Governance and Risk
The Role of the Board

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Corporate Governance

The effective separation, management and execution of the relationships, duties, obligations and accountabilities that constitute an entity's existence such that the entity is best able to fulfil its fundamental purpose.

The Four Pillars of Governance Best Practice, IoD

A system by which business organisations are directed and controlled (OECD).

The role of the board

"The basic governance issues are those of power and accountability, where the power lies and who is accountable"

(Sir Adrian Cadbury 2002).

"If the board is not taking the company purposefully into the future, who is?"

(Sir John Harvey Jones, 1988)

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The role of the board

The board is responsible for ensuring that the company is:

- solvent,
- compliant,
- sustainable, and high performing,
- of good reputation.

All are in the best interests of the owners/shareholders.

Strategos (Greek) = military leader or general

- plan of action designed to achieve a long-term or overall aim
- the art of planning and directing overall military operations and movements in a war or battle.

Strategy is about looking to the future and deciding where you want to be, tactics are about how you are going to get there.

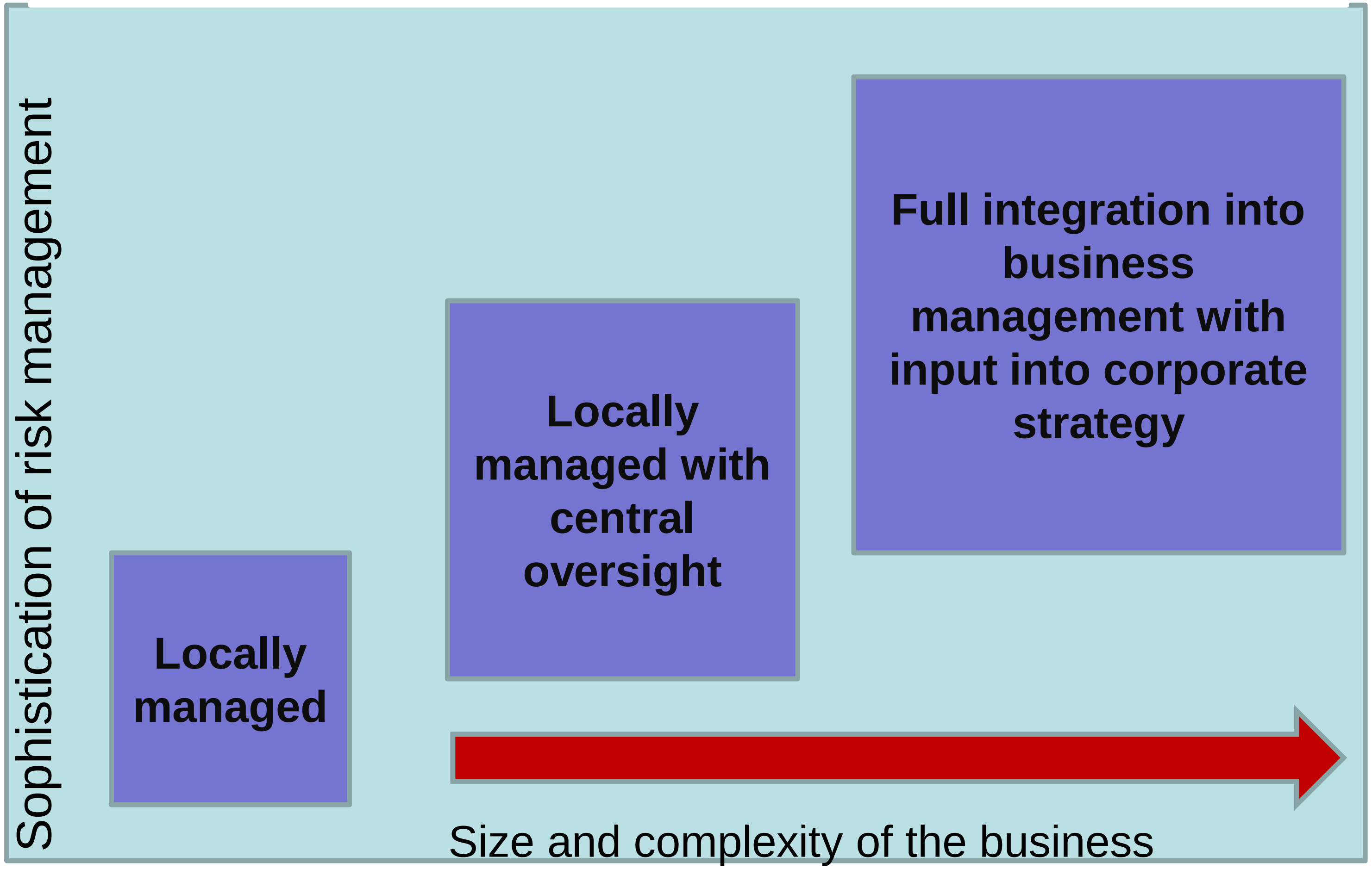
Business is an exercise in managing risk in exchange for potential returns

The board is responsible for ensuring that management and employees understand that comprehensive risk management should not impede the conduct of the business. It is not merely a *supplement* to the firm's compliance obligations but is ***an essential component*** of strategy, culture and operations

Harvard Business Review 2012

SIZE and COMPLEXITY

Growth of business and increasing sophistication of risk



Roles and Responsibilities

1. The **board** sets the tone from the top which should then permeate the firm's culture, ethics, risk oversight and intolerance of compliance failures.

