

Board evaluation and director appraisal

Board performance

With attention on corporate governance and accountability increased by the global financial crisis, there is an expectation that the performance of boards and individual directors will be regularly evaluated.

This is reflected in Recommendation 1.6 (a) of the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations 3e* (2014) which states that listed companies should:

"... have and disclose a process for periodically evaluating the performance of the board, its committees and individual directors".

Similarly, the Australian Prudential Regulation Authority's Prudential Standard CPS 510 *Governance* (effective from 1 January 2015) states in clause 46 that:

"The board of a locally incorporated regulated institution must have procedures for assessing, at least annually, the board's performance relative to its objectives. It must also have in place a procedure for assessing, at least annually, the performance of individual directors".

Past methods of evaluating board success purely by reference to share price growth, CEO performance or the success of strategic initiatives are now understood to be inadequate. Whilst the success of the organisation is the ultimate goal, it does not follow that a successful organisation is the result of an effective board. Sometimes an organisation's success can be 'in spite of' rather than 'because of' the board. However, it is equally important that the more board-focused process of board evaluation does not become an unproductive and burdensome box-ticking exercise.

Although these processes are now quite common, some directors are still resistant to the notion of board evaluation and especially of peer appraisal.

This can be particularly so for unremunerated directors on not-for-profit boards, who may resent being evaluated themselves or resist evaluating their volunteer director peers. Hence it is critical to emphasise, preferably with leadership on the point from the chair, that board evaluation and director appraisal is not about critiquing one another but is about continuous governance improvement. It is about ensuring that the board work as effectively as possible for the good of the organisation.

The key message is that handled correctly, board evaluation and director appraisal gives the opportunity for constructive group and peer feedback to help the board as a whole and directors individually to improve their ability to contribute to the work of the board.

The important questions for the board

There are a number of questions to clarify before commencing with a board evaluation:

- What are the purpose and objectives of the evaluation?
- What will be evaluated?
- How will the evaluation be done?
- What evaluation method will be used?
- What should be the outcome?

What are the purpose and objectives of the evaluation?

The immediate objective is continuous governance improvement – identifying board performance improvement opportunities and governance framework gaps.

Specific and/or longer term objectives may include developing team work, better decision making, improving the effectiveness of meetings, gaining greater clarity of roles.

What will be evaluated?

The board evaluation exercise is ultimately about the effectiveness of the board and its component parts.

Firstly, it's important to clarify which of these component parts will be evaluated, and in each case what is to be evaluated. The potential component parts for evaluation comprise:

- **The board as a whole** – This assesses how well it is functioning – including in its key relationship with management – to deliver its governance role and functions, considered against the expectations of directors (for example, usually set out in the board's own charter/role statement, etc.)
- **The board's committees** – This assesses the adequacy of the board's committee structure and how well they respectively function to support the board in its role, considered against the expectations of the committees (for example, the terms of reference/charters of committees, etc.)
- **Individual directors** – This assesses how well directors perceive themselves and each other to be contributing positively to the work of the board and the ways in which their contributions could be improved, considered against the expectations of directors (for example, the board's composition matrix, code of conduct for the board, etc.)
- **The chair of the board and chairs of committees** – This assesses specifically how well the chair/s fulfil their role/s, considered against the expectations of those roles (for example, chair's role statement and board/committee charters)

How will the evaluation be done?

Annual board evaluations are generally:

- **Internally managed** – Managed by the board chair or a relevant committee of the board, this can incorporate the use of available survey tools (for example, the AICD's Governance Analysis Tool) and would usually include one-to-one meetings between the chair and each individual director. The benefit of the internally managed evaluation is that it is usually 'lighter touch' and less costly and less 'confronting' for directors.
- **Externally facilitated** – Using an external consultant to manage the process. Whilst it will generally be a more costly exercise than an internally managed process, the benefit is that it enables greater objectivity, encouraging complete candour by directors (and management) and a level of benchmarking, or at least comparison, to the good governance practices of other boards through the consultant's wide exposure to other boards and their practices.

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In addition to the formal annual evaluation, it is also now common practice to evaluate the effectiveness of the board in its regular meetings, at the end of each meeting, rather than being left to the annual board evaluation process. This has the significant benefit of allowing true continuous improvement and giving the chair and management constructive and real-time feedback on better structuring of agendas and development of board papers.

What evaluation method will be used?

Whether internally managed or externally facilitated, the precise method chosen by each board usually depends on the size and maturity of the organisation and the board and the issues it faces.

Methods are generally based on one or both of the following approaches:

- **Interview-based methods** – These are usually more qualitative in nature. They are good for delving into complex board/management dynamic and often sensitive interpersonal relationships issues in depth.
- **Survey-based methods** – Usually more ‘quantitative’ in nature these approaches help to focus the minds of the participants in the evaluation and can enable ‘benchmarking’ of results over time. Beware, however, that survey methods are ultimately largely qualitative in nature in so far as they will ask directors (and management if participating) to assess the performance of the board on a numbered scale in relation to various matters which is of course a matter of director and management ‘opinion’ and not a truly quantifiable measure in the strict sense.

In any case, whether the approach taken is interview-based, survey-based, or a combination of the two, the process should also involve a discussion by the board as a whole of the issues teased out by the interviews and/or surveys.

As implied above, in addition to the directors contributing their views to the evaluation, it is important to consider whether the opinions of senior executives will also be sought in relation to the operation of the board as a whole and its committees. Without input from executives, a board evaluation, even one managed by an external facilitator, amounts to pure self-assessment by directors. Hence management involvement ought to be encouraged, especially since board/management relationships are one of the most important contributors to an effective board.

For clarity, executives who are not also members of the board would not generally be asked to participate in the peer assessment of individual directors.

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Occasionally the board may also seek input from outsiders with whom they have regular dealings (eg major suppliers, substantial shareholders) although this is not common and should be handled with care. As a general rule these types of stakeholders do not have a true or deep understanding of the board’s operation. They may have a very clear view of the performance of the company, which is important for the board to understand, but this does not correlate directly with the effectiveness of the board.

What should be the outcome?

Once the board evaluation and/or director peer assessment process has been completed, the resulting improvement actions should be agreed by the board, in the form of a board improvement action plan. Where the process has included appraisal of individual directors, personal director development plans may also result.

The board improvement action plan, like all performance appraisal approaches, should include specific and measurable KPIs and the chair of the board, or a relevant committee of the board, perhaps with support from the company secretary, should be responsible to oversee its implementation over the ensuing year. In this way the board’s improvement action plan forms the basis, or at least the starting point, for the following year’s board evaluation process.

Underperforming directors that are identified through the board evaluation process should be carefully counselled by the chair or, in cases where there are issues of concern about the chair’s performance, by one of the appropriate directors – perhaps the deputy chair or the chair of a relevant committee.

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