20 Questions

Directors Should Ask about Governance Assessments

Richard W. Leblanc, PhD

The Canadian Institute of Chartered Accountants

How to use this publication

Each "20 Questions" briefing is designed to be a concise, easy to-read introduction to an issue of importance to directors. The question format reflects the oversight role of directors which includes asking management — and themselves — tough questions.

In some cases, Boards may not want to ask the questions directly and prefer to ask management to include the topics or answers to the questions in presentations to the Board. The questions are not intended to be a precise checklist, but rather a way to provide insight and stimulate discussion on important topics.

The comments that accompany the questions provide directors with a basis for critically assessing the answers they get and digging deeper as necessary. The comments summarize current thinking on the issues and the practices of leading organizations. Although the questions apply to most medium to large organizations, the answers will vary according to the size, complexity and sophistication of each individual organization.

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Preface

The Risk Management and Governance Board of the Canadian Institute of Chartered Accountants (CICA) has developed this briefing to help members of Boards of public companies to conduct governance assessments of the Board, Board committees and individual directors. It is intended primarily to help individual directors but Boards and audit committees may also wish to use it for orientation and discussion. The content of this briefing may also be helpful to Boards and directors of not-for-profit organizations and private companies.

This briefing provides suggested questions for Boards to ask themselves, senior management and others. For each question, there is a brief explanatory background and some suggestions. We hope that directors and CEOs will find it useful in assessing their approach to governance assessment.

The Board acknowledges and thanks the members of the Directors Advisory Group for their invaluable advice, the author, Richard Leblanc, and the CICA staff who provided support to the project. David Conklin, Peter Stephenson and Nelson Luscombe are also thanked for their helpful suggestions and review.

Thomas Peddie, FCA
Chair, Risk Management and Governance Board

Introduction

Recent high-profile corporate failures, scandals and, in some cases, executive corruption, have focused international regulatory and public attention on the need for having appropriate corporate governance standards and practices. Canada, the United States, United Kingdom, Australia, New Zealand and other countries have enacted corporate governance rules, codes and guidelines of varying types for publicly traded companies. Such guidelines address the issue of governance assessments, i.e., the requirement/recommendation that the effectiveness of boards of directors, committees of boards and individual directors, as the case may be, be assessed on a regular basis.

> As evaluation progresses, it must serve one clear objective: to provide guidance that creates superior long-term value.
>
> *National Association of Corporate Directors, Report of the NACD Blue Ribbon Commission on Board Evaluation: Improving Director Effectiveness.*

Implicit in this regulatory attention to assessments is the belief that (i) such assessments enhance the effectiveness of boards, committees and individual directors and (ii) more effective boards, committees and directors are in the best interests of corporations and contribute positively to their continued performance and success.

> An increasing percentage of boards evaluate the CEO, themselves and their individual members. Of the three practices, two (board and member evaluations) have been found to be related to board effectiveness. …Boards that assess their members and themselves tend to be more effective than those that don't.
>
> *Edward E. Lawler III and David L. Finegold, "The Changing Face of Corporate Boards."*

The process of undertaking governance reviews is much easier said than done. Directors may not think they are necessary. They may not be comfortable with the prospect of being assessed or of assessing their fellow directors. And directors may have concerns about what assessments might disclose and who will be privy to that information. These are legitimate concerns that this publication will address.

> Directors are reluctant to pass judgment on their peers.
>
> *(regulator)*

This publication will respond to board members' objections and concerns and offer guidance on how to conduct assessments, based on the research experience of the author. By posing and commenting on a set of questions, this document will help boards, chairs and individual directors understand the assessment process and be better equipped to undertake or improve upon governance assessments within their own boards. There may be select excerpts from this publication, including qualitative data, that originate from Dr. Leblanc's doctoral data set, ongoing work with boards and *Inside the Boardroom: How Boards Really Work and the Coming Revolution in Corporate Governance*, co-authored with James Gillies (Wiley: 2005).

> Evaluation of the board? What about litigation? You want me to [submit] a personal evaluation? You're nuts!
>
> *(director)*

> The peer appraisal is a smoking gun on both sides.
>
> *(director)*

Preparing for the assessment

On April 15, 2005, members of the Canadian Securities Administrators (CSA) published two initiatives requiring reporting issuers to provide greater disclosure about their corporate governance practices: National Policy 58-201 *Corporate Governance Guidelines* (the "Policy") and National Instrument 58-101 *Disclosure of Corporate Governance Practices* (the "Instrument"). The Policy and the Instrument came into force in Canadian jurisdictions on June 30, 2005. The Instrument applies to information circulars or annual information forms which are filed following financial years ending on or after June 30, 2005.

The National Instrument 58-101 *Disclosure of Corporate Governance Practices* sets out corporate governance disclosure in the areas of the board of directors, the board mandate, position descriptions, orientation and continuing education, ethical business conduct, the nomination of directors, compensation, other board committees, and lastly, assessments. Reporting issuers to which the Instrument applies will be required to disclose whether or not the board, its committees and individual directors are regularly assessed with respect to their effectiveness and contribution. If assessments are conducted, the process will need to be described. If the board does not conduct governance assessments, it will need to justify this decision.

1. What are the principal types of governance assessments that a board of directors is recommended to perform?

There are four main types of governance assessments. They are:

i) Board Assessments

This is the type most frequently practiced and involves the board assessing its own effectiveness, typically against its mandate and via a self-administered, written questionnaire.