2. The development of a risk strategy is the responsibility of **management and the board**.

3. Day-to-day risk management is **management's** responsibility.

4. The **board** ultimately owns it as guardian of the firm's brand and reputation.

Directors DUTIES

The Companies Act 1993 requires directors to exercise:

s.131 **A fiduciary duty** to act in good faith and generally in **what** they believe to be the best interests of the company (may be exceptions, where constitution expressly permits:

- if company is wholly owned subsidiary, may act in interests of parent
- director may act in best interests of major shareholder and board has approved)

s.135 **A duty not to act recklessly** by permitting a company to carry on business in a way likely to result in substantial loss to creditors

s.137 **A duty of care**, diligence and skill requiring them to be active and inquiring in the conduct of their duties

Separation of powers is a bulwark against tyranny

Holding to Account

1. Delegation of most functions and operational decision-making rights to professional management.
2. Management of the relationship between the board and management and the roles of the chair and CEO.
3. Collective responsibility.

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Separation of FUNCTIONS

Governance *What, Where, Why?*

- Is about a defined leadership role
- Is about longer term vision
- Bird's eye or helicopter focus

Management *How?*

- Concerns day to day operations
- Works to business plan
- Responsibility for ensuring operational processes, including risk management, are in place, monitored and controlled

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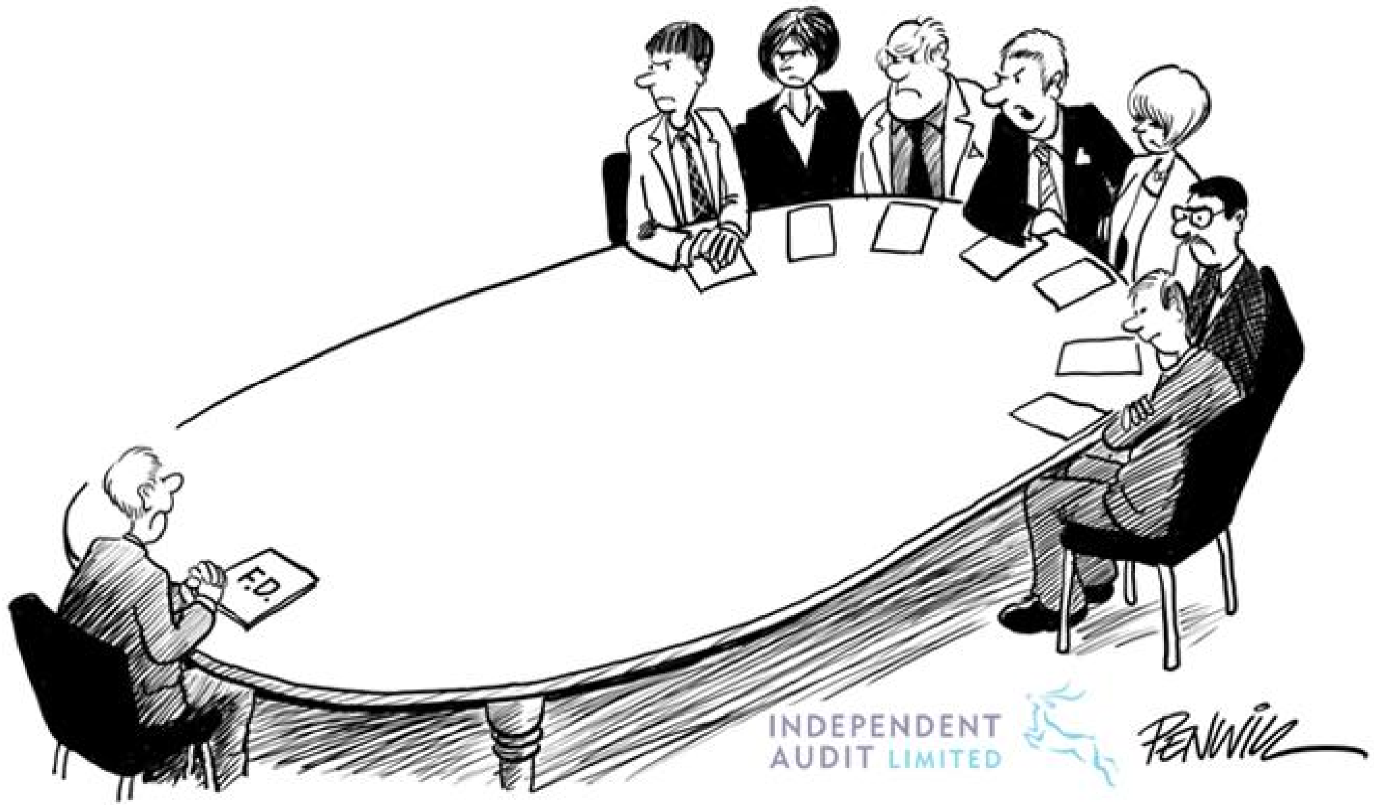
The board works *with,* not against management



