# The Effective Board

INDEPENDENT BOARD REVIEW
January 2015

## Oversight and Management


Wording in the Corporate Governance Code and its Guidance can at times seem innocuous. But the FRC rarely uses words without intent. And sometimes the meaning or significance only becomes apparent when boards work out how to implement changes. We're coming across a prime example emerging from last September's change in Guidance on risk management and internal control (replacing "Turnbull"): the need for boards to consider "whether the leadership style and management structures, HR policies and rewards systems support or undermine the risk management and internal control systems".

This includes looking at whether the "management group... has the necessary skills, experience, authority and support..." (Guidance page 6). This goes beyond conventional approaches to looking at the effectiveness of risk management. Boards are now beginning to ask themselves whether they are doing enough to assess management structures – and who should be doing it

| Good practices to consider... | Things to avoid... |
|---|---|
| Recognise that it's not just about risk management systems and controls – it's about how the organisation is managed to meet its objectives. Risk management should be an integral part of good management, not a special exercise or process – and that means that you need to look at whether the management systems are fit for purpose, now and for the foreseeable future. | Regarding the new Guidance wording as just a continuation of what's gone before. Now it's putting a different emphasis on the Board's responsibility for understanding how the business is managed. (And you're supposed to report on how the Guidance is implemented, so it shouldn't just be dodged – especially as there are signs that shareholders are starting to take more of an interest in governance reporting.) |
| A good place to start: the Board thinking through what its responsibilities actually are around "considering leadership style and management structures". | Assuming that because it's in the Guidance on Risk Management and Internal Control it's just about risk management systems – and simply falls to the Audit Committee to sort out. It might do the more detailed work – but "how management manage" is surely a matter for the whole board. |
| Appreciating that leadership style and management structures are strategic issues – and major risks. Get them wrong – overly controlled, too much power in a few hands (or one pair), weak control over a fast-growing business, unclear accountabilities – and things can turn pear-shaped uncomfortably quickly. | Regarding it as a management matter that the Board shouldn't stray into. The Board has a clear responsibility to know that the management system is effective, robust and sustainable. |
| The Board can ask itself – "Do we actually know how the business works – and how the management structures fit together?" It doesn't fit neatly into the board agenda as a typical item but a good board will make room for it. One possibility is to tie this into its consideration of strategic risks. | Failing to give enough emphasis to the widely – recognised fact that organisations have different structures, processes and cultures – with some more effective than others. How all of these work together has of course a big impact on delivering the strategy – so the Board needs to know, and this will take some effort by both management and the directors |

| Good practices to consider... | Things to avoid... |
|---|---|
| Recognising that "leadership style" reaches beyond the executive team they see in the boardroom. A strong board will be out in the organisation, learning about how the business is run – and listening to a cross-section of those being managed. | Assuming that what they see in meetings is indicative of the style management use to run the business. It could be quite different – or, given the nature of board meetings, not evident in any case. |
| Looking for different and varied sources of indicators or assurance on how the structure works. Do staff surveys and exit interviews tell us anything? What does the Head of Internal Audit say? What's the external audit partner's perception? | Relying on one view that may bring only a narrow perspective. The Head of Internal Audit's view needs to carry weight and is a good starting point. But will it be sufficiently balanced or over-emphasise the control angle? |
| Thinking through what the Board actually does now to assess "leadership style" and how far it is in line with what's needed for strategic success. And whether that's changing as the organisation changes through growth, acquisition, technological change, geographical spread.... | Leaving "leadership" assessment to the Remuneration Committee as a reward issue. Achieving targets is, of course, important and a good reflection as to how well the business is being run. But it's not the same as looking at how far the management style is what's really needed now or for the future. |
| Making sure there's an opportunity for the non-executives to consider "leadership issues" from time to time without the executive present. Informal time, for example over a dinner, can work well. | Never quite having the right time to have a proper discussion. There might be snatched moments over coffee – but rarely without the odd executive being within earshot. NED only meetings might be an opportunity, but the Chairman may need to make the topic explicit. |
| Getting a clear sense of the way in which checks and balances operate within the executive team, and how these might be affected – for better or for worse – if certain executives were to leave. | Assuming that the existence of formal structures such as an ExCo means that executives can challenge freely. Or that presentations by executives at board meetings mean you have a complete understanding of how they're thinking, and how the executives make decisions. |
| Knowing whether unwelcome news and admission of failure can travel up through the hierarchy or if there are pressures for negative messages to get buried – or even lost – along the way. | Thinking that the formal reporting systems can be taken at face value. The culture (another thing that the new Guidance emphasises is a board responsibility) has a key part to play. |

If you have any questions on the issues covered here, please contact Richard Sheath at
richard.sheath@independentaudit.com

This eBulletin is published monthly. To see back issues click here: "The Effective Board".
To subscribe click here

We are leading specialist advisors on corporate governance. We assess the effectiveness of boards, committees, internal audit, external audit and risk management.

INDEPENDENT
AUDIT LIMITED

We perform full independent reviews or support your internal self-assessment or external facilitation using our online service:

THINKING
BOARD