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Joined up

Getting the best from
board committees



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Joined up

At the heart of the idea of board committees exists a paradox. A board establishes a committee because a topic is so important that it should be looked at by someone other than the board. Of course, this is an abstraction, but it does show that successfully setting up and operating board committees is rarely a simple process.

From nominating the right people to ensuring proper reporting lines, committees are a core, but oft-maligned, aspect of the board's operations – one that companies can ill-afford to get wrong. Thanks to the financial crisis, companies' approaches to risk and corporate governance, two subjects often closely related to committees, are now very much in the spotlight.

In that spirit, this issue of ICSA Focus is not just about making committees 'good enough' to tick that particular governance box – it's about making the most of your committees, getting them to really work for your board. From divining current trends to outlining best practice, it provides invaluable advice on all aspects of making your committees a success.

Gareth Pearce

Assistant Editor of *Chartered Secretary* magazine
gpearce@icsaglobal.com



In recent years, the workload placed upon directors has increased to such an extent that the delegation of their duties to committees has become less of an option and more of a necessity. The heightened focus on issues such as the adequacy of financial controls, management of risk appetite, corporate responsibility and executive remuneration has required boards to broaden the scope of their existing committees or establish new committees to ensure that key issues receive adequate consideration.

Every organisation faces its own particular challenges and no two boards will have the same requirements for their committees. It is therefore important for all organisations to have a clear understanding of what committees are appropriate for their organisation and, more importantly, how those committees will improve and not hinder the board's ability to govern.

In this issue of ICSA Focus, we will assess how the traditional 'Audit, Rem and Nom' board committee structure for listed companies, originally recommended by the Combined Code, has evolved, how committees differ across the public and private sectors and how company secretaries can help to ensure that board committees operate effectively.

Mark Cleland

Managing Director of Capita Company Secretarial Services
mark.cleland@capita.co.uk

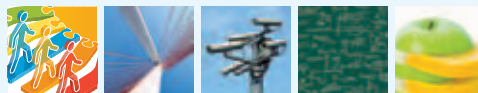


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ICSA FOCUS

» Editorial

Editor:
Rachael Johnson
020 7612 7094
rjohnson@icsaglobal.com

Assistant Editor:
Gareth Pearce
020 7612 7038
gpearce@icsaglobal.com

Senior Graphic Designer:
Mareike Schulz
020 7612 7046
mschulz@icsaglobal.com

Assistant Marketing Manager:
Joanne Glover
020 7612 7029
jglover@icsaglobal.com

E-mail for editorial enquiries only:
rjohnson@icsaglobal.com
gpearce@icsaglobal.com

» Advertising and sponsor enquiries

Advertising Account Manager:
Warren Mackenzie
020 7657 1828
warren.mackenzie@tenalps.com

Ten Alps Media
Commonwealth House
1 New Oxford Street
London
WC1A 1NV

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W1B 1AH

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New forms



Jonathan Dale provides an overview of how committees have evolved to their current state, and looks at some emerging trends.

Although audit committees have been a requirement for companies listed on the New York Stock Exchange since 1978, it was not until Sir Adrian Cadbury's Committee on the Financial Aspects of Corporate Governance published its code of best practice in 1992 that they became a firm part of corporate governance practice in the UK. Prior to that, companies' articles of association almost universally allowed for the delegation of responsibility to committees, but until the publication of this code of practice, the duties of board committees had been left entirely to individual boards to determine. Although not exactly heralding a landslide of new committees, the introduction of the audit committee to the UK corporate governance landscape did create something of a sea change, and was swiftly followed by the introduction of further requirements via the Greenbury Report in 1995 (remuneration committee) and Hampel

Report in 1998 (nomination committee).

In the 13 years since the publication of the Hampel Report, this three-committee-system has become firmly established in the UK's corporate governance framework, evolving as each new corporate governance review has been undertaken. Despite

the ongoing development of corporate governance, however, we have seen no new committees or fundamental changes to the remit of those committees. So is the time now right to consider the roles of committees? Will the impact of the credit crunch on corporate governance stop at a review of the existing committees, or will we see wholesale change?

Enhanced

The Cadbury Report recommended the setting up of committees to 'prevent board meetings becoming overloaded' and either 'going on too long' or 'requiring discussion to be curtailed'. It also suggested that committees would enable non-executive directors to 'play their full part in the governance of the company'. These recommendations were not universally supported, with some chairmen of UK companies arguing that there was a danger they would usurp the function of the board. The counter-argument to these reservations contended that the board retained responsibility by virtue of its determination of terms of reference of committees.

Supporters of board committees would argue that the introduction of the audit, remuneration and nomination committees has enhanced the governance process, providing directors with the opportunity to focus on key aspects of their roles and creating greater transparency in decision-making processes. They have also served to provide investors with greater assurance that the integrity of financial reporting is receiving the scrutiny it requires, and has demonstrated that issues such as directors' remuneration and board succession are being afforded appropriate time and focus by non-executives.

Any suggestion of introducing a requirement for further committees, such as a governance committee, is likely to be met with strong opposition by those who believe that committees dilute the powers and effectiveness of boards. There is certainly a danger that too many committees can create an environment in which management spend the large majority of its time simply attending meetings. It is also important that non-executive directors remain just that – increasing the number of committees that they attend, and consequently their time commitments, could compromise their independence.

Around 25% of FTSE 100 firms have five or more board committees.

Realities

Leaving more philosophical discussions aside for the moment, what are the realities of committees in practice? Most listed companies will have an executive committee in some form or another, and many will have appointed investment/finance committees to enable the executives to work through the financial consequences of material proposals

The new contenders

Risk

These are particularly relevant to banks, other financial institutions and companies in other sectors where a risk committee, separate from the audit committee, is considered necessary or desirable by the board.