> "Nearly half the leading companies in the English-speaking world now carry out some type of board performance reviews… As positive as that seems, the fact remains that most of these reviews focus on the board, and not on individual directors. …Performance appraisal for individual directors, as well as boards, is an idea whose time has come."
>
> *Colin B. Carter and Jay W. Lorsch,*
> *Back to the Drawing Board:*
> *Designing Corporate Boards for a Complex World.*

ii) Committee Assessments

These assessments are similar to board assessments but occur at the committee level. They typically involve a committee of the board, e.g., the audit committee, the compensation committee and the nominating/corporate governance committee, assessing their own effectiveness against their respective written charters.

iii) Assessments of the Chairs of the Board and Committees

These assessments consider the position descriptions which the board should develop for the chair of the board and the chair of each board committee, as well as the competencies and skills each individual director is expected to bring to the board.

iv) Assessments of Individual Directors

This occurs when the individual directors are assessed regarding their effectiveness and contribution. The assessment should consider the position description(s), as well as the competencies and skills each individual director is expected to bring to the board.

> For instance, some directors perform in committee. Some directors perform more one-on-one. Some directors use their outside expertise. Some directors are active in the community. So effectiveness measurements should measure the different ways the directors contribute.
>
> *(director)*

The lines among these four types of assessments may blur. For example, a board assessment might involve canvassing directors on their views of executive compensation oversight, which may fall under the initial purview of the charter of the compensation committee. A board or committee assessment may canvass members' views on the effectiveness of the chair of the board or the chair of the respective committee, and in doing so, incorporate the assessment of those individual directors.

2. How should a board of directors approach the assessment process?

A board of directors should proceed with an assessment once all directors have heard an explanation of the rationale for doing so, have had an opportunity to express their views and the board collectively has agreed on an optimal process for doing so. Boards should progress deliberately, especially in assessing the effectiveness of individual directors, and resist any temptation or pressure to act

> For director evaluations, the two questions are 'on what basis?' and 'by whom?'
>
> *(director)*

prematurely. Undue haste could cause irreparable harm to board dynamics. A board would know that it is ready to proceed with a rigorous assessment process once it has collectively agreed, under the leadership of an independent director, on (i) what is being assessed, (ii) how the data will be managed and (iii) how the overall self-assessment process is expected to play out. There should be appropriate assurances of confidentiality and confidence in the data compilation, interpretation and feedback provided to individual directors. For a discussion of legal concerns involved in individual director assessments, and how they might be addressed in a positive fashion, see Appendix 1.

> First, this is new. Second, directors are uncomfortable being critical of their colleagues. It's okay for management to be evaluated but there's ego and fear for directors being judged by their fellows. My own view is that this can be done so that it is tasteful, thoughtful and rigorous. Sacking under-performing directors is the stick. Some positives are that assessing other directors is not necessarily not of value — it can enhance director performance. You can identify individual performance that can be corrected.
>
> *(chair of a governance committee)*

Full board assessments are typically undertaken before assessing the effectiveness of committees of the board and before assessing the effectiveness and contribution of individual directors. This time gap allows boards to get comfortable in assessing their own effectiveness before turning their attention to assessing individual members.

As well, new directors should be given time to get "up-to-speed" before they become involved in any assessments. Experienced directors suggest that many new directors require time to become proficient on the board, especially if they are not experienced in the company's particular industry sector.

> Directors need to thoroughly understand the nature of the business and businesses. Each new director should have a substantive written briefing on the business, its nature, and over the first year it's best to schedule to spend half a day at each of the major manufacturing sites to get up to speed. You need to develop an understanding then through osmosis and put significant time into it.
>
> *(director)*

3. What techniques or methods may be used when conducting an assessment?

There are various approaches and methods for assessing boards and directors depending on each board's particular needs. Boards need to adopt a governance assessment approach appropriate for their particular circumstances, and then refine and adapt the approach as they become more comfortable with the assessment process. Assessment approaches are summarized under the broad headings of "quantitative" and "qualitative."

Quantitative Analysis

A questionnaire or survey is a preferred method of quantitative assessments. Care needs to be taken in creating the questionnaire to ensure that the full range of effectiveness issues is assessed and that the right questions for each particular board are asked in order to surface key issues that contribute to board and individual director effectiveness. Surveys should also contain a combination of quantitative scoring metrics, as well as providing the opportunity for directors to provide open-ended, candid but constructive verbal commentary that contributes background and context to quantitative scores. The raw verbal commentary, which could be summarized, should not be attributed to a particular director(s), i.e., anonymity should be preserved to the extent possible.

Once completed, the questionnaires are collected, the data are analyzed and summarized, recommendations may be made, and a collective dialogue based on the summary can occur.

Qualitative Analysis

The two most common approaches to qualitative analysis are interviews and direct observations, the former being far more prevalent. An interview can be structured or more unstructured and free-flowing, and can create a powerful dynamic if done properly. An interview can be between the director and the chair of the board, the chair of a particular committee, or a governance adviser. An interview may provide greater candour and be more effective in addressing sensitive issues that may not surface in a questionnaire.

A governance assessment model can be designed so that a questionnaire — canvassing a wider scope and identification of key issues — can precede a more qualitative, in-depth interview, where deep dives and key insights are possible. An interview can also be more collective in nature, with varying degrees of director participation, e.g., a facilitated group discussion with a board.

The second qualitative method is direct observation of a board of directors and committees in action. This is not an option for many boards because of confidentiality concerns; however, unobtrusive observation by a trained qualitative observer may provide robust data on board and individual director effectiveness. Direct observation of the board as a group in real time can be designed to "round out" a quantitative questionnaire and interviews with individual directors.

Assessing the board and individual committees

There is no generally accepted definition of "board effectiveness." One could say in broad terms that such a definition would encompass the elements necessary to enable a board to discharge its responsibilities owed to the corporation and its shareholders as required by legislation or regulation.

