Good Governance Guide

Issues to consider in board evaluations

Governance Institute of Australia

Board structure

It is **good governance** for an organisation to implement a process for regular, formal evaluations of the board, its committees and individual directors as well as addressing any issues that may emerge from that review.

A formal periodic evaluation not only involves examining past and current performance, but has a strategic focus in looking forward at how the board can add further value to the performance of the organisation.

Benefits of board evaluation

Board evaluation can provide a board with meaningful information as the basis for improvement, and will assist in optimising board performance and effectiveness.

A formal evaluation process is an opportunity to:

- assess the extent to which the board believes it is meeting its responsibilities at law and as set out board and committee charters, and whether those charters are still fit for purpose or require change
- review whether individual directors are meeting the time requirements of a non-executive director and whether they have sufficient time capacity going forward
- clarify individual and collective roles in the organisation's governance system
- optimise the effectiveness of board and committee meetings
- reflect upon the relationship between the board and management
- identify areas for improvement in internal and external reporting, including information provided by management to the board and its committees
- examine areas for training and development of board members
- review the effectiveness of the board's strategic thinking and decision-making
- review board and committee composition (the development of a board skills matrix will also assist in this regard — see *Good Governance Guide: Creating and disclosing a board skills matrix*)
- assess board behaviours and provide team building opportunities among directors.

Objectives

First, the board should establish the purpose of the evaluation. Clearly identified objectives enable the board to set specific goals for the evaluation and make decisions about the scope of the review. Each organisation is unique and each board will need to determine its own role and basis for operating. This will often change as the organisation itself evolves. The board needs to articulate its expectations of high standards of performance to set a benchmark against which it can measure itself.

The periodic board evaluation is an ideal time to assess the board's composition, and develop the board skills matrix as recommended by the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*. This is also an opportunity for directors to indicate areas for the individual and collective development of skills and knowledge so that the company secretary can develop an ongoing education/development program for directors.

Disclosure

ASX-listed entities will need to take account of the recommendation in the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* that a listed entity should have and disclose a process for periodically evaluating the performance of the board, its committees and individual directors; and disclose whether a performance evaluation was undertaken in accordance with that process.

Disclosure of the process and undertaking of a board evaluation in a reporting period is aimed at providing confidence to investors that the board takes governance seriously and is committed to regular, critical evaluation of its performance with an objective of improvement.

The *process* of board evaluation enables critical examination of the board's operations and how it can improve its effectiveness and performance. The board needs to consider whether it is appropriate to disclose detailed outcomes of board evaluations that do not create sensitivities, to provide the confidence that investors/members seek, with year-on-year monitoring of outcomes and follow-up. How any such outcomes are communicated is important, as any room for improvements noted in the evaluation should not be taken as flaws or dysfunction in current board practices.

While unlisted entities will find it useful to undertake board evaluations, they need to consider if disclosing the process or the fact that one was undertaken is of benefit. Each organisation will need to consider its own circumstances and decide whether or not, depending on its members, disclosure of the board evaluation process will bring benefit to the members.

Method and timing

The board needs to decide the best methodology for undertaking a board evaluation. The method chosen may differ from year to year. The different options available include:

- internally or externally facilitated review
- questionnaires and/or interviews
- group and/or individual appraisals.

A board should set a time for the periodic review of its performance as part of its annual calendar of commitments. It should establish the terms of the review, its performance measures and expected outcomes, and garner the support of all the directors in the process.

An external reviewer may be used every second or third year, with the board conducting an internal review in the alternate years. An external review can be supplemented by a review of the committees or a review of the independent directors in the intervening years.

APRA-regulated entities are required under the prudential standards to undertake a review at least annually of the board's performance relative to its objectives, as well as a review of individual directors in this regard.

Internal review

A board may choose to conduct individual interviews, using questions designed especially for the exercise and administer it internally. An internal evaluation may be conducted under the leadership of the chair, or the lead independent director or deputy chair (if one has been appointed), or a board committee chair, and the company secretary. An alternative internal approach is for the board evaluation to be led by a special board committee or the nomination committee. Selecting the right questions is the first step to ensuring that the board review questionnaire is appropriate to the needs of the board and the organisation.

It can be beneficial to make the review process an inclusive one and collect this information from a broader sample of key stakeholders, including senior management and the company secretary, as well as major shareholders, who may have knowledge and opinions of the board that could differ from those of the directors themselves.

External review

An external facilitator has the advantage of providing an impartial appraisal process and an unbiased reporting of the review findings. Directors are more likely to contribute openly if they can do so confidentially. If the decision is taken to use an outside group, the external reviewer is likely to suggest individual interviews, using questions designed especially for the exercise.

Individual director assessments

A confidential question and answer session can give board members the opportunity to comment on the strengths and weaknesses of their colleagues. These comments can be compared to the answers given by the directors about themselves. Any peer review that examines the contribution of individual directors requires a sensitive approach, with buy-in from all involved.

If there is a feeling that a particular individual has been not contributing effectively or is disruptive and that change is necessary, a director review may become an important part of the process of change.

A review of the performance of the chair is an important aspect of individual director assessments, and they should be evaluated as a director and the leader of the board. A lead independent director, who may be the deputy chair (if appointed), or a board committee chair may assist in this process.

Informal evaluation

While a formal board evaluation may be undertaken only periodically, informal board evaluation can be undertaken more regularly to provide more immediate and ongoing feedback. Different methods can be considered, including:

- directors holding a private session after the formal board meeting to assess how the meeting was conducted, looking at the quality of the information provided, the quality of presentations given, the quality of debate among directors and the way in which directors reached decisions
- a director being appointed by the board to provide feedback to the other board members on how the meeting was conducted and board performance. The appointed director contacts the other directors after the board meeting seeking their feedback and collates the responses, which are provided without attribution to the directors at the next board meeting.

Measuring performance

Establishing KPIs that are measurable and relate directly to the board's role and sphere of influence is important in ensuring a valid assessment process. This can be a difficult objective to achieve even when establishing them is a desired outcome from the board review. Measurements of board performance are likely to be both quantitative and qualitative.

While the key issues may change from year to year, it is desirable that the process remains stable. This puts the onus on the board to establish a robust process so that various measures can be compared from year to year, and if there is a marked deterioration, corrective action can be taken quickly. It will be clear to the board if performance generally is improving or deteriorating.

The company secretary

One element of the board evaluating its own performance is to monitor the effectiveness of the company secretary in their role of being accountable to the board, via the chair, on all matters relating to the functioning of the board. The board should consider setting performance goals and key performance indicators for the company secretary and review the company secretary's performance against them.