Disclosure

Usually appointed to deal with all matters relating to public announcements and oversee the Company's compliance with the UK Listing Authority's Listing and Disclosure & Transparency Rules.

Governance

Intended to monitor corporate governance developments and ensure that principles, practices and processes are embedded within the culture and operation of companies.

Corporate responsibility

Responsible for setting guidance, direction and overseeing policies and progress on corporate responsibility matters such as reputation, support of local community, donations, and social and environmental impact.

Health, safety and environment

These tend to be favoured by companies in industrial and mining sectors where the wellbeing of employees and the natural environment are fundamental. They are responsible for formulating and recommending policies to address group responsibilities in relation to health and safety, the environment and the community.

(not their merits) before submitting them to the full board for approval.

Based upon the information available in the annual reports of FTSE 100 companies, almost two thirds of the index's constituents have established board committees with non-executive members, other than audit, nomination and remuneration committees. Of these companies, around 5% of constituents have six or more board committees and another 20% have five committees.

In addition to forming additional committees, a number of companies have chosen to vary the terms of reference of existing committees to incorporate other responsibilities. The most common

combination is the audit and risk committee, perhaps in recognition of the close working relationship between their group risk and internal audit functions. A less obvious, but still popular combination is a nomination and governance committee. The reasons for combining the responsibilities of the nomination committee with the oversight of the group's governance are not so clear, but nonetheless it is a combination that has been adopted by more than 10% of FTSE 100 constituents.

Emerging

Three topics that have drawn particular focus of late are risk, governance and social responsibility – the existence of committees focussing specifically on these areas is evidence that the constituents of the FTSE 100 have prioritised these topics.

As mentioned above, it is not uncommon to see the board's risk and audit responsibilities combined in one committee. The importance of establishing a risk committee prompted ICSA to prepare specimen terms of reference that could be used by those companies who have especial regard to risk; primarily those financial institutions affected by the 2010 Walker Review of corporate governance in UK banks and other financial industry entities. In the financial services industry, the importance of the board's consideration of its risk responsibilities has also been heightened by the introduction of the Financial Services Authority's enhanced capital adequacy regime. This requires companies to develop group-wide risk frameworks and then apply capital values to the risks identified. The complexity of this regime is reflected in the fact that almost 20% of FTSE 100 companies have now established separate risk committees.

In 2007, the Health & Safety Commission, in partnership with the Institute of Directors, published a guidance note to directors entitled *Leading Health & Safety at Work: Leadership Actions for Directors and Board Members*. The guidance aligned the issue of health and safety in the work place with corporate governance and recommended that boards should integrate health and safety into companies' main governance structures. While 15% of the index has set up committees with health and/or safety within its title (principally in the industrial and mining sectors), a further 20% have formed committees to focus on the broader topic of corporate social responsibility (CSR). CSR normally encompasses themes of employee welfare and employer accountability, but also often looks at relations and interactions with other stakeholders. Its growing influence on corporate behaviours can be seen in the number of corporate responsibility committees that have sprung up.

In general, an enhanced focus on

governance, in the broader sense, is evident from a range of committees that have been formed to oversee specific aspects of the boards' roles: governance committees are focussing on corporate governance developments; chairman's committees are providing chairmen with the assurance that their boards are taking account of best practice; and conflicts committees ensure that boards are observing their statutory duty to avoid conflicts of interest. The twin drivers of heightened media coverage and more regular and detailed reporting required by regulators, have also led boards to create committees that focus on the transparency and reporting aspects of corporate governance, such as disclosure, annual results or filings assurance committees.



So, with this proliferation of committees, is there room for another, perhaps governance-focused, committee in the UK's corporate governance requirements? It is clear that the majority of the FTSE 100 have determined that there is a business need to delegate key functions to bodies of non-executive directors, either to ensure key topics receive adequate consideration, or to enable non-strategic decisions to be made in a more efficient manner by removing the need to convene the whole board. The workload of plc boards has shown no signs of shrinking in recent years, and a number of commentators have suggested that the boards of listed companies, particularly those in heavily regulated sectors, may not have sufficient time in board meetings to focus on the strategies of their companies. They have highlighted the impact that increased regulatory burdens have placed upon the make up of board agendas that are awash with risk and regulation-based items.

Although committees do strip some of the responsibility for the consideration of key governance topics away from boards, the overall time commitments of directors will have to increase to incorporate the additional meetings. If directors are to attend an increasing number of meetings, is there a risk that their independence will be eroded? And have the establishment of further committees had the effect of increasing the loads on directors, as opposed to lightening them? One thing is for certain, board committees, as a means of focusing the responsibilities of the board, look set to form an influential part of the future of UK businesses. ■

» About the author

Jonathan Dale is a Manager at Capita Company Secretarial Services. He can be contacted at jonathan.dale@capita.co.uk.

Supporting success



Jenny McCarthy, Kevin Mayger and Alice Alfert examine how you can ensure your committees are as effective as possible.

While the board of directors remains ultimately accountable for the performance and affairs of a company, certain functions may be delegated to sub-committees to assist boards in discharging their duties. Committees support boards in a number of ways including the provision of advice, making recommendations and undertaking those decisions that it would be inappropriate for the board to have high levels of participation in, such as directors' remuneration. Committees are an integral

part of today's corporate structure. The benefits of board committees are obvious – they relieve the main board of having a potentially overwhelming agenda and being distracted from its key strategic focus. It is therefore essential that committees are as effective and efficient as possible.

