and behave as customers, employees and citizens. This means that human resources leaders will need new ways to motivate employees to function at their highest capacity and marketing functions will need

to rethink branding and advertising if consumers' purchasing decisions are dependent on technology. Investor relations must be vigilant against new forms of disinformation. This requires new skill sets that organizations must now strategically plan for to be future-ready.

Unbounded work and life

The boundaries that define work, leisure and learning are blurring more than ever as norms in working hours, leisure time, retirement and learning continue to evolve. For employers, this poses both opportunities and challenges that are intertwined. How do we best balance what makes for job satisfaction, productivity and a conducive work environment?

Traditionally, boards have tended to prioritize other issues over people: the *EY Global Board Risk Survey* conducted in late 2019 found that board directors ranked people issues as only the seventh-most important risk in the short term. With the shifting norms, boards need to elevate the people agenda and view people issues in the context of the broader organizational purpose.

Boards should work with the management to consider how to engage talent in the new, decentralized operating environment, and encourage the organization to conduct frequent pulse surveys and make corrections where necessary. They should also review the existing employer brand promise to employees to ensure it is fresh, relevant and actionable. With shifting workplace norms and a dispersed workforce, it is even more essential for boards to advocate a culture of inclusiveness to foster belonging within the organization.

Behavioral economy

Human behavior is becoming a commodity — quantified, standardized, packaged, and traded, as much as consumer data is today. Organizations will be increasingly using behavioral economics together with affective computing — also known as emotion AI — to measure, understand and shape consumer behavior.

Organizations must also stay attuned to what kind of consumer is emerging and what new customer segments are being created. The 2020 *EY Future Consumer Index* found that 62% of respondents are more likely to purchase from companies that are doing good for society. Organizations also need to demonstrate transparency, not secrecy or defensiveness. Those that do it well will have a huge competitive advantage.

To leverage this megatrend, bringing the voice of the customer into the boardroom is key. Boards should question critically how the organization is working to stay relevant to the customers of the future. The use of sophisticated customer-focused techniques, such as behavioral economics or affective computing, could be useful, as is bringing behavioral expertise or subject matter experts into boardrooms to better understand evolving consumer needs.

Taking a holistic perspective

By viewing their organizations through the lens of these megatrends, boards will be better placed to work with the management to take informed and decisive actions for long-term success. They should not consider the potential implications of each megatrend singularly but rather, interdependently, as they weave these considerations into the organization's strategic frameworks. Boards and management teams should also conduct scenario planning that encompasses these trends. If properly done, it provides an invaluable basis for them to better exploit the upsides and anticipate the downsides in a post-COVID-19 world where the rules of business are being rewritten. BMQ

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How boards can navigate the digital economy

Understanding how digital winds are transforming business domains will enable boards to lead the way in capitalizing on digital's potential.

By Cheang Wai Keat

Making sense of the digital economy and navigating its uncertainties and opportunities pose challenges for every leader. The task only gets harder as various technologies sweep into everyday business decisions.

Boards can steer their organizations to becoming successful enterprises in the fast-moving digital space by understanding how digital technologies could change the way business is conducted. The business domains that would be most impacted are strategy, workplace, operations, risk management, and customers. Armed with this understanding, the board can then work effectively with the management to identify where the organization is located on its digital journey, plot where it wants to get to, determine the execution road map, and drive support from stakeholders.

Realizing a strategy fit for the digital world

When a business creates a robust digital strategy, it can forge disruptive business models, spur innovation and create a competitive advantage. Yet, many firms are doing digital rather than being digital: they are using technology to fix stand-alone problems rather than as part of a holistic strategy. Rather than ask themselves what the best way is to invest in a digital strategy, companies should be asking instead: "Is our business strategy fit for a digital world?"

Fundamentally, digital companies think differently. They have a different mindset for approaching problems, such as seeking collaborations across the organization and with alliances and ecosystem relationships. They innovate like start-ups and know how to scale. They focus on customers, not products, and they think a lot more about experiences.

Implementing a digital strategy can be both time- and resource-intensive, but the consequences of inertia can be dire, just as how the first-mover advantage can be very rewarding. The board should work with the management to create and entrench a digital culture that supports and incentivizes innovation and encourages digitally savvy employees to speak up and be the voice of the customer. In short, companies that want to create a strategy fit for a digital world need to develop a mindset built around experiences, innovation, customer needs, data, and technology.