"WE DON'T WANT YOU TO VIEW THIS AUDIT COMMITTEE AS BEING IN ANY WAY CONFRONTATIONAL"

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The board's principal focus must be on the company's strategy and risk.

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A FOCUS on achieving strategy

BOARD SETS STRATEGY, MONITORS PERFORMANCE AGAINST ACHIEVEMENT OF STRATEGY

↓

MANAGEMENT CONTRIBUTES TO SETTING OF STRATEGY, WORKS TO ACHIEVE STRATEGY

↓

PROGRESS TOWARDS ACHIEVING STRATEGY RESULTS IN THE REALISATION OF FUNDAMENTAL PURPOSE AND LONG TERM GOALS

Power and accountability

To recap, the board:

- must understand why it is there
- who it is accountable to
- what its responsibilities are

The board's main functions are to:

- define the company's purpose
- agree strategies and plans for achieving that purpose
- establish the company's policies
- appoint the chief executive
- monitor and assess the performance of the executive team
- assess their own performance (Cadbury 2002)

An EFFECTIVE board

"It's not rules and regulations. It's the way people work together. What distinguishes exemplary boards is that they are robust, effective social systems"

Jeffrey Sonnenfeld, Harvard Business Review 2002

An effective board is a living organism

- a climate of trust and candour
- a culture of open constructive dissent
- a fluid portfolio of roles
- individual accountability and collective responsibility
- the board evaluates performance

A board evaluates its performance as well as management's

"NEXT ITEM - CARRYING OUT OUR OBJECTIVE SELF-ASSESSMENT"

A Commitment to DIVERSITY

- **Diversity** – of thought and skills primarily and based on gender, age, experiential and ethnic diversity.

  the antidote to
- **Groupthink** “A progressive loss in the collective grasp of reality”

  (Victor Palmieri 1980’s)

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DISASTER

The disaster occurred because of what one analyst calls "**an incremental descent into poor judgment**". A "success" oriented culture, mind numbing complexity, and unrealistic performance goals all mixed until the violation of stands became the standard. Nothing looked amiss from the outside until, boom, it was all over.

Fortune Magazine May 2002 – Why companies fail

?

Companies that fail

Common characteristics

1 Defective organisations

   Domineering chief executive

   Weak board

2. Lack of management experience and skills

   E.g. financial skills

   – Failure to use budgeting and planning tools
   – Failure to respond to danger signals
   – Failure to use regular reporting of actual results to adjust business strategies

3. Failure to plan

   No clear goals, strategy and/or business plan

Common characteristics (continued)

4. Poor risk management
   - Lack of a robust risk management framework
   - Don't see danger signals before they show in the financials

5. Failure to respond to change
   - No proactive strategies
   - Quality of financial reporting
   - Analysis against plans, explain trends and take action

6. Poor understanding of what generates or destroys value

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Warning indicators

Board and management relationships

- Chairman and CEO dominating the meetings and making decisions without consulting the board
- Delays in information flows to the board, especially in problem areas
- Relationship problems between the CEO and directors
- Instances where appropriate authorisation has not been obtained by the CEO or management
- A number of director and senior management resignations

Smooth Operator Roles

Chairman – responsible for smooth operation of the board

CEO – responsible for smooth operation of organisation

Relationship

Chairman and CEO:

- have regular interaction
- chairman is available to act as sounding board/advisor to CEO - a ‘critical friend’
- chairman must ensure CEO understands and performs CEO role properly
- CEO ensures chairman is well informed – **NO SURPRISES!**

HIGH PERFORMANCE

A High performing company board will

- Focus on strategy
- Understand risk, set and monitor the company's risk strategy and policy and ensure that this permeates the organisation
- Create an effective, participatory culture focussed on high performance and ethical standards
- Assemble the right skills around the board table
- Set clear boundaries of responsibility and accountability
- Strive to maintain the highest standards of excellence possible
- Regularly and rigorously assess performance, including its own

Leading from the top the board and its directors must commit completely to achieving best practice which is not about minimum standards but about being **BEST IN CLASS**.

THE FOUR PILLARS OF GOVERNANCE BEST PRACTICE

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