The board should assess its own effectiveness and contribution against its responsibilities and written mandate. Committees of the board should also regularly assess their effectiveness and contribution and such assessments should consider the charter of each respective board committee.

4. Does the board have a mandate and do board committees have charters?

Prior to assessing its effectiveness, the board of directors needs to identify and describe its specific responsibilities. These responsibilities should be reflected in a comprehensive, up-to-date mandate for the board and charters for the principal committees of the board. Section 3.4 of CSA Policy 58-201 recommends and describes the elements of a written mandate. See Appendix 3.

When assessing the effectiveness of a board of directors, directors should be canvassed as to whether elements of the mandate of the board are being fulfilled.

5. Who should lead and conduct the assessment of the board of directors and committees of the board?

Board Assessments

There are various options for responsibility for leading the assessment of the board. The person most often considered appropriate is the non-executive chair of the board. If the chair and CEO roles are combined, it should be the "lead director" or the chair of a committee of the board, e.g., the governance committee or another independent director on behalf of the board. Another option is for the chair of the board and chair of the governance committee to co-lead the board assessment.

Management may also play a supportive and facilitative role in the assessment, e.g., the corporate secretary in administering questionnaires etc., but it is important that ultimate authority for leading and conducting the assessment rest with the independent board leader.

Committee Assessments

There are also options for who should lead committee assessments. The person frequently considered most appropriate to lead and conduct a committee assessment is the chair of that respective committee, i.e., the chair of the audit committee leads the audit committee assessment, the chair of the compensation committee leads the compensation committee assessment, and so on. Many boards, however, entrust these assessments to the chair and/or chair of the governance committee for independence and consistency, and to facilitate analysis of the relative effectiveness of various committees.

6. Should a board of directors obtain external assistance with an assessment?

An advantage that a board of directors has in conducting an internal self-assessment, with administrative support from management as appropriate, is that, providing there is candour on the part of directors, the board is presumably most informed and able to judge whether or not the board, committees of the board and individual directors are effective.

However, some disadvantages of a board conducting its own internal review, depending on the board make-up, include the following:

i) the board may not possess the knowledge of leading assessment practices or may lack experience in conducting the review;
ii) the board may lack sufficient objectivity;
iii) the board, as any small group, may be vulnerable to subtle political or interpersonal agendas and relations; and
iv) directors may simply lack the time and resources to conduct a thorough review.

> "There is so much pride and ego with high rollers that it is worse than death to be embarrassed or lose face in front of their peers. So you must manage the process of board and peer assessments so there is no war path or sabotage."
>
> *(professional adviser)*

A source of assistance and support to the board is an external governance adviser or service provider who specializes in advising boards and has the experience and expertise in conducting board reviews. These advisers — who are accountable to the board rather than management — may bring a level of objectivity and independence to the process. They may also assist boards, committees and directors in compiling the data and providing feedback and recommendations to the board and to individual directors.

This said, however, the board as a whole must own the entire assessment process and be completely comfortable with it. An expert brings expertise, but may never fully appreciate the complex subtleties, alliances, dynamics and the historical and political landscape within a given boardroom.

7. Who should participate in the assessment of the board of directors and committees of the board?

All directors should participate in the board assessment process.

Committee assessments should solicit the input of committee members as part of the assessment. The committee may also solicit the input of other directors who may not sit on a particular committee, yet have views on that committee's effectiveness at fulfilling the terms of its charter and reporting its activities and recommendations to the full board.

If board members are comfortable doing so, members of management may also participate in a particular questionnaire or governance assessment, in a so-called "360 degree" feedback method, through specific questionnaires or interviews or in providing 'upward feedback' to the board, its committees and individual directors. For example, a CEO may offer constructive views on how a director can more effectively understand the key drivers of the business, and in doing so, improve that director's effectiveness at providing strategic input to the CEO and management team. The CFO could offer constructive suggestions to members of the audit committee; the chief risk officer might offer similar suggestions to members of a risk management committee; the chief human resources officer vis-à-vis the compensation committee, and so on.

The advantage to involving management is that they are most informed about the company and so aware of what they need from the board. Therefore they may offer valid, constructive feedback on the effectiveness of the board, committee or individual director, as appropriate, e.g., by helping the board to perform well.

8. What should be evaluated when the effectiveness and contribution of a board of directors and its committees is assessed?

At a minimum, the board's (and its committees) effectiveness should be assessed and measured against its mandate. In doing so the directors should consider the effectiveness of the board's process.

> "At least as important are the human dynamics of boards as social systems where leadership character, individual values, decision making processes, conflict management, and strategic thinking will truly differentiate a firm's governance. Can fellow directors be trusted? Does management provide the full story? Is there enough time for advanced reading and full discussion of materials? Is dissent encouraged? Are people well prepared? Does management allow themselves to be vulnerable? How are board members kept accountable for their preparation and decisions? How is assessment conducted so board members can learn and improve?"
>
> *Jeffrey A. Sonnenfeld, "Good Governance and the Misleading Myths of Bad Metrics."*

Board process refers to how directors make decisions. Boards of directors, like most groups, are made up of diverse individuals, all of whom have different behavioural patterns that govern their actions. Board process should be an important part of any board or committee assessment. Board process includes the following elements:

- board leadership effectiveness, i.e., the independence of mind, competencies, skills, breadth of experiences and behaviours of the chair of the board and chairs of board committees;
- the "hard" components, including:
  - — information flow, setting of board and committee agendas, work plans, calendars of responsibilities, etc.;
  - — length, frequency and location of board and committee meetings;
  - — management resources and support provided to the board and committees;
  - — external/independent advice and resources available to the board;
- the "soft" components, including:
  - — the quality of board discussions and overall decision-making effectiveness;
  - — the balance of director behaviours that the board possesses to ensure an effective decision-making dynamic;
  - — the behavioural orientation of the CEO towards governance and the relationship between the CEO and the board;
  - — committee reporting effectively to the board;
  - — relationship with the CEO's direct reports and the quality of management presentations;
  - — relationship with independent advisers and the quality of executive sessions; and
  - — informal processes such as board dinners, offline communications, strategic retreats, etc.