Reimagining the workplace and reinventing operations

The next few years will see digital transformation creating more disruptive shifts in the workplace, particularly in three areas: accelerating organizational change, empowering seamless virtual team collaboration, and unlocking workforce productivity. Similarly, operations will be reinvented as businesses of all types start to deploy digital tools and techniques to automate processes, leverage the Internet of Things and machine learning to increase quality and productivity, and capture insights that fuel process improvements and cost savings. Digital operations at scale create better returns for stakeholders through cost efficiencies and products that respond quickly to consumer demand. They also improve the workplace by shifting mundane tasks to robots and high-value assignments to human experts.

With the creation of the new digital workplace comes new responsibilities that will have to be accepted by business leaders and even by employees themselves. They will need to automate intelligently and report responsibly; in terms of responsibilities to employees, the board should work with the management to bring them along the journey and provide them with the skills to succeed and rethink career development.

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Redefining risk management

As digitalization accelerates, the focus on risk management should also shift toward looking at it as a way of identifying opportunities. Companies that fully understand their risk profile – seeing risk as both a threat and a prelude to growth – will be best-positioned to create value for their customers and stakeholders and help build trust. In this regard, blockchain, artificial intelligence and robotic process automation can be used as disruptive technologies that transform how risk is being managed in the business. That said, digitalization also introduces a raft of new threats in business strategy, operations, internal controls, compliance, and cybersecurity. To guard against these uncertainties, companies should build risk prevention into processes, tools and products at the start of their development, not after.

For boards and the management, the big takeaway about managing risk is that the most significant threat comes from ourselves. It is the risk of failing to act, of not responding to the disruption that is changing the nature of competition and competitive advantage. Leading risk functions are those that provide leadership with the confidence to take the steps needed to embrace change in a way that builds and maintains stakeholder trust. As companies learn to be smarter about the bets they place, they will continue to grow even as the world changes around them.

Understanding the customer

The next few years will be crucial if companies want to create impactful experiences that attract and delight customers. Companies need to be much more aggressive about deploying advanced technologies like AI and data analytics to improve customer experiences. Traditional organizational structures need to be redrawn from top to bottom with the customer at the center of the hub. Likewise, personalization and consumer privacy are emerging trends in the customer experience that cannot be overlooked. If your company still believes that the sales or marketing department "owns" the customer, you are set up for failure as the next decade approaches. In the digital enterprise, everyone owns the customer, and nobody owns the customer.

Making the transition to digital may seem daunting, but digital technologies are helping to enhance employee, customer and other stakeholder experiences for leading companies, while also increasing the bottom line for shareholders. To realize the benefits of a digital enterprise, boards must be confident that the management has a clear business strategy that is supported by a digital strategy and road map holistically addressing the opportunities in customer, workplace, operations and risk management.

Boards should consider the following questions:

- Does the organization foster a culture of innovation that empowers employees from all levels to feed on open innovation?
- How will you build a road map that balances the investments in digitalization between back-end operations and front-end experiences?
- Do you have the digital capabilities to drive your digital strategy and will you buy or build these capabilities?
- What is your capital strategy, including divestments and partners, to drive digitalization in the next two years?
- How are you evolving your board composition with the right expertise to enhance oversight of the opportunities and risks in digital transformation? BMQ

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Three ways boards can drive the sustainability agenda

Boards must steer organizations to take concerted action to create long-term value for stakeholders, beyond shareholders.

By Simon Yeo

Recent developments in climate change, social unrest, unequal wealth distribution and working conditions are changing stakeholders' expectations of the role of businesses. The COVID-19 pandemic has further exposed the vulnerabilities of businesses and societies in the face of a global threat and laid bare long-standing sustainability issues relating to health and safety, supply chains, equality, access to economic opportunities and health care.

Governments and consumers are becoming more aware of environmental, social and governance (ESG) issues and are taking the lead in holding businesses accountable for their impact on the environment and society. Likewise, investors are increasingly assessing companies' performance using ESG factors. In fact, 91% of investors said that nonfinancial performance has played a pivotal role in their investment decision-making over the past 12 months either "frequently" (43%) or "occasionally" (48%), according to the *2020 EY Climate Change and Sustainability Services fifth global institutional investor survey*.