In the aftermath of the financial crisis, boards of directors and their committees have found themselves subject to increased scrutiny, be that from regulatory bodies or external stakeholders. The roles of committees are, therefore, more prominent than ever before. The 2010 review of the

UK Corporate Governance Code reinforced the Financial Reporting Committee (FRC)'s view that the remuneration committee, the nomination committee and the audit committee should form an integral part of every company's board structure. However, although these are the only committees specifically mentioned in the Code, this is by no means an exhaustive list and many companies have determined it appropriate to establish further committees. The FRC has also recognised that the existence of committees alone should not be seen as the end of the company's responsibilities – it recommended that committees should undertake formal and rigorous annual evaluations of their performance and make these public in the annual report. As with all governance reviews, this evaluation process should be seen as much more than a box ticking exercise. It is an opportunity for committees to reflect on what works and what needs improving.

People

An effective committee is, by definition, one that is adequate to accomplish the purpose for which it has been set up. The approach that an organisation takes in determining what makes their committees as effective as possible will depend on, amongst other things, the nature and size of the organisation. For instance, the board committees of a multinational financial institution will have a very different remit and scope to those of a niche investment trust. As such, the determination of the effectiveness of a committee will vary from one organisation to another – there is not a 'one size fits all' approach to being effective. It must not be forgotten that ultimately, it is the people who make up a committee that determine how effective it can be. The UK Corporate Governance Code places a great deal of emphasis on getting the right people. It states that committees 'should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their responsibilities effectively'. Appointing the wrong persons to a committee could easily result in a committee's failure to achieve its goals – the membership of the committees need to form part of an ongoing review process.

Having determined that it is not sufficient to assess a committee's effectiveness on the basis of an annual performance evaluation alone, there are a number of factors which need to be considered as contributing factors to the effectiveness of a committee.

Composition

One of the principal considerations when seeking to establish a successful committee

structure is the composition of the committee, i.e. its members. The Code suggests that each of the remuneration, nomination and audit committees should comprise mainly or wholly of independent non-executive directors. Although the composition requirements differ slightly in respect of the type of committee in question, the committee should have an appropriate balance of skills, experience, independence and knowledge. Independence can be a difficult quality to evaluate in an individual, since this covers not only independence from management but also their independence in regard to any business or other relationship that could materially interfere with the exercise of objective, unfettered judgement by the member. The determination of independence is a decision for the board and must be a decision that the board are able to justify.

Achieving a suitable balance of skills, experience and knowledge carries an equal weight of importance – this means that candidates should be selected from as wide a pool of talent as possible. Appointing those people who genuinely can offer different perspectives on matters being discussed will ensure that the committee

and knowledge. They should be able to stimulate robust debate and challenge during Committee meetings, while leading and guiding productive discussion and decision-making. The company secretary will have a key role in supporting the chairperson; be it assistance with drafting agendas or the preparation and circulation of board papers. To ensure that the committee is operating as effectively as possible, the company secretary should encourage the chairperson to focus on those issues that should be at the forefront of the committee's attention, as well as providing advice and guidance in respect of meeting best practice requirements.

Terms

Each committee should have been established to carry out specific and realistic functions. Although each committee will have different roles and responsibilities, the role of each committee should be clearly outlined and those responsibilities delegated to it by the board should be specified in written terms of reference which the committee members should be familiar with. Although model terms of reference are available from ICSA as a guidance tool, these terms should be

Getting the right composition is a principal concern.

thoroughly debates the topics for which it has been established. An effective committee consists of people who bring independence of mind and challenge, and high standards of integrity and ethics. In order to ensure the committee continues to be effective, the composition of the committee should not be allowed to stagnate and should be reviewed and refreshed on a regular basis. To that end, the committee should satisfy itself on a regular basis that each of the members continues to make an effective contribution and this should be built in to the annual performance evaluation.

Of course, the chairperson plays a pivotal role in ensuring that the committee operates effectively. Choosing the right person can be a challenge. There are a number of factors to consider, including whether or not it would be appropriate for the chairperson to chair any other board or committee within the company. Any potential overreliance on the chairperson, or a failure on their part to commit sufficient time to the role could be damaging to the performance of the committee as a whole. An effective committee should therefore be headed by a committed chairperson who has the required leadership

specific to the company and the committee and should provide an underlying guide to the committee with regards to its duties.

It is the responsibility of the board to decide which matters should be delegated to each committee and accordingly, the board should draw up the terms of reference ensuring that the level of duties delegated to the committee are appropriate and do not infringe on the responsibilities of the board or the wider management of the company. The terms of reference should set out the parameters within which authority has been delegated to the committee by the board. In order to ensure that the committee is effective, they should be specific enough for the members to understand their responsibilities, but not so prescriptive as to unnecessarily limit the committee's scope. They should also set out the limits of the committee's authority, including a prominent statement setting out those activities the committee is not authorised to carry out. It should be borne in mind that the terms of reference are a method by which the activities of the committee are regulated and as such, should be reviewed by the committee on an annual basis to ensure that they continue to be


How not to do it

Working from company secretaries' real-life stories, **Madeleine Cordes** imagines what can happen if you don't plan your committee meetings properly.

Director John Smith is on his way to the committee meeting. He hasn't received the papers but feels sure he'll be able to catch up at the meeting. Having been given a board pack, he is surprised to find restaurant menus halfway through the chair's report. The secretary seems happy there's a quorum, but John's not sure – there are a number of attendees who he's sure are not committee members.

First comes a lengthy discussion on a large proposed redundancy package for a senior member of staff. The committee approves this immediately, without checking the terms of reference or the delegated authorities – John wonders whether the committee really has the authority to agree this. The secretary, who is the chief executives' assistant and new to minuting meetings, says she doesn't have the documents with her but would take advice after the meeting – the chair notes that the board could always ratify it after the event.

A number of people take part in the meeting by phone, but hardly any of them say anything. John notices that one neighbour is playing on his phone, and the other appears to be asleep. One attendee warily asks whether this is the board or committee meeting – he requests that the secretary sort the minutes out for the different meetings.