A lack of attention to board process during a board effectiveness assessment means ignoring an important reality — it is the behaviour of directors and the mix of behavioural characteristics of directors that really determine the decision-making effectiveness of the board.

9. Once the feedback is provided to the board on the results of the assessment, how should a board go about acting on the results?

It is important that the board prioritize opportunities for improvement and not try to do too much too soon or, worse yet, not act on the data. The board could commit to agree upon three or four key issues and work on those for the next year, or until the next assessment. Boards should therefore take assessments one step at a time, have a work plan to address the issues, act on the data and hold themselves accountable for taking action. Otherwise, the assessment process will lack credibility and directors may become cynical if improvement suggestions are not acted upon. In setting priorities, leadership by the chair or lead director is essential.

The feedback and action planning for committee assessments are similar. Once the data from the committee assessment (e.g., the audit committee) is tabulated, analyzed and reported back to committee members and the rest of the board, the chair of the committee should take ownership of the results and create an action plan on a going-forward basis that addresses the assessment, incorporating the findings into the committee's calendar of responsibilities and annual work plan. The governance committee (or its equivalent, the board as a whole or the chair of the board) may be the focal point for holding individual committees accountable for acting on their assessments.

"An evaluation process is only as effective as the decisions and action plans that come out of it."

Geoffrey Kiel, "Effective Board Assessment: Practices, Opportunities and Issues."

"The problem is that the information [from the director assessment] isn't acted upon, other than the individual director initiative…. Directors aren't acting upon the data. There's no 360-degree mechanism for feedback."

(director)

"That's why it's so important to have a regular performance [assessment] process, for everyone to see, with objective data. The better job the board does at a performance management system, the better it will detect performance problems and then have to deal with them. For example, 'here are the five objectives that we have not accomplished.'"

(director)

Assessing individual directors

Each individual director should be regularly assessed regarding his or her effectiveness and contribution. The assessment should consider the position description(s), as well as the competencies and skills each individual director is expected to bring to the board.

10. Are there position descriptions for directors?

The board should develop clear position descriptions for directors, including the chair of the board and the chair of each board committee. The specification and assessment of the duties and responsibilities — to be an effective chair of a board, chair of a committee, individual director and CEO — must be undertaken to assure efficient board operations. There are important reasons why the preparation and adoption of position descriptions are necessary, but two are important — first, it is a way to ensure that all the essential elements for the effective operation of a board are being addressed; and, second, without specific performance expectations, it is unlikely, or at least quite difficult, to assess the leadership and effectiveness of individual directors involved in the board's decision-making.[1]

The duties and responsibilities included in director position descriptions may involve such routine tasks as attendance at board and committee meetings by directors, the relationship between the chair and the chief executive officer when the two positions are separated, the activities and actions that committees should take and so on. Unless such responsibilities are made explicit and measured in some way, they may not be properly fulfilled.

11. Has the board defined the competencies and skills it needs in its membership?

A major condition for board success is having directors on the board with the competencies needed to assure the company can achieve its goals. Director competencies may be defined broadly as the knowledge, experience, education and training that a director brings to the boardroom. They may be classified as core competencies required of all directors, e.g., business judgment, or include more specific, functional competencies that are aligned with the company's business, circumstances and strategic environment.

> For example, competencies that the board of a financial services institution may consider necessary for the board, as a whole, to possess, could include financial, technology, risk management/compliance, marketing, human resources/compensation, regulatory/legal, real estate, e-commerce/Internet, or another special type of competency the board requires, e.g., knowledge of hedge funds.

Defining and assessing specific competencies that individual directors possess is difficult for many boards to do, but such an exercise must be undertaken if the board is to have the right directors serving on it. The first step in determining that the board collectively has the appropriate competencies to fulfill its responsibilities is the creation of a director competency and skills analysis as recommended in CSA's Policy 58-201. Once such a matrix analysis is prepared, the gaps between the current and desired board competencies can be readily identified.[2]

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[1] See e.g., chapter 4 of R. Leblanc and J. Gillies, *Inside the Boardroom* (Toronto: Wiley & Sons, 2005), where comprehensive position descriptions are provided based on Dr. Leblanc's study.
[2] *Ibid.* at chapter 9: The "C-B-S-R" model (competency, behaviour, strategy and recruitment).

> Defining and more importantly assessing very precise, specific competencies that individual directors possess is difficult for most boards to do.

12. What should be evaluated when the effectiveness and contribution of an individual director is assessed?

In CSA Policy 58-201 Section 3.18 it is recommended that each individual director should be regularly assessed regarding his or her effectiveness and contribution. An assessment should consider the applicable position description(s) as well as the competencies and skills each individual director is expected to bring to the board. "The board should develop clear position descriptions of the chair of the board and the chair of each board committee." (Policy Section 3.5)

> "The assessment needs to recognize the distinctive set of competencies that each director brings to the boardroom. At the same time, there should be a set of general dimensions that describe what is expected from every director irrespective of his or her expertise."
>
> *Jay A. Conger and Edward Lawler III, "Individual Director Evaluations: The Next Step in Boardroom Effectiveness."*

The assessment of individual directors should take into account the applicable position description(s). If there is no position description, the assessment should consider criteria developed by the nominating or governance committee for use in director recruitment and in director orientation.[3]

> It is the behaviour of directors, and the mix of behavioural characteristics of directors, that really determine the effectiveness of the board.