Amid these changing sentiments, businesses need to shift their focus to stakeholder value, taking into account their employees, communities and the environment. Such a shift toward stakeholder capitalism will not be easy. Boards are in a unique position to lead and influence the sustainability agenda and translate it into incentives and strategies that empower the management's efforts to act. Boards can direct the management to drive impactful changes in three ways: review value chains for sustainability opportunities and risks, link executive remuneration with sustainability performance, and integrate sustainability into the long-term strategy.

Review value chains for sustainability opportunities and risks

Companies need to look beyond their internal operations when assessing sustainability risks and opportunities. Boards should call for the management to review value chains — from upstream to downstream — to understand material sustainability risks and opportunities. The management should also consider forming effective partnerships with stakeholders in the value chains to scale up its efforts to address the various sustainability risks or opportunities.

Technological advances, such as artificial intelligence (AI) and blockchain, have made such collaborations easier — companies can now connect more closely with suppliers, collect more granular data, and achieve greater transparency in their supply chains. An example is Unilever's partnership with Google to use satellite imagery, cloud computing and AI to support sustainable sourcing and create a deforestation-free supply chain by 2023.[1] The technology provides insights on the impact of the company's sourcing activities on the environment and local communities, which allows Unilever to take timely action, if necessary, to raise sustainable sourcing standards for its suppliers and bring it closer to its goal of ending deforestation and regenerating nature.

Link executive remuneration with sustainability performance

Among leading companies in sustainability, a growing trend is the inclusion of sustainability performance as part of the management's key performance indicators (KPIs). This measure is effective on two fronts. First, it helps to incentivize the achievement of sustainability goals. Second, it sends an unequivocal message of the organization's commitment to sustainability, which in turn helps to instill a sense of purpose in employees.

For example, Singaporean real estate company City Developments Limited — whose ESG goals are mapped out in its Future Value 2030 sustainability blueprint — links ESG performance to the appraisal and remuneration of its heads of department and line managers.[2]

Setting KPIs to drive behavior is a compelling move in an organization's bid to future-proof its existence. It is worthwhile for boards to explore how linking sustainability performance with the management's appraisal and remuneration could be a viable option to drive greater accountability for the organization's sustainable goals and practices.

1 "Unilever and Google Cloud Team up to Reimagine the Future of Sustainable Sourcing," *Google Cloud website*, https://cloud.google.com/press-releases/2020/0922/unilever-to-reimagine-future-of-sustainable-sourcing, accessed 2 December 2020.

2 "Integrated Sustainability Report 2020: Changing the Climate. Changing the Future.," *City Developments Limited*, 2020, ©2020 City Developments Limited.

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Integrate sustainability into long-term strategy

Organizations making the shift toward sustainability may gain access to a wealth of opportunities, which could be in the form of new business opportunities, products or services. *New Nature Economy Report II: The Future Of Nature And Business* by the World Economic Forum published in July 2020 sets out how a blueprint of action for nature-positive transitions could generate up to US$10.1 trillion in annual business value and create 395 million jobs by 2030.[3] These opportunities to generate value could be found in building transparent and sustainable supply chains, developing nature-positive built environment designs, and creating circular and resource-efficient models, among others.

Boards should therefore mandate that the management embeds sustainability risks and opportunities into its long-term corporate strategy. This could unlock the potential for the company to increase innovation, anticipate and stay ahead of policy changes, and improve operational efficiency and resources management.

Ultimately, genuine transformation to create stakeholder value through a strengthened sustainability agenda should be entrenched across the organization, from governance, strategy and risk management to targets and incentives. The board's stewardship in driving this challenging transformation is imperative to making it a success.

The board should consider the following questions:

- How does the company develop a clear understanding of its stakeholders and their key concerns on ESG issues?
- How is the understanding of key stakeholders' ESG concerns reflected in the company's purpose and business model?
- Has the company assessed how various ESG trends will impact the business in the form of new opportunities and risks?
- Has the company established robust measurement and reporting systems to track the progress of its ESG performance?
- Do current performance incentives consider the company's ESG performance? BMQ

3 "New Nature Economy Report II: The Future Of Nature And Business," *World Economic Forum website*, www.weforum.org/reports/new-nature-economy-report-ii-the-future-of-nature-and-business, accessed 26 November 2020.

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How audit committees can enhance risk oversight

As risks evolve rapidly during the COVID-19 crisis, agile risk management and a risk management mindset for the new normal are crucial.