The chairman takes the agenda items out of order, and adds in new items that weren't even on the agenda, meaning everyone has to jump around in their board pack. One of the directors continually interrupts, throwing the meeting off track. A number of attendees read out their report verbatim even though the chair encouraged them to just focus on the highlights. The meeting overruns, and people miss their trains. A few weeks later, John enquires about the minutes – they're still not available. 

Questions of effectiveness

When considering the effectiveness of a committee, there are a number of questions which should be asked:

1. Does the committee comprise an appropriate mix of skills, experience, knowledge and independence to allow for constructive discussion and debate?
2. Does the committee stray from its remit or is the chairperson guided by the terms of reference?
3. Does the committee have the appropriate mix of executive and non-executive directors?
4. Has the composition of the committee been considered in the last twelve months and has the committee membership been refreshed if necessary?
5. Are appropriate terms of reference in place for each committee and are the committee members aware of their responsibilities and boundaries?
6. Are there sufficient practices in place with regards to the preparation and circulation of committee meeting papers and agendas?
7. Does the chairperson carry out other roles within the company, for example an executive role, and is he/she an effective leader who is able to stimulate robust debate and challenge within committee meetings?
8. Is the committee's performance reviewed on an annual basis and are suitable plans implemented as a result of the performance reviews?

appropriate. Following this review, the terms of reference should be recommended to the board for approval before any changes are adopted by the committee.

Meeting protocol

A further consideration that should be given to running an effective committee is defining suitable meeting protocols. A committee may only meet a limited number of times during the year, so it should ensure that the time spent in each meeting is as productive as possible. The company secretary, in conjunction with the chairperson of the committee, should ensure that an appropriate agenda is prepared and circulated in advance of the meeting. Each agenda should be drafted to encompass relevant issues at each period during the year (for example, the reappointment of the auditors by the audit committee and should be used as a tool to guide the business of the meeting). The company secretary can further assist with preparations in advance of meetings by ensuring that the committee receives accurate, timely and clear information in advance of the meetings, in a suitably agreed form. The committee should be given sufficient time to review the information provided to them to ensure that they are able to participate fully during the meetings. Should agendas and board papers be circulated with little time before the meeting, the members of the committee may have insufficient time to fully consider the information and prepare for the meeting, which could have a severe impact on the quality of any decisions taken.

During the course of the committee meetings, the chairperson should be responsible for guiding the meeting and ensuring that each of the agenda items are addressed and decisions are taken.

Committees' terms should also include what actions are not authorised.

Furthermore, the chairperson should be fully aware of the level of authority that has been delegated to the committee and should ensure that the committee acts within this. Following the meeting, the company secretary or other designated person, should prepare minutes of the meeting. Not only do the minutes ensure that the committee maintains an accurate record of the business transacted but they also act as an aide memoir for the chairperson and the rest of the committee members. It is also important for the chairperson to maintain effective communications with the main board – any decisions that have been taken by the committee should be communicated in a timely manner to the main board.

In planning committee meetings, it is imperative that sufficient time is allocated for each meeting. It is often the case that a committee meeting will be held on the same day as a board meeting. If the main board meeting were to overrun, not only could it encroach on the time allowed for the committee meeting, but there could also be implications with regards to

committee member's availability, which could result in the meeting being postponed and important decisions being delayed. Therefore the company secretary, together with the chairperson, should consider whether it is appropriate for committee meetings to be held on the same day as the board meeting and if it is not deemed appropriate, should consider any practical implications in holding the meetings on different days. Such considerations may include whether the committee is required to make a recommendation to the board on a particular matter and the availability of non-executive directors.

Evaluation

To ensure continuing effectiveness, the chairperson of each committee should instigate and lead an annual review of the committee's performance. The review may typically take the form of a questionnaire, but to ensure that it is a 'value adding' process as opposed to a 'box ticking' exercise, the committee members should be given sufficient opportunity to comment on the different aspects of the committee. Furthermore, the committee chairperson should act on the results of the performance review

considering any changes to the composition or terms of the committee where necessary to combat any emerging issues.



Real value can be added to a company by ensuring that committees are as effective and efficient as possible. Effective committees allow boards to be more focused on the strategic aspects of running the company, enhancing corporate governance. Ultimately, an effectively-managed committee will be more time and cost effective thereby improving performance throughout the business. ■

» About the authors

Jenny McCarthy, Consultant, Kevin Mayger, Assistant Consultant and Alice Alfert, Assistant Consultant all work for Capita Company Secretarial Services. They can be contacted at jenny.mccarthy@capita.co.uk, kevin.mayger@capita.co.uk and alice.alfert@capita.co.uk.

Watchful eyes



Tim Copnell investigates the complexities of audit and risk committees.

The wind of change is blowing through UK boardrooms, and their focus is coming to rest directly on risk. This is not surprising given continuing economic uncertainty and increasing regulatory pressure, both in the UK and internationally, to address the fallout from the financial crisis. Additionally, the potential reputational damage of failing to properly manage risk is now recognised as a major threat. As a result, many companies are reassessing their risk management processes and, in particular, the roles played by the board, the audit committee and the risk committee in providing effective risk oversight.

Oversight

The UK Corporate Governance Code sets out that the full board has primary responsibility for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives; and for maintaining sound risk management and internal control systems. This is consistent with the board's oversight role in assessing the appropriateness of the company's strategy and the inherent risk in that strategy – and very few people, if any, would argue that such an oversight responsibility doesn't rest properly with the board.

However, many boards are striving to

understand what this means in practice. Among the questions frequently heard around the boardroom are: in a practical sense, what role should the full board play in risk management? Should we consider establishing a risk committee? What is a realistic role for the audit committee? Where does oversight end and operational management begin?

Before considering the answers to these questions, it is worth first considering the goals and objectives of board oversight. What should the board seek to accomplish in its oversight role?