Presumably, if directors have independence of judgment, competence and motivation, then a board consisting of such directors will have most of the necessary ingredients to be effective. However, this is not necessarily the case. It is the appropriate combination of the varying behaviour characteristics of such directors (i.e., the "chemistry" among them) that determines whether the board will operate effectively. Individually, directors can be independent and competent, but if they do not interact and are led inappropriately, they may not be effective. Therefore, the softer "skills" of directors should also form part of this assessment. CSA's Policy recommends that "Attention should also be paid to the personality and other qualities of each director, as these may ultimately determine the boardroom dynamic." (at Section 3.12).

13. Who should lead and conduct the assessment of the effectiveness and contribution of individual directors?

The chair, on behalf of the board, may be the person who assesses the effectiveness of individual directors. This type of assessment may involve individual directors assessing their own effectiveness, either in writing, e.g., questionnaire, and/or through a discussion with the chair of the board.

The benefits of this type of assessment are that (i) it allows an opportunity for self-reflection on one's performance and how it

[3] See Appendix 2 for examples of criteria, based on a previous CICA publication.

might be enhanced; (ii) the data sharing is confined primarily to the individual director, and therefore may be more self-critical and less intimidating to individual directors; (iii) the self-assessment provides a convenient step before proceeding to peer feedback for those boards wishing to do so.

Alternatively, directors may collectively assess one another based on the position description for individual directors, e.g., a peer assessment, whereby directors assess one another's effectiveness.

This is the least-widely practiced and most challenging form of assessment and involves directors assessing one another on a number of performance dimensions. The raw data are not typically shared collectively with all other directors, other than in aggregate form. Only the chair of the board may see more.

The chief benefits of a director peer assessment are that (i) it allows for collegial feedback on one's own performance as a director, and in this sense may be more objective than a self-assessment; (ii) the peer assessment provides for collective focal points of discussion for key issues surrounding the effectiveness of individual directors. There may be a greater tendency to act on data that is collectively shared.

It is critical however that a board contemplating peer assessment be ready to do so. "Readiness" may involve (i) proceeding through board, committee and self-assessments; (ii) a collective commitment by all directors to the peer assessment, including the criteria for individual director assessment, how the peer assessment process will work, how the data will be managed and how feedback will be provided; and (iii) effective board leadership in overseeing and managing the overall process.

14. Who should lead and conduct the assessment of the effectiveness and contribution of the chairs of the board and board committees?

For the assessment of the effectiveness and contribution of the chair of the board, the chair of the nominating or governance committee, on behalf of the board, may be the person who conducts the assessment, considering the position description for the chair of the board, i.e., assessing the chair's performance against this position description. The opinions of all directors could also be solicited for an assessment of the effectiveness and contribution of the chair of the board.

The views of all committee members (and possibly non-committee members and members of management, as appropriate) could be solicited for an assessment of the effectiveness and contribution of a chair of a committee of the board, considering the committee chair's position description and performance against that position description. The chair of the board, on behalf of the board, may also provide input on the effectiveness and contribution of directors who chair particular committees of the board.

After the assessment

15. What should a board do with the information produced by the assessment?

The data emerging from governance assessments is sensitive. There needs to be appropriate assurances of confidentiality and confidence in the data compilation, interpretation and the provision of feedback to individual directors and to the board. That said, there are various possibilities for carrying this out. Directors need to be comfortable with the process and tailor it to suit their circumstances.

In general terms, for board and committee assessments, feedback is shared with and discussed by the full board and respective committees. The data and/or recommendations flowing from the assessment may also be shared selectively as appropriate with members of management, in addition to the CEO (e.g., CFO, risk officer, corporate secretary, etc.), in certain instances or circumstances, for remediation purposes.

Feedback from the assessment of the chair of the board, which may occur as part of the board assessment, may be provided to all directors. Alternatively, the chair's assessment may occur separately, with data provided to the director responsible for conducting the assessment, e.g., chair of the governance committee, depending on the preferences of the individuals involved.

> "How will the feedback be handled? This is probably the single most important component of the entire process. Deciding who will share the feedback with whom, in what settings, under what conditions and employing what steps to turn feedback into action — those are the choices that may ultimately determine whether the assessment is a success or a failure."
>
> *David A. Nadler, "Minefields in the Boardroom."*

Similarly, feedback from the assessment of the effectiveness of committee chairs, which may occur as part of the committee's regular assessment or separately, may be provided to the respective committee members or the entire board.

Feedback from individual director 'self' assessments remains with individual directors. Directors may, however, be encouraged to use it as the basis for a discussion with the chair of the board for professional development purposes.

Feedback from individual director 'peer' assessments (i.e., directors assessing one another's performance) is typically provided to the individual director being assessed and is not shared with other directors, with the exception of the chair of the board for feedback and remediation purposes. In other words, directors see their own individual results for professional development purposes but not the results of their colleagues. The feedback provided could consist of quantitative scores on various performance dimensions and anonymous, constructive verbal commentary provided by the director's colleagues.

If the purpose of the individual director assessment is for re-nomination purposes, in addition to professional development, a summary of the assessment results for an individual director may be provided to the chair of the board or a committee of the board to facilitate a discussion about an individual director's past contribution, anticipated contribution given the challenges facing the organization, individual director development needs and, ultimately, whether the director should continue to serve on the board.

