Financial Reporting Council

GUIDANCE ON BOARD EFFECTIVENESS

JULY 2018

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INTRODUCTION

1. The primary purpose of the *Guidance on Board Effectiveness* (the Guidance) is to stimulate boards' thinking on how they can carry out their role and encourage them to focus on continually improving their effectiveness.
2. Ultimately, it is for individual boards to decide on the governance arrangements most appropriate to their company's circumstances, applying the Principles of *The UK Corporate Governance Code* (the Code) and following good practice set out in the Code provisions and supplemented in this Guidance.
3. The Guidance is not mandatory and is not prescriptive. It contains suggestions of good practice to support directors and their advisors in applying the Code. We encourage boards to refer to the Guidance alongside the Code. The Guidance will be updated periodically as good practice develops.
4. The Guidance will also be helpful to a wide range of stakeholders when assessing the actions taken by the board in relation to the governance of the company.
5. The Code has evolved since it was first introduced in 1992. It has always placed great importance on clarity of roles and responsibilities, and on accountability and transparency. While these are necessary for good governance, they are not sufficient on their own. The structures and processes that boards put in place are essential for them to function effectively and efficiently, but on their own they will not deliver success.
6. Boards need to think deeply about the way in which they carry out their role. The behaviours that they display, individually as directors and collectively as the board, set the tone from the top.
7. The Code places considerable emphasis on decision-making and outcomes. It promotes a more inclusive approach to stakeholder engagement and encourages boards to reflect on the way in which decisions are taken and how that might affect the quality of those decisions. By encouraging a broader focus and a willingness to listen to different voices and influences, the Code, supplemented by the Guidance, supports openness and accountability in delivering the long-term sustainable success of the company.
8. The structure of the Guidance follows the structure of the Code. It primarily covers matters related to board effectiveness dealt within Sections 1-3 of the Code and matters related to remuneration dealt within Section 5 of the Code. The FRC has issued separate, in-depth guidance documents on audit, risk and internal control. Section 4 of the Code is therefore covered only briefly in the Guidance.

9. The Guidance now includes some of the procedural aspects of governance which, historically, were covered by the Code. Such former features of the Code are now well-established as good practice and compliance levels are high. The Guidance is intended to act as a reminder to boards and their support teams that good practice and procedure should continue to be followed.

10. The tools and techniques for board effectiveness suggested in the Guidance will assist companies in applying the Principles in the Code and offer inspiration when it comes to illustrating in the annual report how this has been done.

1 BOARD LEADERSHIP AND COMPANY PURPOSE

AN EFFECTIVE BOARD

11. An effective board defines the company's purpose and then sets a strategy to deliver it, underpinned by the values and behaviours that shape its culture and the way it conducts its business. It will be able to explain the main trends and factors affecting the long-term success and future viability of the company[1] – for example technological change or environmental impacts – and how these and the company's principal risks and uncertainties have been addressed.

12. A company's purpose is the reason for which it exists. The board is responsible for setting and reconfirming the company's purpose. A well-defined purpose[2] will help companies to articulate their business model, and develop their strategy, operating practices and approach to risk. Companies with a clear purpose often find it easier to engage with their workforce, customers and the wider public.

13. A sound understanding at board level of how value is created over time is key in steering strategies and business models towards a sustainable future. This is not limited to value that is found in the financial statements. An understanding of how intangible sources of value are developed, managed and sustained – for example a highly trained workforce, intellectual property or brand recognition – is increasingly relevant to an understanding of the company's performance and the impact of its activity. These are important considerations for boards when setting corporate strategy.

14. Boards have a responsibility for the health of the company and need to take a long-term view. This is in contrast to the priorities of some investors, not all of whom will be aligned with the pursuit of success over the long-term. An effective board will manage the conflict between short-term interests and the long-term impacts of its decisions; it will assess shareholder and stakeholder interests from the perspective of the long-term sustainable success of the company.

[1] Provision 1

[2] Principle B

Questions for boards

- How do we know that management is identifying and addressing future challenges and opportunities, for example, changes in technology, environmental issues or changing stakeholder expectations?
- What proportion of board time is spent on financial performance management versus other matters of strategic importance?
- Is the balance between the focus on immediate issues and long-term success appropriate?
- Are we playing an active role in shaping long-term investment plans to underpin delivery of strategy and value creation?
- Is sufficient board time allocated to idea generation, opportunity identification and innovation?
- Are we using scenario analysis to help us assess the strategic importance and potential impact of our challenges and opportunities?
- Are we securing the benefits of 'big data' to give us a competitive edge?
- How will we assess and measure the impact of our decisions on financial performance, the value for shareholders and the impact on key stakeholders?
- Are shareholders driving the company to act in a way that is out of line with its purpose, values and wider responsibilities?

15. Effective directors will understand their duties both collectively and individually. Directors' duties are formally set out in sections 171–177 of the Companies Act 2006. Directors are expected to act in a manner consistent with their statutory duties, and to uphold the highest standards of integrity and support the chair in instilling the appropriate values, behaviours and culture in the boardroom and beyond.[3]
16. The boardroom should be a place for robust debate where challenge, support, diversity of thought and teamwork are essential features. Diversity of skills, background and personal strengths is an important driver of a board's effectiveness, creating different perspectives among directors, and breaking down a tendency towards 'group think'.
17. Openness and accountability matter at every level. Good governance means a focus on how this takes place throughout the company and by those who act on its behalf. The quality of governance will be evident in the way the company conducts business, for example, how it treats its workforce, customers and suppliers.

[3] Principle B

18. The board sets the framework of values within which the desired corporate culture can evolve and thrive. Ownership of the values will be stronger if a collaborative approach is taken and both the leadership and the workforce are involved in a two-way process to define the company's values.

19. It is important for trust that companies avoid giving contradictory messages through their decisions, strategies or conduct. Directors can reinforce values through their own behaviour and decisions. To do this effectively, executive and non-executive directors may need to increase their visibility.