As a minimum, the following overarching objectives provide a reasonable framework for boards seeking to clarify their oversight role. Specifically, every board should satisfy itself that:



Effective committees

Watchful eyes continued from page 9



- the risk appetite implicit in the company's business strategy is appropriate;
- expected risks are commensurate with expected rewards;
- management has implemented a system to manage risk and the system is appropriate given the strategy;
- the risk management system operates to inform the board of the major risks facing the company;
- an appropriate culture of risk-awareness exists throughout the company; and
- there is recognition that management of risk is essential to the execution of the company's strategy.

So far, so good. Understanding the board role provides the bedrock for the management of risk, but how do board committees fit in to the process?

Board committees are used to ensure that the main board receives good quality advice and information and to enhance the quality of oversight, not as a substitute for board discussion or decision-making. The committee structure through which this support is provided will naturally vary between companies, but it is fair to say that many companies are currently engaged in a debate about the pros and cons of establishing board-level risk committees as well as the

continuing role of audit committees in providing risk oversight.

Until relatively recently, audit committees were mainly concerned with internal financial controls rather than the wider aspects of risk management. But this all changed when, in the light of corporate governance crises at the beginning of the millennium, both the UK Financial Reporting Council (FRC) and the European Union upped the expectations placed on audit committees by introducing the concept that they should (unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself) review both internal control and risk management systems. This means that, in addition to financial reporting risks, audit committees were taking on responsibility for the oversight of financial risks – such as risks associated with taxes, environmental claims, litigation, insurance, financial instruments, complex transactions – not to mention operational risks, strategic risks and compliance risks, including the risks with the new Bribery Act. The immediate question in the light of such increased expectations was whether audit committees realistically have the time, knowledge and skills to oversee all these areas, in particular operational and strategic risks?

On the other hand, the idea of this extended role does seem to have merit – operational and strategic risks are often intertwined with financial risks; and for many companies a separate risk committee would, of necessity, be comprised of the same board members as the audit committee. These competing principles are important for every board to consider when composing the terms of reference of its audit committee.

Movement

The specific reference in what was then the Combined Code (now the UK Corporate Governance Code) to board risk committees was perhaps the start of the current rogue

for board risk committees – a concept that has been enthusiastically embraced by UK and EU regulators in the wake of the recent financial crisis.

Sir David Walker's seminal report, *A review of corporate governance in UK banks and other financial industry entities*, argued that audit committees bear a heavy load and that this, together with the need for a closely-related but separate capability to focus on risk in future strategy, led to the recommendation that listed banks and life assurance companies should establish a board risk committee separate from the audit committee. The European Commission reached a similar conclusion when proposing that institutions establish risk committees composed of non-executive directors to advise the board on matters relating to risk appetite and strategy.

It is argued that the traditional audit committee role – oversight of and reporting to the board on the financial statements and adoption of appropriate accounting policies, internal control, compliance and other matters – is essentially, though not exclusively, backward-looking; it relates to the effective implementation by management of the policies decided upon by the board as part of the company's strategy. This can be contrasted with the largely forward-looking focus associated with the oversight of risk in real-time; and the determination by the board of its risk tolerance and risk appetite in the context of future strategy. Many companies see the risk committee as having an important role in providing a clear differentiation between these backward- and forward-looking risk functions. Others would argue that all risk is, by definition, forward-looking and that the distinction between the roles played by the audit committee and that played by the risk committee is more functional. Audit committees, playing to their traditional strengths, provide the board with assurance that the processes in place for the management and control of risk are adequate to fulfil the overall strategy decided by the board; whereas risk committees concern themselves with matters relating to risk appetite and the determination of risk strategy. Whatever the precise dividing line between the audit committee and the board, and between the audit and risk committees, the essential requirement is that of clarity. Responsibility for reviewing internal controls and the process of risk management on behalf of the board may be delegated to board committees, but in no way does this detract from the board's strategic responsibility for risk decision-taking.

As an aside, the current regulatory enthusiasm for board risk committees are curious – several recently failed institutions

had risk committees, and still failed. Risk committees, of themselves, do not ensure good governance – a point that did not escape the House of Commons Treasury Committee when it heavily criticised the risk committee of one of the failed UK banks for failing to act as an effective restraining force on the strategy of the executive board members. The key to good governance, in this respect is how such committees go about their business. This is then more of an issue of board behaviour than corporate governance structures per se.

But it's not just about the audit and risk committees. When assessing its committee structure, every board should consider whether there is a need for a separate committee to oversee a specific area of risk that might pose a particular concern for the business. For example, some boards have formed finance committees to focus on mergers and acquisitions and financing; many technology companies have technology or science committees to review priorities and investments for research and development; and many retailers have formed corporate social responsibility committees to address ethical, community, environmental and safety issues.

Despite the benefits board committees can offer the board in terms of expertise and time commitment, an overly-complex committee structure may pose its own risk. Additional committees can create confusion about responsibilities and/or lead to risk being compartmentalised, particularly if the board was tempted to devolve its own responsibilities to the committee. A fragmented committee structure with no one seeing the 'big picture' is clearly a retrograde step.

Relationships

Ensuring an effective relationship between different board committees, and between the committees and the Board, is probably more important than the exact committee

Ten principles for effective risk oversight

For boards looking to assess the adequacy of their risk oversight processes, these are the basic questions they should be answering:

- **Understand** the company's key drivers of success.
- **Assess** the risk in the company's strategy.
- **Define** the role of the full board and its standing committees with regard to risk oversight.
- **Consider** whether the company's risk management system – including people and processes – is appropriate and has sufficient resources.
- **Work** with management to understand and agree on the types (and format) of risk information the board requires.
- **Encourage** a dynamic and constructive risk dialogue between management and the board, including a willingness to challenge assumptions.
- **Closely monitor** the potential risks in the company's culture and its incentive structure.
- **Monitor** critical alignments – of strategy, risk, controls, compliance, incentives and people.
- **Consider** emerging and interrelated risks: What's around the next corner?
- **Periodically assess** the board's risk oversight processes: Do they enable the board to achieve its risk oversight objectives?