Over time, as boards and individual directors become more comfortable with assessments, there may be an increasing likelihood that assessment data will be shared more broadly with other directors, in a constructive, enabling manner and if there is a tremendous level of readiness by the board. In other words, the data from an assessment of the chair of the board may be shared with all directors; the data from an assessment of the chair of committees may be shared with all directors; and the data from individual director peer assessments may be shared with all directors. It is important however to remember that boards should design a process to suit their circumstances, preferences and their stage of evolution concerning assessments.

> The leadership of the board chair is the single most important factor impacting effective board process, optimal decision-making and overall board effectiveness.

16. Following an assessment, how should a board address the finding that an aspect(s) of the chair's effectiveness might be enhanced?

The leadership of the board is perhaps the single most important factor impacting effective board process, optimal decision-making and overall board effectiveness. The leadership skills necessary for the chair's position require a person who can lead the process of setting the agenda, running meetings effectively, controlling discussion appropriately, managing dissent, working towards consensus, communicating persuasively with colleagues and management, inside and outside of board meetings and, most importantly, setting the tone and culture for effective corporate governance.

> "Although board chairmen have no statutory position, the choice of who is to fill that post is crucial to board effectiveness. Broadening the point, when we attend a meeting of any kind, we can sense almost from the start whether the chairman is competent or not. Providing he or she is, the meeting will serve its purpose. If the chairman is not up to the task, it is improbable that the meeting will achieve anything but frustration and waste of that most precious of resources — time."
>
> *Adrian Cadbury, "Corporate Governance and Chairmanship: A Personal View"*

As is the case with other directors, the chair must receive appropriate feedback about his/her performance and have an opportunity for remediation to improve his/her effectiveness, as warranted. The feedback discussion should occur between the chair of the board (as recipient of the feedback) and the chair of the corporate governance committee, or its equivalent.

Chairs who exhibit ineffectiveness in a particular area may be counseled by a peer director (e.g., chair of the nominating and corporate governance committee, vice-chair, lead director, etc.) in a tactful, discreet manner as to how they might improve their performance. An under-performing chair may, however, not seek or may refuse developmental input. If an ineffective chair neither acknowledges his/her leadership flaws, nor desires to improve, the board has a serious problem. If it is deemed that the chair cannot or will not improve, he/she should be asked to step down as chair or leave the board.

> There should be a special course for how to be a chairman. Training for chairmen. The right chairman creates the right atmosphere. With the wrong chairman, it's completely different.
>
> *(director)*

17. Following an assessment, how should a board address the finding that an individual director is under-performing?

A concerted effort should be made to "close the loop" on individual feedback and remediation so that development opportunities can be provided to directors. A one-on-one meeting between the director and the chair of the board may be the most appropriate forum for this de-briefing. At this meeting, the director should be encouraged to share his or her assessment with the chair, as a basis for a candid discussion.

As warranted, the chair and the individual director should create a developmental path for the director based on the director's assessment (self or peer). Often the data are sufficient as a prompt for remediation, but an effective chair will ensure that the director gets any assistance he or she needs. This might include courses, outside assistance, private tutorials, time with management to develop a better understanding of the business model and drivers, and talking with the chair about how that director might augment his or her contribution or shift or modify his/her behaviour to become more effective.

> The peer appraisal was effective for one director… his performance increased significantly.
>
> *(CEO)*

From a competency and behavioural standpoint, the task of improving the effectiveness of directors is a difficult undertaking. Behavioural characteristics may be ingrained. Dysfunctional or otherwise under-performing directors may not recognize the need to improve, particularly if the manner in which they behave appears to be accepted by the rest of the board. Even when they do understand and appreciate the need for improvement, ego may preclude them from trying to improve on their own or seeking assistance from fellow directors.

Ineffective directors (i.e., those who refuse to perform, or are incapable of performing for whatever reason, despite having undergone remediation) must be asked to step down and/or not seek re-election. This requires intervention and effective board leadership. Leaving ineffective directors on the board may be easier than removing them but the cost of doing so is resentment by fellow directors and an overall decline in total board effectiveness.

18. How might the assessment of the effectiveness and contribution of individual directors be integrated with director tenure?

The majority of boards have some type of formal or informal retirement plan — including age, tenure, geographical restrictions, change-in-principal-occupation restrictions or restrictions on the number of external directorships. Part of the rationale for these types of policies is that they provide transparency and remove the perception or possibility of inconsistent or arbitrary treatment of directors. These types of policies do, however, have a significant downside: these types of measurements (e.g., age, tenure etc.) may not be indicative of the actual effectiveness of a particular director.

Unfortunately, boards may knowingly make poor governance choices, e.g., retiring an effective director from a board who has reached mandatory retirement age, to, as one respondent put it, "avoid taking a hit from the rating agencies."

The implication of this for the assessment of individual director effectiveness is that tenure on a board should be based on, or at least incorporate the results from, director effectiveness reviews: you continue to serve on a board as long as you remain effective in the eyes of those who know your performance most — your board colleagues. Shareholders should therefore insist that this link be made more explicit by corporate boards, namely the link between director effectiveness and director tenure.

> I don't see the need for tenure. Both age 70 and tenure are mechanisms to deal with the issue of non-performers. Otherwise, why participate and have an age of 70? Really as a board it's a real loss [in losing an effective director because of a fixed retirement age] and others we couldn't wait and should strike them at age 66. Tenure is designed to avoid dealing with performance.
>
> *(director)*

> The fuzzy stuff about lowering the retirement age, tenure — it all comes down, as non-executive chairman, you tap old Charlie, the non-performer, on the shoulder, after you've talked to others, and say 'he has no time [to commit to board service]' if he's young, or tell him 'don't stand for re-election'. So fire me if I'm not doing my job. Don't use tenure or retirement. They're excuses for non-performers.
>
> *(chair)*

19. How might directors' concerns with governance assessment confidentiality be balanced with appropriate disclosure to shareholders?

