

# Company Secretary's Review

## External Board Evaluations

*Last month a new draft Code of Practice on independent external board evaluations was published. Seamus Gillen from Advanced Boardroom Excellence explains the reason for producing the draft Code, sets out the contents of the Code, and considers what will happen next.*

### The effective board

An effective board creates value. It is more likely to make the high-quality decisions which will help the company achieve its objectives, manage its risks and safeguard its reputation. Board evaluations are one of the principal methods for building board effectiveness.

The UK Corporate Governance Code requires that a board undertakes a "formal and rigorous" annual evaluation of its own performance and that of its committees and individual directors (Main Principle B.6). Following changes made to the Code in 2010 board evaluations in FTSE 350 companies should be conducted by an external facilitator at least every three years.

The draft Code of Practice suggests that board evaluation must be owned by the company and its board, and tailored to suit the needs of the business. It should be professionally delivered and its outcomes implemented. There is a perception, however, that the scope and service quality of evaluations, particularly those conducted by independent external consultants, is variable, and there is a concern about standards.

Advanced Boardroom Excellence has produced a draft Code of Practice on board evaluation with the aim of starting a discussion to address and resolve this perceived lack of market confidence.

The Code was prepared with the valuable contribution of a number of market participants and, once adopted, is expected to play a significant role in strengthening the board evaluation process, improving board effectiveness and, thereby, helping UK companies succeed and excel.

### The company secretary

The company secretary, traditionally viewed as the person who "simply" kept the company compliant, is now acknowledged as a key player inside the boardroom. As the person responsible for advising the board through the chairman on all governance matters, he or she will usually have a significant involvement supporting the chairman in the commissioning and running of an external board evaluation.

### The Code

The Code of Practice on board evaluation ("the Code") has been created to provide a framework within which independent external board evaluations can be conducted. Its aim is to introduce high professional standards in a rapidly-developing sector, and to give chairmen, company secretaries and key stakeholders assurance, and greater clarity, on the service and standards they should be able to expect from consultants; and to give consultants confidence in the degree of

## Contents

### LAW REPORTS

page 179

### NEWS

pages 180–181

### AUDITING

FRC reviews and recommendations  
for audit committees  
pages 182–183

EU proposals for audit reform  
page 184

commitment they can expect from companies.

The Code, it is argued, should help the sector achieve higher levels of performance, while maintaining a flexible framework which retains the scope for diversity of approach and methodology, and further innovation.

The Code identifies the following areas of activity requiring attention:

- ◆ professionalism of approach;
- ◆ competencies and capabilities;
- ◆ expectations of the client by the consultants;
- ◆ clarifying the terms of the engagement; and
- ◆ efficiency of process.

### Professionalism of approach

The Code states that consultants should regard the client's requirements and interests as paramount at all times, and should conduct themselves in such a way as to maximise the value generated by the board evaluation. The consultants, it is argued, should display, at all times, behaviours of independence, integrity, competence, respect, objectivity, tact and high standards of personal conduct.

### Competencies and capabilities

The Code recommends that consultants should be highly qualified, with appropriate

levels of technical and behavioural expertise. They should be competent to cover any or all of the areas identified in the FRC's guidance on board effectiveness.

The Code warns against promoting a one-size-fits-all approach. In terms of looking at wider issues, the Code talks about appreciating the critical importance of diversity on a board which, it is argued, should be understood to be broader than issues of genetics, e.g. gender, ethnicity etc.

In terms of understanding of commercial context, consultants are asked to develop an understanding of the company's business model, strategy, approach to risk and other relevant issues, to understand how effectively the board challenges itself on the key issues.

The Code emphasises that significant insights will potentially be generated by directors being prepared to talk frankly, and should make clear, and ensure, that such conversations take place in a secure environment, and in a way that allows confidentiality to be preserved, if appropriate, while ensuring the discussions are incorporated tactfully into the report back to the chairman and board.

An effective independent external evaluation should generate insights which a board will not have been able, or willing, to identify for itself. The Code argues that consultants will be able to demonstrate the skills required to advise a board on how to address and resolve the resulting issues identified in the evaluation.

### **Expectations of the client by the consultants**

The Code makes clear that a board evaluation involves two partners, and that both need to play their part in making the process successful.

For companies, therefore, it is important that the client enters into the exercise with commitment. This includes commitment from the whole board, sufficient involvement of all the directors, a willingness to accept direct board observation as necessary for the consultants to understand the dynamic and behaviours of the board and its members, and the provision of adequate company information (placing the consultant in the same position as other trusted advisors who are insiders).

In terms of reporting back to the board, it is suggested that the client should be

willing to let the consultants be "courageous" and offer feedback which may not be viewed by all board members as welcome. The client is also asked to acknowledge that the outcome of a board evaluation process is of material interest to key stakeholders, notably investors, and to consider how to disclose the outcomes of an evaluation in an appropriate way in the annual report and accounts.

### **Clarifying the terms of the engagement**

The consultants and the client are advised to be clear about the levels of expectation associated with the assignment. This is most likely to happen if both parties communicate openly and transparently to avoid the risk of misunderstandings and maximise the benefits of the engagement. Agreements should be set out formally and in writing. Consultants should be prepared to take out appropriate professional indemnity insurance.

### **Efficiency of process**

The Code also emphasises the importance of efficient housekeeping, and considers that the consultants should be able to reassure the client that all activities will be undertaken at the highest level of professionalism. This includes, for example, the consultants undertaking that they will not use any confidential information about a client's affairs, elicited during the course of an assignment, for personal benefit, professional benefit, or for the benefit of others outside the client organisation. An example where this provision applies is in the area of board and executive search.

### **Innovation in the Code**

Market participants will ask how this new Code will make a difference in terms of the way in which evaluations are conducted. The Code introduces proposals which represent a significant departure from current accepted thinking, including:

- ◆ not pursuing more than two consecutive assignments in order to remain independent;
- ◆ avoiding, or resolving, conflicts of interest;
- ◆ being suitably qualified and experienced to conduct an evaluation credibly;
- ◆ agreeing with the client how sensitive issues are handled effectively; and

- ◆ ensuring the outcome of a board evaluation is disclosed in an appropriate manner.

### **Independent oversight of the Code**

There is a view that an independent oversight body is needed to oversee the application of, and adherence to, the Code. The Code therefore proposes that consideration be given to creation of such a body, comprising senior market participants meeting on a periodic basis, to review adherence to the Code by consultants and to make recommendations for improvement and further actions. This, it is suggested, will help ensure appropriate levels of accountability, and build confidence among market participants, and wider groups of stakeholders.

The independent oversight body would be serviced by a secretariat, which would maintain a Register of consultants. Early issues for consideration would be whether consultants would be expected to sign up to the Code, what systems of quality control would be introduced to determine whether a consultant should be entitled to join, and subsequently remain, on the Register, and the role of the oversight body in maintaining standards. Costs, it is suggested, would be met by a levy on consultants.

### **Consultation**

The Code is not yet the finished article and further work is necessary if the Code is to be accepted as credible by all market participants. For this reason, the Code has been formally handed to the Institute of Chartered Secretaries and Administrators ("ICSA"), who will run a public consultation to which all market participants and interested parties will be invited to contribute. The ICSA will appoint a steering group of key stakeholders and the consultation is expected to run from **March** to the end of **May 2014**.

Depending on the outcome of the consultation, it is possible that a final Code will be in place in the autumn. This will represent a significant step forward in raising standards in the sector.

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