Questions for boards

- How do we demonstrate ethical leadership and display the behaviours we expect from others?
- To what extent is our own way of operating a reflection of the values we are promoting? Can we give good and bad examples?
- Is the board clear on what sort of culture is needed to underpin the company's purpose and its long-term success?
- How do we articulate and communicate what we consider to be acceptable business practices?
- What behaviours are being driven when setting strategy and financial targets?
- How consistent is company strategy – for example, on tax and capital allocation – with our purpose and values, and our responsibilities for long-term success and to contribute to wider society?

20. To have an impact on behavioural outcomes and influence the way business is done, values need to be embedded at every level of the organisation. Boards will need assurance from management that it has effectively embedded the company's purpose and values in operational policies and practices. In particular, incentives, rewards and promotion decisions should be aligned to value.

Questions for boards to ask management

- How have the values and expected behaviours been reinforced in our recruitment, promotion, reward, performance management and other policies, processes and practices?
- Do reward structures produce appropriate incentives that encourage desired behaviours and responsible risk-taking?
- What steps has management taken to communicate values and expected behaviours widely and clearly across the company?
- What assurance is there that the code of conduct and ethics training programmes are up to date, adequately communicated and understood by the workforce?
- What steps has management taken to ensure that suppliers meet expected standards of behaviour?
- Has management identified appropriate KPIs that are properly aligned to desired outcomes and behaviours?

Monitoring culture

21. The focus on culture needs to be continuous. Periodic reflection on whether the culture continues to be relevant in a changing environment can help the company adapt its culture to ensure it continues to support the company's success. The board is expected to assess and monitor culture for alignment with purpose and values.[4] The first step is to establish a benchmark against which future monitoring can take place. One approach to monitoring culture might be to identify and track core characteristics that are typical features of a positive culture, such as those in Figure 1, and link this to commitment to company values.

Figure 1 – Common attributes of a healthy culture

- Honesty
- Openness
- Respect
- Adaptability
- Reliability
- Recognition
- Acceptance of challenge
- Accountability
- A sense of shared purpose

[4] Provision 2

22. It is important that the board develops a common and consistent language around culture, and pays attention to factors that can influence culture, such as corporate history, local traditions and the pressures of regulatory regimes. Boards will also need to be alert to signs of possible cultural problems such as those in Figure 2.

23. Monitoring culture will involve regular analysis and interpretation of evidence and information gathered from a range of sources. Drawing insight from multiple quantitative and qualitative sources helps guard against forming views based on incomplete or limited information. The workforce will be a vital source of insight into the culture of the company.

Sources of culture insights

- Turnover and absenteeism rates
- Training data
- Recruitment, reward and promotion decisions
- Use of non-disclosure agreements
- Whistleblowing, grievance and 'speak-up' data
- Employee surveys
- Board interaction with senior management and workforce
- Health and safety data, including near misses
- Promptness of payments to suppliers
- Attitudes to regulators, internal audit and employees
- Exit interviews

24. Boards can draw on existing internal capabilities and information to shape their monitoring efforts. Human resources, internal audit, risk and compliance all have a role to play; an integrated approach is likely to yield a more sophisticated understanding of how behaviours and culture impact performance. Senior professionals from these fields can get beneath the surface and offer expert analysis and advice to the board.

25. The board will be looking to identify areas of good practice and excellence that can be used to drive up standards across the business, reinforcing the value that a healthy culture can add. It will also be seeking evidence of business practices that are consistent with company values.

Figure 2 – Signs of a possible culture problem

- Silo thinking
- Dominant chief executive
- Leadership arrogance
- Pressure to meet the numbers/overambitious targets
- Lack of access to information
- Low levels of meaningful engagement between leadership and employees
- Lack of openness to challenge
- Tolerance of regulatory or code of ethics breaches
- Short-term focus
- Misaligned incentives

26. One objective of monitoring is to capture information about individual sub-cultures or pockets of autonomy that could undermine the overall culture. Identifying hotspots and outliers can alert the board to a possible problem, and prompt a more in-depth assessment. Where cultural issues are found, it is important to understand why these exist as well as what they are. Root cause analysis is an important tool for understanding the underlying causes of a poor culture and taking effective action to correct it.

Questions for boards

- What does the workforce say about 'the tone from the top' and the 'tone from the middle'?
- What evidence do we have that the chief executive is willing to listen, take criticism and let others make decisions?
- What do examples of communications from leadership and middle management tell us about the commitment to values, openness and accountability?
- What action do we take against leaders or top performers who do not uphold the company's values?
- How are key promotions decided?
- Is management using root cause analysis where cultural issues are found, examining not just what went wrong but why?
- How can we use technology to analyse, interpret and present information?
- Do we need to invest in human resources or internal audit, develop skills and capabilities or encourage the use of multi-disciplinary teams?
- How does the company deal with breaches of company rules or codes of conduct?
- Does internal audit have the degree of independence needed and a clear mandate to look at culture?
- How will we address any negative trends or misalignment between values and behaviours?

Decision-making

27. Well-informed and high-quality decision-making does not happen by accident. Many of the factors that lead to poor decision-making are predictable and preventable. Boards can minimise the risk of poor decisions by investing time in the design of their decision-making policies and processes, including the contribution of committees and obtaining input from key stakeholders and expert opinions when necessary.

28. Meeting regularly is essential for the board to discharge its duties effectively and to allow adequate time for consideration of all the issues falling within its remit. Ensuring there is a formal schedule of matters reserved for its decision will assist the board's planning and provide clarity to all over where responsibility for decision-making lies.

29. Most complex decisions depend on judgement, but the decisions of well-intentioned and experienced leaders can, in certain circumstances, be distorted. Factors known to distort judgement are conflicts of interest, emotional attachments, unconscious bias and inappropriate reliance on previous experience and decisions.