Whether or not a board, its committees and individual directors are regularly assessed, and if so, the process used to conduct such assessments, should be disclosed to shareholders (as per National Instrument 58-101 *Disclosure of Corporate Governance Practices* at section 9), but such disclosure should not include any specific results. Some boards may also wish to disclose the competencies and skills that the board as a whole should possess or that individual directors are expected to bring to the board in addition to disclosing governance position descriptions, e.g., in biographical background of directors.

> Shareholders' understanding of board and director assessment processes and criteria is indispensable to both board credibility and shareholders' ability to appraise the board's recommended resolutions and proposed slate of directors. Boards should disclose evaluation procedures to shareholders in the proxy statement or other shareholder communication. Board disclosure of procedures is distinct from sharing the substance of such deliberations, which should be confidential.
>
> *National Association of Corporate Directors, Report of the NACD Blue Ribbon Commission on Director Professionalism — 2005 Edition.*

There needs to be, however, a balance between disclosure to shareholders about governance assessment criteria and processes and the legitimate need to have a zone of "privilege" surrounding the feedback from these assessments in order to promote the disclosure of candid, meaningful data by directors.

Therefore, the data from governance assessments must be confidential and not disclosed to outsiders without full board approval. Without this confidentiality, directors will be deterred from being candid and the assessment process will lose its value as a tool for enhancing board effectiveness.

20. Once a board has experience with assessing its effectiveness, how often should assessments be done?

Once board, committee and individual director assessments are underway, the process should be reviewed and continued on a regular basis. Given annual business and director election cycles and the desire to track their progress regularly, many boards opt for an annual assessment process.

Boards may experiment with the frequency and type of assessment used. For example, a more comprehensive review might be undertaken in alternate years with a less formal assessment occurring every second year.

Assessment data can be compared to those of previous assessment cycles, providing trend-lines and patterns so boards may track their progress. Bench-marking against best practices and comparator data can provide useful comparisons on how a board's effectiveness scores compare to that of other similar boards.

In summary, while assessments of the board and individual director effectiveness may be considered to be controversial and can raise many sensitive and legitimate concerns, they are an important investment in board effectiveness. Experience shows that, when conducted diligently, they can play an important role in enhancing board and individual director effectiveness.

Appendix 1: Legal concerns — from the author

There are two major legal concerns about individual director assessments. They are (i) disclosure of the assessment document itself and (ii) enhanced liability for directors. Boards of directors should seek the advice of experienced counsel in this area when undertaking individual director assessments.

Disclosure of the assessment document

Once the competencies and skills of directors begin to be assessed on an individual basis, plaintiffs' lawyers may attempt to obtain and utilize such individual director reviews as evidence that a director or group of directors possessed or lacked the appropriate standard of care required. There is concern in particular with director peer assessments that, if they are completed, the records of them and their conclusions will be disclosed in legal actions brought against the company, its officers and directors. This fear leads people to believe they should as a general practice, discard all records and keep records of discussions to a minimum. It also leads directors to be wary of having assessments done of individual director performance. If done, there is a desire to have such assessments "privileged" or shielded from subsequent "discovery" (disclosure) in the event that a board of directors is sued.

In most jurisdictions and certainly throughout Canada, a party is required to disclose records that are in some way relevant to the factual and legal issues raised in an action. If the action deals with allegations that the board failed to ensure some fact or conduct were disclosed, the findings in a peer assessment simply may not be relevant because the relevant issue is whether the fact was or was not material. Under such circumstances, the assessment therefore would not be disclosed in the action.

Assuming relevance can be established, individual director evaluations prepared internally or by an outside expert are likely to be discoverable unless the company can establish that such assessments were prepared for the dominant purpose of receiving legal advice about contemplated litigation, i.e., they were "privileged," which would generally not be the case of routine individual director assessments.

There may be greater chances of obtaining privilege protection if the director assessments were conducted and organized by counsel for the purpose of providing legal advice to the board, i.e., a true attorney-client communication, e.g., director assessments would be undertaken for the purpose of ensuring that the board and its members are prepared to deal with anticipated legal actions.

For example, the peer assessment could be done as part of an effort to ensure the board was fulfilling its duty to exercise reasonable business judgment. If a peer review were done in this fashion, the claim could be made that the peer assessments are privileged and therefore not producible to a party in a civil action.

This approach has evidently never been tested, but the justification for maintaining privilege is consistent with the legal authorities, according to one litigation lawyer with experience in director and officer liability. Privilege could be asserted against any outsider to the company. But, if there is an oppression claim brought against directors by shareholders, the privilege would not apply. Instead, one would focus on whether anything in the assessments was relevant to the oppression claim.

Another way of thinking about individual director assessment is to view the process as one means through which boards fulfill their 'duty of care'. Boards create and use a robust assessment process to help ensure that directors are contributing effectively. This assertion is enhanced if the assessment process requires that individual assessment feedback is shared with individual directors and the chair, and that a discussion occurs between individual directors and the chair that leads to developmental action.

The general view appears to be, however, after canvassing experienced counsel in Canada and the United States, that routine director assessments may not be covered by attorney-client privilege and hence may be discoverable in the event of litigation.

It would be prudent therefore for boards of directors to seek the opinion of counsel when undertaking individual director assessments given the factual circumstances of a particular board.

Enhanced liability for directors

A second concern is that an individual director with a particular competency or skill may be subsequently found by a court to be more or less liable than his or her colleagues. Similarly, if an individual director's competencies and skills were found as a result of a director assessment review to be lacking, then this may be evidence that may expose the company and its management (as well as the individual director) to liability for failing to act on this knowledge.