Source: Report of the NACD Blue Ribbon Commission – Risk Governance: Balancing Risk and Reward, October 2009.

committee memberships or informal cross-attendance at committee meetings to help facilitate knowledge transfer between committees. Holding joint committee meetings at least once a year or regular meetings of standing committee chairs to discuss oversight activities and issues that may be relevant to the oversight responsibilities of multiple committees is another idea that some companies employ to ensure there is no unnecessary duplication or, worse still, oversight 'gaps'.



Whatever committees exist and whatever techniques are employed, two things are essential. First, the universe of risk oversight responsibilities should be mapped to each

did, what conclusion they reached and any recommendations for the board.

Assessing and clarifying the board's risk oversight framework – the roles and responsibilities of the board and its committees – is only one step in assessing the adequacy and effectiveness of the board's risk oversight processes. The behavioural aspect of how the board, through its committee structure, actually exercises its oversight is absolutely critical. For boards looking to assess the adequacy of their risk oversight processes, the Blue Ribbon Commission's report 'Balancing Risk and Reward' offers important insights and guidance in the form of ten principles for effective risk oversight (see boxout).

More and more boards are coming to the conclusion that it is unlikely that any committee – including an audit or risk committee – has the time, resources or expertise to assume full responsibility for risk oversight. In fact, more and more boards are recognising that risk oversight is a 'team sport' involving the full board and all of its standing committees. Just as every player in the team needs to understand their role, the challenge for every board is to ensure proper alignment and coordination of the risk oversight responsibilities and activities of its various standing committees. ■

Several recently failed institutions *had* risk committees.

structure adopted. Where initial oversight of risk rests with the audit committee, members might consider splitting their meetings into two halves – one for audit matters and the other for risk. Other board members might be invited to participate in that part of the audit committee meeting dealing with risk.

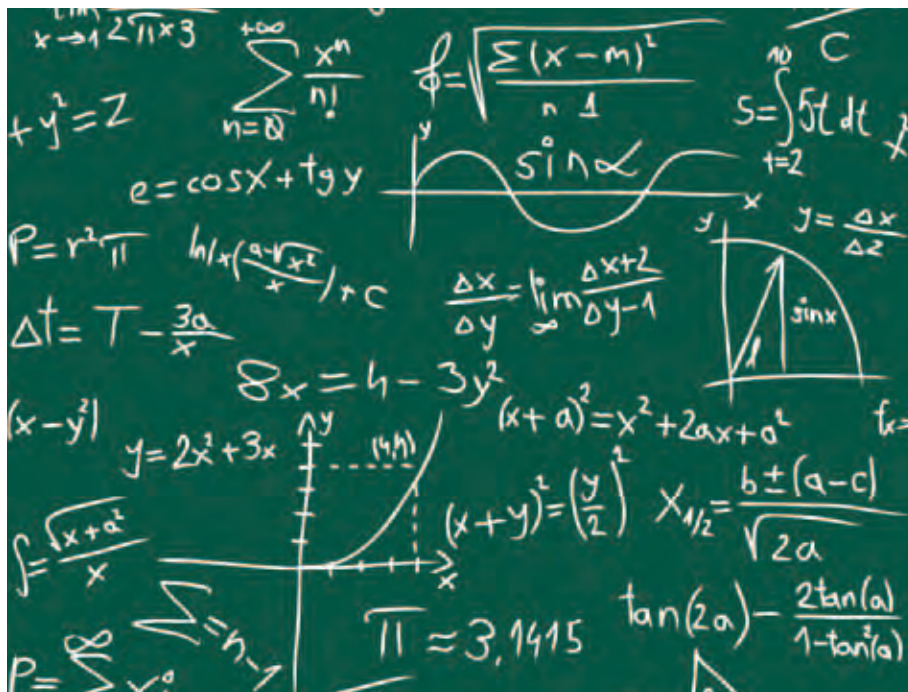
Where separate audit and risk committees exist, boards might consider overlapping

committee and the board itself. This should both provide complete transparency over which body does what and highlight any unnecessary duplication and oversight gaps. Furthermore, the board should ensure that all committees provide regular and robust reports to the full board on how they discharged their oversight responsibilities. This should include what the committee actually

» About the author

Tim Copnell is Associate Partner, Audit Committee Institute, KPMG. He can be contacted at tim.copnell@kpmg.co.uk.

Back to basics



What's on the agenda for the remuneration and nomination committees? *Chartered Secretary* takes a look.

The ICSA guidance notes on terms of reference for both committees (available from tiny.cc/hjdjs) set out general best practice as well as outlining key duties and responsibilities. In general, they indicate that the committees should have access to sufficient resources and training and review their own performance. The chair of each committee should attend the AGM and be prepared to answer questions about any matters within the areas for which the committee is responsible and the terms of reference of the committee should be made available (usually by putting them on the company's website).

Remuneration

The UK Corporate Governance Code provides that the committee should be made up of at least three independent non-executive directors (NEDs), but this is reduced to two for smaller companies. One of these NEDs may be the board chair, as long as they were independent when they were appointed to that position. The board chair should not also chair the remuneration committee. Others that may be expected to be invited to the committee (but who do not have a right to attend) would be the chief executive, head of

human resources and external advisers such as remuneration consultants. The committee would be expected to meet at least twice a year. Key duties include:

- agreeing with the board, the remuneration policy for the board chair, the executive directors, company secretary and others who are part of the executive management team. This should ensure that executives are provided with appropriate incentives to encourage *enhanced* performance and are, in a *fair and responsible manner*, rewarded for their individual contributions to the success of the company;

- having regard to the remuneration needs across the group;
- approving long and short-term incentive plans, pension arrangements and termination payments;
- being *exclusively responsible* for setting the selection criteria and for appointing any remuneration consultants which advise it;
- production of the annual remuneration report.