30. In addition, boards need to be aware of factors that can limit effective decision-making, such as those in Figure 3.

31. There are ways in which boards can create conditions that support sound decision-making. For example, some chairs favour a series of separate discussions for important decisions, covering steps like concept, proposal for discussion and proposal for decision. Where more than one part of the business is affected, integrated and joined-up information is likely to aid decision-making.

Figure 3 – Risk factors for poor decision-making

- A dominant personality or group of directors on the board, inhibiting contribution from others
- Insufficient diversity of perspective on the board, which can contribute to 'group think'
- Excess focus on risk mitigation or insufficient attention to risk
- A compliance mindset and failure to treat risk as part of the decision-making process
- Insufficient knowledge and ability to test underlying assumptions
- Failure to listen to and act upon concerns that are raised
- Failure to recognise the consequences of running the business on the basis of self-interest and other poor ethical standards
- A lack of openness by management, a reluctance to involve non-executive directors, or a tendency to bring matters to the board for sign-off rather than debate
- Complacent or intransigent attitudes
- Inability to challenge effectively
- Inadequate information or analysis
- Poor quality papers
- Lack of time for debate and truncated debate
- Undue focus on short-term time horizons
- Insufficient notice

Questions for boards

- Have relevant members of the executive team been invited to explain the issues at the earlier stages, enabling all directors to share concerns or challenge assumptions well before the point of decision?
- Does the board have a clear idea of the success criteria related to a particular decision?
- What are we doing to test key decisions for alignment with values? Can we give examples and explain how this was considered?
- What are the risks that the decision could encourage undesirable behaviours or send the wrong message?
- Can we explain how the impact on key stakeholders has been taken into account?

32. For significant decisions, a board may wish to consider extra steps, for example:
    - describing in board papers the process that has been used to arrive at and challenge the proposal prior to presenting it to the board, thereby allowing directors not involved in the project to assess the appropriateness of the process before assessing the merits of the project itself;
    - where appropriate, putting in place additional safeguards to reduce the risk of distorted judgements by, for example, commissioning an independent report, seeking advice from an expert, introducing a devil's advocate to provide challenge, establishing a specific sub-committee, and convening additional meetings; or
    - ensuring that board minutes document the discussion that led to the decision, including the issues raised and the reasons for the decision.[5]
33. Once a significant decision has been made and implemented the board may find it useful to review the effectiveness of the decision-making process, and the merits of the decision itself where it considers it relevant to do so. This could also be considered as part of the board evaluation process.

[5] ICSA: The Governance Institute provides guidance on minute taking that is available at: www.icsa.org.uk/knowledge/minutetaking

RELATIONS WITH STAKEHOLDERS

34. An effective board will appreciate the importance of dialogue with shareholders, the workforce and other key stakeholders, be proactive in ensuring that such dialogue takes place and that the feedback is taken into account in the board's decision-making. How the board approaches this will provide useful insight into the company's culture.

Relations with shareholders

35. The chair has an important role in fostering constructive relations with major shareholders and in conveying their views to the board as a whole.[6] When called upon, the senior independent director should seek to meet a sufficient range of major shareholders in order to develop a balanced understanding of their views. Non-executive directors should take opportunities such as attendance at general and other meetings, to understand the concerns of shareholders.

36. It is important that all shareholders are able to discharge their stewardship duties effectively. Formal ways of doing this are shareholder meetings and the annual general meeting (AGM). To ensure there is sufficient time to consider the issues, the notice of the AGM and related papers should be sent at least 20 working days before the AGM.

37. Smaller investors can be overlooked when board focus is primarily on major shareholders. Boards may want to consider additional ways to engage with smaller shareholders, for example, via methods of group engagement such as shareholder roundtables or webinars.

38. The chairs of the audit, remuneration and nomination committees should be available to answer questions at the AGM. The chair should encourage them to make a statement on the activities and achievements of the committee over the year. This could include details of engagement with shareholders on significant matters.

39. The chair has a key role to play in representing the company to its key stakeholders and is encouraged to report personally in the annual report about board leadership and effectiveness.

Relations with other key stakeholders

40. Directors have a duty to promote the success of the company over the long-term for the benefit of shareholders as a whole, having regard to a range of other key stakeholders and interests. This duty is set out in section 172 of the Companies Act 2006 (see Figure 4).

Figure 4 – Section 172, Companies Act 2006

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to the:

- (a) likely consequences of any decision in the long-term,
- (b) interests of the company's employees,
- (c) need to foster the company's business relationships with suppliers, customers and others,
- (d) impact of the company's operations on the community and the environment,
- (e) desirability of the company maintaining a reputation for high standards of business conduct, and
- (f) need to act fairly as between members of the company.

[6] Provision 3

41. An effective board understands that a company has to engage with its workforce and build and maintain relationships with suppliers, customers and others in order to be successful over the long-term. It will be able to explain how those relationships contribute to that success and help deliver the company's purpose. The company's approach to stakeholder engagement will be an important topic in the induction programme for new directors.

42. Dialogue with stakeholders can help boards to understand significant changes in the landscape, predict future developments and trends, and re-align strategy. Boards will find it useful to start by identifying and prioritising those key stakeholders who are important in the context of their business. This is likely to include the workforce, customers and suppliers. It may also include other stakeholders who are specific to the company's circumstances, such as regulators, government, bondholders, banks and other creditors, trade unions and community groups.

43. Boards will sometimes be faced with complex decisions whose impacts will benefit some stakeholders but disadvantage others; these difficult choices are made in the long-term interests of the company. Directors need to be able to explain their decisions, including how impacts on affected stakeholders have been considered and any action the company plans in mitigation.

44. Having identified the company's key stakeholders, the board will be in a position to develop an engagement strategy for the company based on those issues that are most important to long-term success. Established and formalised communication channels, such as those enjoyed by shareholders and regulators, can help embed the consideration of key stakeholder interests in board discussion and decision-making, and broaden directors' understanding of stakeholder perspectives and interests. Boards also need to be aware of other powerful stakeholder communication channels, including social media.