As jurisprudence continues to develop in the area of director liability, it may be the case that directors who possess "specialized expertise and knowledge" may have enhanced liability exposure. In some cases, however, a legislative "safe harbour" exists to insulate specialized directors from enhanced liability. For example, the Securities and Exchange Commission's rule under the Sarbanes-Oxley Act that requires public companies to disclose whether they have a financial expert on their audit committee contains a specific safe harbour for financial experts that is meant to protect such directors from additional liability under federal securities laws.

Legal concerns and litigation risks should be balanced with the risk of not acting in the areas of board, committee and individual director assessments, when boards had the opportunity to act and were urged to conduct such assessments by regulatory and best practice authorities. A board of directors that decides not to take action on problems that could have been identified, in a manner that at least addresses the litigation risks above, might ultimately expose the board and individual directors to greater liability for not acting when it could or should have.

Appendix 2: Assessment of individual directors — from the CICA

The following material, originating from CICA's *20 Questions Directors Should Ask about Building a Board*, may be helpful in assessing the effectiveness and contribution of individual directors.

The qualities of good directors include:

Personal Qualities

Individual directors need to be selected based upon the fit between their skills, experience and knowledge and that required by a board, depending upon organization strategy and circumstances. Several generic qualities of good directors include:

- **Integrity** — they have personal integrity and insist that the company behaves ethically.
- **Courage** — they have the courage to ask tough questions and to voice their support of or opposition to management proposals and actions. Their loyalty to the shareholders' interests may demand that they express dissent and persist in demanding answers to their questions.
- **Good judgement** — they focus on the important issues and base their decisions and actions on sound business and common sense.
- **Perspective** — they have broad knowledge and experience which they apply to discussions and decisions.
- **Commitment to learning** — they are prepared to take the time to get to know their company, know their job and stay up to date. They take responsibility for their own education in areas of their contribution to the Board and participate in educational sessions offered by the company.

Behavioural Skills

The culture of a board is as important as the skills, experience and knowledge of its members. The directors should have the behavioural skills to function and work effectively together as a collegial team. These skills include:

- **Ability to present opinions** — they are able to present their views clearly, frankly and constructively.
- **Willingness and ability to listen** — they listen respectfully and make sure they understand what they have heard.
- **Ability to ask questions** — they know how to ask questions in a way that contributes positively to debates.
- **Flexibility** — they are open to new ideas and responsive to the possibility of change.
- **Dependability** — they do their homework and attend and participate in meetings.

Appendix 3: Board Mandate — from the Canadian Securities Administrators

Section 3.4 of Canadian Securities Administrators (CSA) National Policy 58-201 *Corporate Governance Guidelines* refers to the mandate of the board and reads as follows:

"The board should adopt a written mandate in which it explicitly acknowledges responsibility for the stewardship of the issuer, including responsibility for:

a) to the extent feasible, satisfying itself as to the integrity of the chief executive officer (the CEO) and other executive officers and that the CEO and other executive officers create a culture of integrity throughout the organization;

b) adopting a strategic planning process and approving, on at least an annual basis, a strategic plan which takes into account, among other things, the opportunities and risks of the business;

c) the identification of the principal risks of the issuer's business, and ensuring the implementation of appropriate systems to manage these risks;

d) succession planning (including appointing, training and monitoring senior management);

e) adopting a communication policy for the issuer;

f) the issuer's internal control and management information systems; and

g) developing the issuer's approach to corporate governance, including developing a set of corporate governance principles and guidelines that are specifically applicable to the issuer.

The written mandate of the board should also set out:

i) measures for receiving feedback from stakeholders (e.g., the board may wish to establish a process to permit stakeholders to directly contact the independent directors), and

ii) expectations and responsibilities of directors, including basic duties and responsibilities with respect to attendance at board meetings and advance review of meeting materials. …"

Where to find more information

Canadian Institute of Chartered Accountants publications

The 20 Questions series

20 Questions Directors Should Ask about Building a Board
20 Questions Directors Should Ask about Codes of Conduct
20 Questions Directors Should Ask about Director Compensation
20 Questions Directors Should Ask about Executive Compensation
20 Questions Directors Should Ask about IT
20 Questions Directors Should Ask about Internal Audit
20 Questions Directors Should Ask about Management's Discussion and Analysis
20 Questions Directors Should Ask about Privacy
20 Questions Directors Should Ask about Risk
20 Questions Directors Should Ask about Strategy
20 Questions Directors Should Ask about their Role in Pension Governance

The CFO series

Financial Aspects of Governance: What Boards Should Expect from CFOs
Risk Management: What Boards Should Expect from CFOs
Strategic Planning: What Boards Should Expect from CFOs

Other CICA publications on governance, strategy and risk

20 Questions Directors Should Ask about Information Technology Outsourcing
Crisis Management for Directors
Guidance for Directors: Dealing with Risk in the Boardroom
Guidance for Directors: Governance Processes for Control
Integrity in the Spotlight: Opportunities for Audit Committees
Managing Risk in the New Economy
Understanding Disclosure Controls and Procedures: Helping CEOs and CFOs Respond to the Need for Better Disclosure

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— National Instrument 58-101 *Disclosure of Corporate Governance Practices*

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Notes

Notes

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Dr. Leblanc's doctoral dissertation was adjudicated as the winner of the Best Dissertation Award by the Administrative Sciences Association of Canada and voted runner-up in the governance and management category for a global award. His recently published book, co-authored with Professor James Gillies, is entitled "*Inside the Boardroom: How Boards Really Work and the Coming Revolution in Corporate Governance*."

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