NEDs' remuneration should be determined by the whole board, without NEDs taking part.

Nomination

The Code states that there should be a nomination committee that leads the process for board appointments and makes recommendations to the board. A majority of members of the committee should be independent NEDs. The chair of the committee should be the board chair or an independent NED. The ICSA best practice guide suggests that the committee should meet at least twice a year to deal with regular matters within its remit, and at other times as required when board appointments are under consideration. Key duties include:

- evaluation of the balance of skills, experience, independence, knowledge and diversity on the board;
- preparation of role descriptions for board appointments;
- keeping the leadership needs of the organisation under review and formulating plans for board succession – particularly the key roles of chair and chief executive;
- being responsible for identifying and nominating for approval by the board, candidates to fill board vacancies;
- ensuring NEDs get formal appointment letters, are able to meet the necessary time commitment and disclose any relevant business interests that could result in a conflict;
- reviewing the results of board performance evaluation;
- making recommendations to the board

Remuneration is an issue that never seems to go away.

- determining the total individual remuneration package of those mentioned above. Many committees now consider and approve any remuneration packages for employees paid above a certain threshold. This threshold will vary from company to company;

about certain appointments, such as the senior independent director (SID), committee members; considering the continuation in office of NEDs at the end of their terms of appointment, and whether they should be put forward for re-election at the AGM.

The 2003 Higgs Report drew attention to the importance of board diversity and the role of the nomination committee in ensuring a fair and transparent appointments process. Even then the boards of many larger companies were perceived to be populated by members of the 'old boys' network'.

There was discussion about 'widening the pool' from which to draw new talent. At that time, if company secretaries were asked if their company had a nomination committee, many might have scratched their heads and responded with an expression of vague recollection.

Eight years on we have now had the Davies review in response to the recommendation in the latest version of the Code that boards should give due regard to the benefits of diversity on the board, including gender, when appointing new directors. When you notice in the report the rather depressing statistics that FTSE 100 boards are made up of 87.5% men and 12.5% women and that at the current rate of change it will take over 70 years to achieve gender balanced boardrooms in the UK, you could be forgiven for thinking that the nomination committee had been locked in the cupboard and the key thrown away.

In July this year, in response to a recommendation in the Davies' review,

leading executive search firms launched a new voluntary Code of Conduct (available from www.bis.gov.uk) covering boardroom appointments. Nomination committees may wish to find out before appointing a search firm, whether or not they support the Code of Conduct.

Many of the areas covered by the nomination committee can be difficult to handle. How long should directors stay? Have they performed well enough to be put up for re-election? Should the board take a risk in appointing a candidate with different attributes and abilities to the other directors – or go for the safe option and the candidate who will 'fit in' because they are similar to everyone else? Directors and board chairs need to be brave enough to tackle these issues in an open and transparent way and company secretaries can remind them of the need to do so and encourage them along the way. The issue of succession planning should not be ignored either – many firms have been caught on the hop when unexpected departures have occurred.



What's on the horizon for remuneration and nomination committees?

A recent government consultation paper, *A Long Term Focus for Corporate Britain*, focusing on executive pay considered, among other suggestions, variations to the composition of both the remuneration and nomination committees. By widening the pool of experience and backgrounds of the members of remuneration committees (possibly to include independent members who are not directors, but who might be employees) some people felt that a more balanced view could be reached about what is 'reasonable' in terms of executive pay. In a committee made up entirely of other board directors (even if independent in terms of the Code) there is a risk that their view of 'normal' pay levels will be considerably higher than the view of many others who do not work in big businesses. A similar idea to broaden membership of nomination committees to include shareholders was aired in the paper. Whatever the result of the consultation, expect change – remuneration never stands still. ■

» More information

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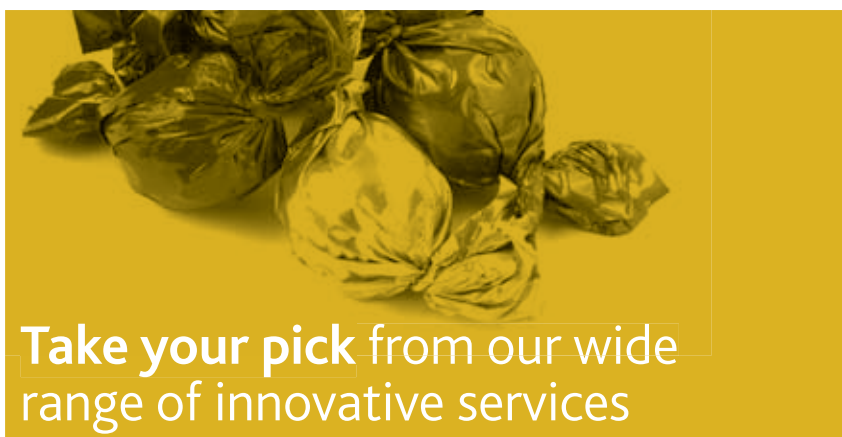
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Same difference?

Louise Thomson considers the differences between public and private sector committees.

'Any committee that is of the slightest use is composed of people who are too busy to want to sit on it for a second longer than they have to,' said Katharine Whitehorn. You only have to spend a few minutes online searching for quotes about committees to realise that they are not a greatly appreciated or valued aspect of organisational activity. Peter Drucker is quoted as saying: 'Meetings are a symptom of bad organization. The fewer meetings the better.'