Sources of stakeholder feedback

- Contacts with key customers
- Customer complaints and satisfaction data
- Supplier feedback
- Surveys
- Social media
- Bespoke engagement activities on specific issues, for example, with trade unions, special interest groups or the local community

45. The board may wish to refer to *The Stakeholder Voice in Board Decision Making,* issued jointly by ICSA: The Governance Institute and The Investment Association, for detailed guidance on how to build stakeholder considerations into board discussions. This guidance sets out core principles for stakeholder identification and engagement.

46. In considering the impact of the company's operations on the community and the environment, boards may wish to refer to a source of guidance or a voluntary framework to help identify social and environmental considerations that are relevant for the business and link these to company strategy. Boards may also find a commonly understood framework useful in informing and communicating business strategy. Guidance is provided by various internationally recognised sets of principles and guidelines, examples of which can be found in Figure 5.

Figure 5 – Sources of social and environmental guidance

- UN Sustainable Development Goals
- Taskforce for Climate-related Financial Disclosures
- OECD Guidelines for Multinational Enterprises
- Ten principles of the United Nations Global Compact
- ISO 26000 Guidance Standard on Social Responsibility
- ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy
- United Nations Guiding Principles on Business and Human Rights

Questions for boards

- Can we describe how stakeholders are prioritised and why?
- What are the key concerns of our workforce, our suppliers and our customers, and how are we addressing them?
- Does the workforce consider that customers and suppliers are treated fairly and that the company cares about its impact on the environment and community?
- Have we sought input from enough stakeholders to be comfortable that we have a rounded view?
- Have we listened properly to the stakeholder voice and what impact has this had on our decisions?
- Have we considered how environmental and social issues might impact on the business or linked our strategy to a recognised international framework?

Relations with the workforce

47. The board has ultimate responsibility for ensuring that workforce policies and practices are in line with the company's purpose and values, and support the desired culture. This will involve reviewing policies and practices that have an impact on the experience of the workforce and drive behaviours, for example, recruitment and retention, promotion and progression, performance management, training and development, reskilling and flexible working.

48. The remuneration committee has a role in advising the board in respect of policies on rewards, incentives, terms and conditions and other related matters.[7] Published pay ratios and pay gaps will also offer valuable data that can prompt reflection on workforce pay. One way that boards could consider approaching workforce pay would be to endorse clear principles for pay and reward across the organisation, against which pay policies and outcomes can be justified and benchmarked. Application of the principles, progress towards objectives and consideration of the behaviour they drive could form part of culture monitoring.

Examples of pay principles

- 'Like pay for like work'
- Living wage
- Predictability of income
- Market competitiveness
- Reward for contribution

49. If it wishes, the board can delegate responsibility for reviewing non-pay-related workforce policies to a board committee with relevant responsibilities where one exists, for example, a people committee, a sustainability committee or a corporate responsibility committee. Where the board elects to do this, an integrated approach involving dialogue between the board and the relevant committees will be needed.

[7] Provision 33

Questions for boards

- How well are our values and expected behaviours embedded in our human resources policies, processes and practices?
- Are we treating our people as a strategic asset?
- Have we taken workforce views and priorities into account in developing our approach to investing in our people?
- Are behavioural objectives included in leadership and employee goals, and are behaviours formally assessed as part of performance review activity?
- What are we doing to address gender pay gaps?
- Are we doing enough to train and develop our people with the skills they will need in the future?

Gathering the views of the workforce

50. Communication between the workforce and the company is often referred to as the 'employee voice'. Communication and engagement will involve those with formal contracts of employment (permanent, fixed-term and zero-hours) and other members of the workforce who are affected by the decisions of the board. For example, companies should consider including individuals engaged under contracts of service, agency workers, and remote workers, regardless of their geographical location. Companies should be able to explain who they have included and why.[8] Different sections of the workforce may have different interests and priorities and a combination of engagement methods may be necessary to ensure that a wide selection of views can be gathered.

51. Engagement through a range of formal and informal channels helps the workforce to share ideas and concerns with senior management and the board. It provides useful feedback about business practices from those delivering them, and can help empower colleagues.

52. With the aim of strengthening the 'employee voice' in the boardroom, the Code asks boards to establish a method for gathering the views of the workforce and suggests three ways this might be achieved as set out in Figure 6.[9]

53. Whichever method is chosen, the new arrangements are not intended to displace established channels of communication and consultation arrangements where these exist, for example, collective bargaining arrangements and existing worker representative systems established through trade unions.

Figure 6 – Workforce engagement

- A director appointed from the workforce
- A formal workforce advisory panel
- A designated non-executive director

[8] The use of 'workforce' is for Code purposes and not meant to align with legal definitions of workforce, employee, worker or similar.

[9] Provision 5

54. A director appointed from the workforce will bring a workforce view to the boardroom. They will have the same duties and responsibilities as the other directors and ideally will be in a position to contribute to discussions on wider issues. Training and support will be critical to the successful implementation of this method, for example, in understanding company finance and business decision-making, and how to work in a collaborative, committee environment. While the director may engage with colleagues to understand the issues and challenges in particular parts of the business, their role is not solely to represent the views of the workforce.

55. The three methods specified in the Code are not the only ways of engaging with the workforce. Boards may feel it would be most effective to adopt a combination of methods or multiple channels for engagement at different levels and may want to develop other ways of engaging if they believe these would be effective. Provided the board's approach delivers meaningful, regular dialogue with the workforce and is explained effectively; the Code provision will be met.

56. Non-executive directors and, in particular, the chair should consider ways of reaching out to increase their visibility with the workforce and gain insights into the culture and concerns at different levels of the business. This is likely to involve spending more time in the business.

Examples of workforce engagement activities

- Hosting talent breakfast/lunches, town halls and open-door days
- Listening groups for frontline workers and supervisors
- Focus or consultative groups
- Meeting groups of elected workforce representatives
- Meeting future leaders without senior management present
- Social media updates
- Visiting regional and overseas sites
- Inviting colleagues from different business functions to board meetings
- Employee AGMs
- Involvement in training and development activities
- Surveys
- Digital sharing platforms
- Establishing mentoring between non-executive directors and middle managers

57. Having policies in place that encourage individuals to raise concerns is a core part of an ethical and supportive business culture. Whistleblowing policies that offer effective protection from retaliation, as well as policies that support anti-bribery and corruption legislation are essential components of this.[10] Such policies are important, for example, when attempts to resolve things internally have not worked.

58. Companies need to create an environment in which the workforce feels it is safe to raise concerns. Common fears include being negatively labelled, sidelined for promotion or bonuses, and even loss of employment. Leaders need to ensure there are no negative repercussions as a result of doing so.

59. It is equally important to encourage individuals to speak up. Speak-up arrangements help build trust, act as an early warning system and help to manage risk. It is critical for success that leaders actively listen and feedback how the matter raised has been considered, including any action taken. Companies may want to consider the benefits of extending such arrangements beyond the workforce to external parties, like customers and suppliers.

60. A commonly used tool for capturing workforce sentiment is the annual engagement survey. These are sometimes supplemented by shorter 'pulse surveys' on specific issues. Surveys can be a powerful way to engage people and performing them regularly provides valuable trend data. If published – for example, on the company website – the results can also give investors a useful insight into the views of the workforce. While an annual survey is a useful source of information, it will not be sufficient on its own as an indicator of workforce views. It is important to conduct focus groups following the survey to understand the issues that emerge and to establish a feedback loop so that there is transparency around actions taken to address those issues.

[10] Provision 6

Questions for boards

- Is there a forum for the workforce to share ideas and concerns?
- How do we demonstrate we listen to the ideas and concerns from the workforce?
- Does management provide feedback on how complaints and concerns have been dealt with?
- How comfortable do our people say they are with challenging and reporting issues of concern, and is there any evidence that they are doing this?
- Do colleagues report that leaders and managers live the company's values?
- Do colleagues see the company's values being displayed in the way the business is run and decisions are made, as well as in leadership behaviour?

2 DIVISION OF RESPONSIBILITIES

ROLE OF THE CHAIR

61. The chair is pivotal in creating the conditions for overall board and individual director effectiveness, setting clear expectations concerning the style and tone of board discussions, ensuring the board has effective decision-making processes and applies sufficient challenge to major proposals. It is up to the chair to make certain that all directors are aware of their responsibilities and to hold meetings with the non-executive directors without the executives present in order to facilitate a full and frank airing of views.

The chair's role includes:

- setting a board agenda primarily focused on strategy, performance, value creation, culture, stakeholders and accountability, and ensuring that issues relevant to these areas are reserved for board decision;
- shaping the culture in the boardroom;
- encouraging all board members to engage in board and committee meetings by drawing on their skills, experience and knowledge;
- fostering relationships based on trust, mutual respect and open communication – both in and outside the boardroom – between non-executive directors and the executive team;
- developing a productive working relationship with the chief executive, providing support and advice, while respecting executive responsibility;
- providing guidance and mentoring to new directors as appropriate;
- leading the annual board evaluation, with support from the senior independent director as appropriate, and acting on the results;
- considering having regular externally facilitated board evaluations.

The chair should ensure that:

- adequate time is available for discussion of all agenda items, in particular strategic issues, and that debate is not truncated;
- there is a timely flow of accurate, high-quality and clear information;[11]
- the board determines the nature, and extent, of the significant risks the company is willing to embrace in the implementation of its strategy;
- all directors are aware of and able to discharge their statutory duties;
- the board listens to the views of shareholders, the workforce, customers and other key stakeholders;
- all directors receive a full, formal and tailored induction on joining the board;
- all directors continually update their skills, knowledge and familiarity with the company to fulfil their role both on the board and committees.

BOARD COMMITTEES

62. While the board may make use of committees to assist its consideration of appointments, succession, audit, risk and remuneration it retains responsibility for, and endorses, final decisions in all of these areas. The chair should ensure that sufficient time is allowed at the board for committees to report on the nature and content of discussion, on recommendations, and on actions to be taken. Where there is disagreement between the relevant committee and the board, adequate time should be made available for discussion of the issue with a view to resolving the disagreement. Where any such disagreement cannot be resolved, the committee concerned should have the right to report the issue to the shareholders as part of the report on its activities in the annual report.

63. The chair should ensure board committees are properly structured with appropriate terms of reference, which should be published on the company website. The terms of each committee should set out its responsibilities and the authority delegated to it by the board. The chair should ensure that committee membership is periodically refreshed and that individual independent non-executive directors are not over-burdened when deciding the chairs and membership of committees.

[11] Principle F

64. No one other than the committee chair and members is entitled to be present at a meeting, but others may attend at the invitation of the committee.

65. The minutes of committee meetings should be circulated to all board members and the company secretary, unless, exceptionally, it would be inappropriate to do so. The remit of each committee, and the processes of interaction between committees and between each committee and the board, should be reviewed regularly, for example, during the board evaluation.

ROLE OF THE SENIOR INDEPENDENT DIRECTOR

66. The senior independent director should act as a sounding board for the chair, providing them with support in the delivery of their objectives and leading the evaluation of the chair on behalf of the other directors. The senior independent director might also take responsibility for an orderly succession process for the chair, working closely with the nomination committee. It is a good idea for the senior independent director to serve on committees of the board to improve their knowledge of company governance.

67. The senior independent director should also be available to shareholders if they have concerns that contact through the normal channels of chair, chief executive or other executive directors has failed to resolve or for which such contact is inappropriate.

68. When the board or company is undergoing a period of stress, the senior independent director's role becomes critically important. They are expected to work with the chair and other directors, and/or shareholders, to resolve significant issues. Boards should ensure they have a clear understanding of when the senior independent director might intervene in order to maintain board and company stability. Examples might include where:
    - there is a dispute between the chair and chief executive;
    - shareholders or non-executive directors have expressed concerns that are not being addressed by the chair or chief executive;
    - the strategy is not supported by the entire board;
    - the relationship between the chair and chief executive is particularly close;
    - decisions are being made without the approval of the full board;
    - succession planning is being ignored.

    These issues should be considered when defining the role of the senior independent director.

ROLE OF EXECUTIVE DIRECTORS

69. Executive directors have the same duties as other members of a unitary board. These duties extend to the whole of the business, and not just that part of it covered by their individual executive roles. Nor should executive directors see themselves only as members of the chief executive's team when engaged in board business. Taking the wider view can help achieve the advantage of a unitary system, meaning greater knowledge, involvement and commitment at the point of decision. Executive directors are likely to be able to broaden their understanding of their board responsibilities if they take up a non-executive director position on another board.[12]

70. As the most senior executive director, the chief executive is responsible for proposing company strategy and for delivering the strategy as agreed by the board. The chief executive's relationship with the chair is a key influence on board effectiveness. When deciding the differing responsibilities of the chair and the chief executive, particular attention should be paid to areas of potential overlap.

71. The chief executive has primary responsibility for setting an example to the company's workforce, for communicating to them the expectations in respect of the company's culture, and for ensuring that operational policies and practices drive appropriate behaviour. They are responsible for supporting the chair to make certain that appropriate standards of governance permeate through all parts of the organisation. They will ensure the board is made aware of views gathered via engagement between management and the workforce.

72. It is the responsibility of the chief executive to ensure the board knows the views of the senior management on business issues in order to improve the standard of discussion in the boardroom and, prior to a final decision on an issue, explain in a balanced way any divergence of view.

73. The chief executive is also responsible for ensuring that management fulfils its obligation to provide board directors with:
    - accurate, timely and clear information in a form and of a quality and comprehensiveness that will enable it to discharge its duties;
    - the necessary resources for developing and updating their knowledge and capabilities; and
    - appropriate knowledge of the company, including access to company operations and members of the workforce.

74. Executive directors should welcome constructive challenge from non-executive directors as an essential aspect of good governance, and encourage their non-executive colleagues to test proposals in the light of their wider experience outside the company.

[12] Provision 15

ROLE OF NON-EXECUTIVE DIRECTORS

75. Non-executive directors should, on appointment, devote time to a comprehensive, formal and tailored induction that should extend beyond the boardroom. Initiatives such as partnering a non-executive director with an executive board member may speed up the process of them acquiring an understanding of the main areas of business activity, especially areas involving significant risk. They should expect to visit operations and talk with managers and non-managerial members of the workforce. A non-executive director should use these conversations to better understand the culture of the organisation and the way things are done in practice, and to gain insight into the experience and concerns of the workforce.

76. It is vital that non-executive directors have sufficient time available to discharge their responsibilities effectively. The time commitment to engage with shareholders and other key stakeholders and get to know the business can be considerable. It is advisable for non-executive directors to assess the demands of their portfolios and other commitments carefully before accepting new appointments. They should devote time to developing and refreshing their knowledge and skills to ensure that they continue to make a positive contribution to the board and generate the respect of the other directors.

77. Non-executive directors need to insist on receiving high-quality information sufficiently in advance so that there can be thorough consideration of the issues prior to, and informed debate and challenge at, board meetings. They should seek clarification or amplification from management where they consider the information provided is inadequate or lacks clarity.

Board papers and supporting information should:

- be accurate, clear, comprehensive and up-to-date;
- contain a summary of the contents of any paper; and
- inform the director what is expected of them on that issue.

78. It is important that non-executive directors do not operate exclusively within the confines of the boardroom, but have a good understanding of the business and its relationships with significant stakeholders. Accordingly, it is advisable for them to take opportunities to meet shareholders, key customers and members of the workforce from all levels of the organisation.

BOARD SUPPORT AND THE ROLE OF THE COMPANY SECRETARY

79. The company secretary is responsible for ensuring that board procedures are complied with, advising the board on all governance matters, supporting the chair and helping the board and its committees to function efficiently.

80. The company secretary should report to the chair on all board governance matters. This does not preclude the company secretary also reporting to the chief executive, or other executive director, in relation to their other executive management responsibilities. The remuneration of the company secretary should be determined by the remuneration committee.

81. Under the direction of the chair, the company secretary's responsibilities include ensuring good information flows within the board and its committees and between senior management and non-executive directors, as well as facilitating induction, arranging board training and assisting with professional development as required.

82. The company secretary should arrange for the company to provide the necessary resources for developing and updating its directors' knowledge and capabilities. This should be in a manner that is appropriate to the particular director, and which has the objective of enhancing that director's effectiveness in the board or committees, consistent with the results of the board evaluation processes.

83. It is the responsibility of the company secretary to ensure that directors, especially non-executive directors, have access to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities as directors of the company. Committees should be provided with sufficient resources to undertake their duties.

84. Assisting the chair in establishing the policies and processes the board needs in order to function properly is a core part of the company secretary's role. The chair and the company secretary should periodically review whether the board and the company's governance processes – for example, board and committee evaluation – are fit for purpose, and consider any improvements or initiatives that could strengthen the governance of the company.

85. The company secretary's effectiveness can be enhanced by building relationships of mutual trust with the chair, the senior independent director and the non-executive directors, while maintaining the confidence of executive director colleagues. They are in a unique position between the executive and the board, and well placed to take responsibility for concerns raised by the workforce about conduct, financial improprieties or other matters.

3 COMPOSITION, SUCCESSION AND EVALUATION

ROLE OF THE NOMINATION COMMITTEE

86. The nomination committee is responsible for board recruitment and will conduct a continuous and proactive process of planning and assessment, taking into account the company's strategic priorities and the main trends and factors affecting the long-term success and future viability of the company.

87. Appointing directors who are able to make a positive contribution is one of the key elements of board effectiveness. Directors will be more likely to make good decisions and maximise the opportunities for the company's success if the right skillsets and a breadth of perspectives are present in the boardroom. Non-executive directors should possess a range of critical skills of value to the board and relevant to the challenges and opportunities facing the company.

88. Diversity in the boardroom can have a positive effect on the quality of decision-making by reducing the risk of group think. With input from shareholders, boards need to decide which aspects of diversity are important in the context of the business and its needs.

89. Developing a more diverse executive pipeline is vital to increasing levels of diversity amongst those in senior positions. Improving diversity at each level of the company is important if more diversity at senior levels is to become a reality. Greater transparency about the make-up of the workforce could support this. This might cover a range of different aspects of diversity, including age, disability, ethnicity, education and social background, as well as gender.

90. Working with human resources, the nomination committee will need to take an active role in setting and meeting diversity objectives and strategies for the company as a whole, and in monitoring the impact of diversity initiatives. Examples of the type of actions the nomination committee could consider encouraging include:
    - a commitment to increasing the diversity of the board by setting stretching targets;[13]
    - dedicated initiatives with clear objectives and targets; for example, in areas of the business that lack diversity;
    - a focus on middle management;
    - mentoring and sponsorship schemes;
    - a commitment to more diverse shortlists and interview panels; and
    - positive action to encourage more movement of women into non-traditional roles.

91. Diversity of personal attributes is equally important. The nomination committee will want to ensure the board is comprised of individuals who display a range of softer skills, such as those in Figure 7.

Figure 7 – Important personal attributes

- Sources of intellect, critical assessment and judgement
- Courage
- Openness
- Honesty
- Tact
- Ability to listen
- Ability to forge relationships
- Ability to develop trust
- Strength of character

[13] The targets proposed by the Hampton-Alexander Review and in the Parker Report are relevant here.

Questions for the nomination committee

- Have we assessed what skillset is required for the board and its committees?
- Do we reassess the make-up of the board as a result of emerging trends?
- Do we take account of the technical skills and knowledge required by the committees when recruiting members?
- How often is a skills audit undertaken and are we keeping up with the pace of change?

92. Board appointments should be made on merit against objective criteria.[14] The nomination committee should evaluate the skills, experience and knowledge on the board, and the future challenges affecting the business, and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment. It should then agree the process to be undertaken to identify, sift and interview suitable candidates. It is important to build a proper assessment of values and expected behaviours into the recruitment process.
93. Skills matrices that map the existing skillset against that required to execute strategy and meet future challenges can be an effective way of identifying skills gaps. They are a useful tool for role evaluation and succession planning.
94. Publicly advertising board appointments and working with recruitment consultants who have made a commitment to promote diversity are examples of ways in which the nomination committee can access a more diverse pool of candidates from which to appoint. Attention also needs to be paid to how the interview process is conducted so that candidates with diverse backgrounds are not disadvantaged.
95. Directors are expected to undertake that they will have sufficient time to meet what is expected of them effectively.The role of chair, in particular, is demanding and time-consuming; multiple roles are therefore not advisable. The nomination committee may wish to consider whether to set limits on the number and scale of other appointments it considers the chair and other non-executives may take on without compromising their effectiveness. This could help deal with shareholder concerns that some directors may have too many commitments, sometimes referred to as 'overboarding'.
96. The terms and conditions of appointment of the chair and non-executive directors must be available for inspection.[15] Letters of appointment should set out the expected time commitment and also indicate the possibility of additional commitment when the company is undergoing a period of particularly increased activity, such as an acquisition or takeover, or as a result of some major difficulty with one or more of its operations.

[14] Principle J

[15] Companies Act 2006

SUCCESSION PLANNING

97. The chair's vision for achieving the optimal board composition will help the nomination committee review the skills required, identify the gaps, develop transparent appointment criteria and inform succession planning. It is a good idea for the nomination committee to assess periodically whether the desired outcome has been achieved, and propose changes to the process as necessary.

98. There are risks of becoming too reliant on the skills of one individual. Discussions on tenure at the time of appointment will help to inform and manage the long-term succession strategy. The needs of the company and the board will change over time, so it is wise to manage expectations and encourage non-executive directors to be flexible about term lengths and extensions. It is also a good idea to discuss board refreshment and succession with shareholders.

99. Executive directors may be recruited externally, but companies should also develop internal talent and capability. Initiatives to encourage this could include middle management development programmes, facilitating engagement between middle management and non-executive directors, as well as partnering and mentoring schemes.

100. Talent management can be a strong motivational force for those who wish to develop their career within the company and achieve senior positions. It can provide the nomination committee with a variety of strong candidates. The nomination committee may find it worthwhile to take a more active interest in how talent is managed throughout the organisation.

Succession plans should consider the following different time horizons:

- *contingency planning* – for sudden and unforeseen departures;
- *medium-term planning* – the orderly replacement of current board members and senior executives (e.g. retirement); and
- *long-term planning* – the relationship between the delivery of the company strategy and objectives to the skills needed on the board now and in the future.

101. Putting the succession plan in writing can help ensure it is followed through. Succession plans can also help to increase diversity in the boardroom and build diversity in the executive pipeline.

LENGTH OF SERVICE OF THE CHAIR AND NON-EXECUTIVE DIRECTORS

102. The board should consider which non-executive directors are independent taking into account the circumstances set out in the Code.[16] Non-executive directors should provide the board with sufficient information to allow them to evaluate their independence and notify the board of any change in circumstances that may affect this. The chair is not subject to the Code's independence test other than on appointment.

103. It is crucial that independent non-executive directors provide challenge within the board and use their skills, experience and knowledge to drive productive discussions. Independence should be considered throughout their tenure to ensure they continue to demonstrate that they are holding the board to account.[17] Boards will need to justify why they consider a non-executive director independent beyond nine years.

104. The chair holds a unique position; they need to exercise objective judgement throughout their service and gain a detailed understanding of the business by forming effective relationships with the chief executive and other executive directors. It is recommended that the chair is subject to similar length of service considerations as non-executive directors and should not stay in post longer than nine years. For the chair the nine year period is calculated from when they were first appointed to the board, therefore years spent on the board prior to becoming chair would be included when considering their total length of service.

105. There may be reasons for justifying a limited extension to the term of the chair beyond nine years if prior to being appointed chair, they have been a board member for a significant amount of time, and the appointment supports the company's succession plan and diversity policy.

[16] Provision 10

[17] Provision 18

Questions for consideration when extending the length of service

- Does the chair continue to demonstrate objective judgement and promote constructive challenge amongst other board members?
- How long should length of service be extended and how does this fit with wider succession planning and company objectives?
- Does extending the length of service complement diversity planning?
- Has there been engagement with major shareholders?

EVALUATING THE PERFORMANCE OF THE BOARD AND DIRECTORS

106. Boards continually need to monitor and improve their performance. This can be achieved through evaluation, which provides a powerful and valuable feedback mechanism for improving effectiveness, maximising strengths and highlighting areas for further development. The evaluation process should be objective and rigorous.

107. Like induction and board development, evaluation should be bespoke in its formulation and delivery. The chair has overall responsibility for the process, and should select an effective approach, involving the senior independent director as appropriate. The senior independent director should lead the process that evaluates the performance of the chair and, in certain circumstances, may lead the entire evaluation process.

108. The chair should consider ways in which to obtain feedback from the workforce and other stakeholders – for example, the auditors – on the performance of the board and individual directors. Chairs of board committees should be responsible for the evaluation of their committees.

109. Board evaluations should inform and influence succession planning. They are an opportunity for boards to review skills, assess their composition and agree plans for filling skills gaps, and increasing diversity. They can help companies identify when new board appointments may be needed and the types of skills that are required to maximise board effectiveness.

110. The outcomes from the board evaluation should be shared with and discussed by the board. They should be fed back into the board's work on composition, the design of induction and development programmes, and other relevant areas. It may be useful for a company to review how effective the board evaluation process has been and how well the outcomes have been acted upon. The chair is encouraged to give a summary of the outcomes and actions of the board evaluation process in their statement in the annual report.

111. The Code recommends that FTSE 350 companies have externally facilitated board evaluations at least every three years.[18] Chairs of smaller companies are also encouraged to consider doing this periodically. External facilitation can add value by introducing a fresh perspective and new ways of thinking, and a critical eye to board composition, dynamics and effectiveness. It may also be useful in certain circumstances, such as when there is a new chair, if there is a known problem requiring tactful handling or there is an external perception that the board is, or has been, ineffective.

[18] Provision 21

112. The nature and extent of an external evaluator's contact with the board and individual directors are defining factors in quality. Questionnaire-based external evaluations are unlikely to get underneath the dynamics in the boardroom. The external evaluator should also meet with the executive team to gain their views of the board.

113. Whether facilitated externally or internally, evaluations should be rigorous. They should explore how effective the board is as a unit, as well as the quality of the contributions made by individual directors. Some areas which may be considered, although they are neither prescriptive nor exhaustive, include:

- the mix of skills, experience and knowledge on the board, in the context of developing and delivering the strategy, the challenges and opportunities, and the principal risks facing the company;
- clarity of, and leadership given to, the purpose, direction and values of the company;
- succession and development plans;
- how the board works together as a unit, and the tone set by the chair and the chief executive;
- key board relationships, particularly chair/chief executive, chair/senior independent director, chair/company secretary and executive/non-executive directors;
- effectiveness of individual directors;
- clarity of the senior independent director's role;
- effectiveness of board committees, and how they are connected with the main board;
- quality of the general information provided on the company and its performance;
- quality and timing of papers and presentations to the board;
- quality of discussions around individual proposals and time allowed;
- process the chair uses to ensure sufficient debate for major decisions or contentious issues;
- effectiveness of the company secretary/secretariat;
- clarity of the decision-making processes and authorities, possibly drawing on key decisions made over the year;
- processes for identifying and reviewing risks; and
- how the board communicates with, and listens and responds to, shareholders and other key stakeholders.

EXTERNALLY FACILITATED BOARD EVALUATIONS

114. When selecting a board evaluator, the chair needs to:

- be clear what the board evaluation will offer – each provider will have a different method and experience with cost and approaches varying greatly across providers;
- evaluate the skills, competencies and references of each individual involved in the evaluation against a specification agreed with the board;
- be mindful of existing commercial relationships and other conflicts of interests, and select an evaluator who is able to exercise independent judgement; and
- agree with the evaluator the objectives and scope of the evaluation, expected quality, value and longevity of service, and communicate this to the board.

115. To ensure a more valuable review, the chair will need to ensure full cooperation between the company and the evaluator, including full access to board and committee papers and information, to observe meetings, and meet with directors individually.

116. The chair is responsible for making sure the board gets the most from an externally-facilitated board evaluation and should ensure it is not approached as a compliance exercise. The chair is likely to find the board evaluation process more valuable if:

    - its recommendations are constructive, meaningful and forward-looking;
    - there is a clear set of recommendations and actions, and a time-period for review of progress against agreed outcomes by the evaluator with the board;
    - it includes views from beyond the boardroom, e.g. shareholders, senior executives who regularly interact with the board, auditors and other advisors, and the workforce;
    - it includes peer reviews of directors and the chair plus feedback on each director;
    - good practice observed in other companies is shared;
    - the evaluator observes the interaction between directors and between the chief executive and chair;
    - there is a robust analysis of the quality of information provided to the board;
    - feedback is provided to each individual board member; and
    - the board is challenged on composition, diversity, skills gaps, refreshment and succession.

4 AUDIT, RISK AND INTERNAL CONTROL

117. The audit committee is responsible for discharging governance responsibilities in respect of audit, risk and internal control, and will report to the board as appropriate.

118. The role of the audit committee is in many cases subject to legislation either set out in the Listing Rules (LR) or the Disclosure Guidance and Transparency Rules (DTR). