

Board Reviews: determining the scope and methodology (Briefing Paper #2)

Background

The *UK Corporate Governance Code*¹ (the Code) is largely silent on what matters should be covered by an external Board evaluation. The Financial Reporting Council (FRC) established the core principle of three yearly reviews in the 2010 revisions to the Code but left it to FTSE 350 companies and their advisors to determine the scope and methodology for a review. It did, however, publish its *Guidance on Board Effectiveness*² (the FRC Guidance) in May 2011, an updated version of the original *Higgs Guidance*³, one of a suite of guidance notes.

This Briefing Paper considers some of the principal areas that have been the subject of externally evaluated Board Reviews and suggests how Boards of Directors and their Company Secretaries might approach the task of setting the terms of reference for a Board Review and the methodology to be employed.

Scope of Board Review

JWA Governance believes that Board Reviews are best commenced with agreed terms of reference. These contain the broad areas for review, the proposed methodology and the timetable. They will also include the way in which the final report is to be presented to the client board and the steps for facilitated discussion with directors and others involved with the process.

The objectives for a Board Review will vary on a case-by-case basis. In most cases compliance with the Code will be stated to be an objective, but the opportunity should also be taken for the external evaluator to examine particular governance matters and assist with issues that might be relevant to external stakeholders (including regulators). As the pattern for external evaluations develops, it is to be expected that a key task of an externally evaluated review will be to consider how prior recommendations have been considered and implemented.

The FRC Guidance lists the following areas which might be relevant to a particular company, but notes that the list should not be regarded as prescriptive or exhaustive:

- the mix of skills, experience, knowledge and diversity on the board, in the context of the challenges facing the company;

- clarity of, and leadership given to, the purpose, direction and values of the company;
- succession and development plans;
- how the board works together as a unit, and the tone set by the chairman and the CEO;
- key board relationships, particularly chairman/CEO, chairman/senior independent director, chairman/company secretary and executive/non-executive;
- effectiveness of individual non-executive and executive directors;
- clarity of the senior independent director's role;
- effectiveness of board committees, and how they are connected with the main board;
- quality of the general information provided on the company and its performance;
- quality of papers and presentations to the board;
- quality of discussions around individual proposals;
- process the chairman uses to ensure sufficient debate for major decisions or contentious issues;
- effectiveness of the secretariat;
- clarity of the decision processes and authorities;
- processes for identifying and reviewing risks; and
- how the board communicates with, and listens and responds to, shareholders and other stakeholders.

Methodology of Board Review

The majority of areas for review can best be examined by in-depth interviews with each Director and nominated senior management executive. JWA Governance always recommends that interviews form the core part of the process, but underpins this through reading and reviewing board and committee minutes and key corporate governance documents.

Use can be made of questionnaires. These can be useful as a means of setting the agenda before the interviews, but are rarely useful on their own and are often too formulaic to elicit candid observations from participants.

These areas for review are best probed through discussion with the board as a whole, importantly with the Chairman, the Senior Independent Director and with individual Directors and Chairman of board committees. JWA Governance focuses on the performance of the board as a whole, but as part of that process includes a review of the effectiveness of individual non-executive and executive directors to the extent the terms of reference require.

Outcomes

There is increasing evidence of the issues that are being surfaced through externally evaluated Board Reviews. However, according to a recent report by Grant Thornton⁴ the challenge is how the

outcomes of the reviews and the insights gained are reported. The survey disclosed that only two in five companies provided information. The very best provide a summary of findings, an outline of actions to be taken to address them, and the timescale for doing so, but the majority merely state that findings have been raised.

The current areas of concern to boards appear to include the way strategy is debated and formulated, the company's risk management processes and their oversight by the board and how succession planning is handled, both to cover short term emergencies and in the medium term.

Conclusion

There is clear merit in externally evaluated Board Reviews being planned in some detail with agreed objectives and terms of reference. The proposed methodology is best discussed in advance with Boards of Directors and nominated senior executives. JWA Governance devotes considerable resources at the start of a Board Review to ensure all participants are informed and their views taken into account in planning the review.

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¹ Financial Reporting Council, *The UK Corporate Governance Code* (September 2012) London: FRC.

² Association of British Insurers, *Report on Board Effectiveness: updating progress, promoting best practice* (December 2012) London: ABI.

³ Financial Reporting Council, *The UK Corporate Governance Code* (September 2012) London: FRC. (paragraph B.6.2)

⁴ Grant Thornton, *Corporate Governance Review 2013: Governance steps up a gear* (December 2013) London: Grant Thornton UK LLP.