And yet, established corporate governance principles recognise the need for boards to be supported by a number of committees that discuss, investigate and analyse complex or thorny issues before reporting back to the board for decision. Codes of governance in the corporate and public sector recommend a minimum number of board committees, usually audit, remuneration and nomination committees.

But there is often little understanding of when and why any additional committees should be established, and even less enthusiasm for dissolving those that are no longer needed – when the organisation has grown, or the work of the committee is being undertaken elsewhere.

Powers

Boardrooms should not be comfortable places, and consequently that logic should extend to committees of the board. The strategic and operational success of any organisation depends on clarity of vision, confident leadership, robust and effective governance arrangements. Committees, therefore, constitute an important aid to board decision-making. This is true for boards in both the corporate and the not-for-profit sectors. A board should take full responsibility for the work of its committees and of their recommendations to the board. This includes clarifying and regularly reviewing the remit of each committee; the processes of interaction between (and among) each committee and the board; and the nature and content of

discussions and follow-through.

As such, the number of committees, and who sits on them, needs to be given careful consideration in order to be sure that all board members are involved in committees (but not every committee) and that sufficient information is presented to the board in order to fulfill its oversight function. Great care should be taken to avoid the board of directors simply reiterating discussions that have already taken place at the committee, and to avoid the delegation of decisions that are the legal responsibility of the board.

Of course, good decision-making is a cornerstone of a robust governance framework. Received best practice states that effective decision-making incorporates robust and constructive challenge, within an environment of trust and appropriate boardroom behaviours; receiving timely, relevant and accurate information in a range of formats but with clear recommendations to the board. But how is this played out in practice?

Mind the gap

ICSA's *Mapping the gap* research project was initiated to examine the degree to which Trust boards in the NHS understood issues of governance, and the extent to which actual boardroom behaviour reflected guidance on best practice.

The research demonstrated that board members were aware of the importance of good governance and understood notions of best practice, but that there was a gap between the theory and the reality in a number of key areas: strategy; decision-making; clinical and quality matters; and probity and transparency. Observations of NHS boards suggested that insufficient challenge

- Acute Trusts use between two and eight board committees;
- Primary Care Trusts have structures that incorporate between three and fourteen dedicated committees;
- Foundation Trusts have developed arrangements with a range of between two and ten board committees.

Within the not-for-profit and public sectors, confusion regarding the purpose and use of committees can often start with a lack of understanding of which group is in control, and precisely what their roles are in relation to the organisation. Many charities, for instance, will have management committees who are making decisions about the organisation. However, if you questioned the participants, they would deny being trustees, despite the fact that in reality they are the ones directing and controlling the entity. Other organisations will establish strategy or governance committees – which leads to the question: precisely what is the board doing? Those leading organisations, regardless of nomenclature, need to understand precisely what their legal roles and responsibilities are, and when they can and cannot (or should not) delegate to committees.

Discordance

A cursory glance at some of the names of these many committees lead to further questions about the understanding of the term 'board committees', as opposed to other committees established to assist with the operational aspects of the organisation. In particular, there is a discordance between the corporate use and understanding of the audit committee, and the way such a committee is constituted and deployed in charities and social enterprises.

or 'obvious' question is asked. Within some charities and housing associations, the audit committee can, and does, include lay members who have the specific skills and knowledge required by the organisation. On the surface this appears to be a practical approach to filling a skills gap and strengthening governance arrangements. But the question of holding that lay person to account is a difficult one to resolve, along with establishing the liabilities that person may face.

A similar scenario occurs in the Foundation Trust movement with the dual-board approach of directors and governors. Here, the issue of remuneration committees arises with the Trust having to decide whether to deploy: a single remuneration committee for deciding pay and other terms of service for executive directors; or two committees, with the second dedicated to reviewing the remuneration of non-executive directors (since it is the governors that are responsible for non-executive director remuneration and performance). Both options have been used in the past, with myriad arrangements put in place to fill the middle ground. This already complex situation could be set to get even more complicated – under the proposals set out in the Health and Social Care Bill, the role of governors is set to expand, along with their accountability, which is likely to see an increase in the number of committees Foundation Trusts use. This will invariably create some duplication and overlap in the short to medium term at least.



In essence, then, there are differences in the use of committees between the public and private sectors in terms of the use, and number, of committees, but one cannot say that one sector is 'good and the other is 'bad' – there is poor and good practice to be found in both. It is worth remembering that certain types of organisations' committee requirements are stipulated by law or regulation, while others are guided by best practice. What is essential for all entities, in whichever sector, is for the board to know what committees it needs, when and why. This requires ongoing awareness of which decisions and discussions should take place within the board and which can be formally delegated to a committee. A full understanding of the board's legal duties and corporate governance principles are therefore paramount in ensuring that the organisation is well governed, strategically-focused, risk-aware and effective in meeting its goals. ■

Committees' terms should also include what actions are not authorised.

took place in meetings between participants, with many executive directors restricting their contributions to their departmental areas, and non-executives championing the patient experience. Furthermore, information presented to boards was of variable quality when assessed in terms of accuracy, timeliness and relevance, with a lack of cross-referencing, internal and external validation and data on future trends and market context. A snapshot of the number of NHS committees utilised by NHS Trusts in England discovered that, of those with the information published on their website:

Within the corporate sector, the remit and membership of the nomination, remuneration and audit committees is fairly well defined in the UK Corporate Governance Code. It is explicit that these are committees of the board, and therefore only members of the board can sit on that committee in a fully-active role. Ensuring that the right board members are sat on the right committees is essential to ensure appropriate challenge, avoiding groupthink, and encouraging assumptions to be questioned. This may mean including board members in committees that are not their usual subject area to ensure that the 'silly'

» About the author

Louise Thomson is Joint Head of Policy (Not-for-profit) at ICSA. She can be contacted on lthomson@icsaglobal.com



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