By Christopher Wong

The COVID-19 pandemic has made the risk landscape much more volatile. Its unprecedented impact has highlighted the interconnectedness of risks and the velocity at which the risk landscape can evolve. Long-standing risks have intensified, while new ones have emerged. How can audit committees stay ahead of emerging trends and ensure that risks are managed effectively across the organization? Taking a robust approach that nimbly identifies and manages emerging risks, together with a shift toward a risk management mindset for a post-COVID-19 world, will be imperative.

Robust approach to risk management

Even before the onset of the COVID-19 crisis, businesses were failing to pay enough attention to emerging and existential threats, according to the *EY Global Board Risk Survey* conducted before the pandemic. The survey found that businesses were not equipped to adequately understand, detect and mitigate certain types of risk. Just 40% of boards surveyed said their enterprise risk management (ERM) program was effective in managing atypical and emerging risks, while only 21% said their organization was very prepared to respond to an adverse risk event.

With a heightened risk landscape since the COVID-19 pandemic, audit committees need to assess whether their organization's ERM program and risk assessments are being updated in a timely manner to respond to changes in the internal and external operating environments. The organization should have access to reliable sources of data, tools and talent to identify risks agilely, monitor macroeconomic changes closely, and evaluate legislative and regulatory developments for potential impacts on reporting and disclosure.

Yet, identifying emerging risks is only the first step. A key consideration would be to determine how identified risks — including those related to the pandemic and recovery — and external data are incorporated into business decisions, scenario planning, stress testing, and prospective financial information and models. Audit committees should review updates to scenario plans, stress testing and contingency planning on a regular basis, and assess whether an appropriate range of extreme — and even improbable — scenarios are being evaluated.

Due to the COVID-19 pandemic, audit plans may have been adjusted to address changes in the risk profile, risk appetite and tolerances identified by the company's ERM program. The internal audit's risk coverage may also have been reduced due to travel restrictions. The audit committee should consider whether the frequency and validation process of key controls have materially changed and the impact on the effectiveness of the overall control environment.

To ensure effective risk oversight, audit committees will have to pay close attention to the company's cash flow, sustainability of the business model given current conditions, as well as cyber resilience.

Shift in risk management mindset

The risk landscape's realities exposed by the COVID-19 pandemic mean that audit committees — and boards in general — need to pivot their approach to risk management in the new normal.

First, it is important to get comfortable with discussing risk more frequently and risk should be a mandatory agenda item at every audit committee and board meeting. Audit committees must spend sufficient time working with the management to understand where risks may materialize within the business. These meetings also provide the opportunity to scrutinize the management on the effectiveness of risk fundamentals, such as the adequacy of business continuity plans. The management must not only have these fundamentals in place, but also a plan to test and review them regularly.

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Second, audit committees should be keenly aware of the velocity of risk developments and concentration risk. The COVID-19 crisis has highlighted that risks are interconnected and can materialize at speed. Businesses that are resilient in weathering COVID-19 are not exposed to concentration risk: they are neither reliant on a single-source supplier nor dependent on a single customer, product or business unit to drive profitability and growth. Besides a pandemic, geopolitical tension, climate change and international conflicts can all cause severe interruptions. It is therefore critical to challenge the management on how concentration risk is managed, both within supply chains and across the entire business.

Third, audit committees can no longer think about risk purely in terms of shareholder value. Directors must consider their role in mitigating risks to diverse stakeholders, including employees, customers, suppliers and the wider society. These stakeholders demand greater responsibility from organizations and expect them to create long-term value. Audit committees, and boards in general, should put long-term value front and center in their discussions, or risk capital and talent shifting toward businesses that do.

Engaging with the management more frequently and building a relationship of trust will help the audit committee to drive keener oversight on the risks faced by the organization now and in the future.

Audit committees should consider the following questions:

- Has the organization tested its updated business continuity plans and incorporated recent learnings from peers and postmortems?
- Is the board getting and applying the insights from external experts to understand how global megatrends may create business risks and opportunities for the organization?
- How is the organization using data and analytics to drive insights that support its risk management approach and processes?
- Is the audit committee devoting enough time to discuss risk and institutionalizing such a practice for the long term?
- How is the management assessing and managing risk aggregation and interdependence across the company's entire value chain — including resiliency of its supply chains and other third parties on which the organization relies? BMQ

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How boards can drive business integrity

While businesses understand that integrity is crucial for success, ethical lapses persist, and boards play a key role in reducing this gap.

By Stacy Chai

Successful organizations count on their reputation for respecting laws, keeping promises and acting ethically to maintain stakeholders' trust. A misalignment between business practices and the expectations of an ever-growing list of stakeholders can lead to a trust crisis.

While boards and business leaders generally understand that ethics lies at the core of corporate governance practices, organizational failures show that ethical lapses and shortcuts persist. Over the last five years, at least 33 public companies in Singapore have had major corporate governance or accounting lapses. The cost of getting it wrong has a devastating impact on shareholder value and the personal reputation of directors involved.

Clearly, there seems to be a gap between intentions and actual performance, and boards can play a critical role in reducing this gap by driving a strategic focus on integrity.

Strengthen governance framework and embed integrity into culture

The governance framework is often seen as the formal structure for compliance management, together with policies that guide organizational behavior. However, employees also take their cue from experiences, and their behavior is often shaped by the words and actions of the board and senior management. The business landscape today includes complex corporate structures and broad

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global influences. In such an environment, the board must play a dual role of setting the company's strategic direction toward growth, while ensuring checks and controls are enforced for all relevant areas, including the professional conduct of C-suite executives and senior management personnel.

According to the *EY Global Integrity Report 2020*, 55% of board members are very confident that their managers demonstrate professional integrity, but only 40% of junior employees feel the same. Moreover, only 37% of junior employees say that they have heard management communicate frequently about the importance of behaving with integrity over the last two years. This points to the need for greater organizational engagement on integrity risks, which can be achieved through several ways:

- Holding candid focus group discussions outside of scheduled board meetings with frontline teams and employees working in high-risk areas
- Conducting staff training on ethics that allows employees to participate and share ethical dilemmas that they face
- Sharing lessons from past disciplinary matters with appropriate privacy protections
- Advocating for and ensuring adequate clout and independence of the audit and compliance functions
- Promoting and rewarding ethical behavior by linking it to employee performance indicators and incentives

These initiatives could help to create a supportive culture where employees can distinguish between taking entrepreneurial risks to drive growth and unethical business conduct that may adversely affect the organization. With such a culture, employees would be able to focus more on innovation and more easily recognize unethical behavior that should be avoided.

Ensure transparency and disclosure to stakeholders

Embracing integrity means viewing transparency and disclosures as more than just for compliance. It means not only focusing on materiality, but also putting information sharing that would help shareholders make informed investment decisions as a top priority.

Investigations have shown that companies with failed integrity agendas fell short of this standard. Boards must play a more active role in having a line of sight into outliers in disclosures, especially the ones that can create disproportionate risks. When assessing outliers, boards need to fundamentally change the overarching question from "Is this allowed?" to "Is this right?".

Monitor and respond effectively

While boards are typically not directly involved in the company's day-to-day operations, it is their role to gauge plausible early warning signs and probe the management by asking questions. This involves monitoring how business is conducted and responding effectively when things go wrong. Investigations have also revealed that in the majority of cases, early warning signs were actively hidden from the board or audit committee due to weak oversight mechanisms, or not thoroughly probed or investigated once known.

Many companies still do not test their practices and processes against fraud scenarios and find out whether fraudsters are able to exploit weaknesses in their systems. Boards can direct the management to mandate such reviews to identify weaknesses at both the entity level and the operations level.

Boards should steer the management to implement data analytics techniques and tests on matters beyond financial information for enhanced oversight and better monitoring of business practices. This can include using and linking data points from various sources, such as human resources, communication, IT security controls, operational key performance indicators, customer feedback and high-risk employee activities. Such analytics can be very effective in identifying early integrity-related warning signs.

If things go wrong, boards must ensure that the investigations are conducted independently, without the management's influence, and that disciplinary actions are designed without relevance to the seniority of personnel involved in the matter. Regulators will also test if employees have knowledge of misconduct response procedures, and it is important for companies to help employees understand how these work in practice. This is an area where companies typically fall short in.

Ultimately, a proactive board approach is vital to maintaining the integrity of the organization. Boards should consider the following questions:

- How does the organization define integrity and embody the relevant values?
- How is the board monitoring key integrity risks and holding the management accountable?
- How are staff engaged on ethics and integrity, and are reporting mechanisms available and effective?
- Has the organization considered using technology and nonfinancial data points to identify and monitor early warning signs?
- What is the maturity of the organization's integrity framework and how does the organization plan to work toward industry best practices? BMQ

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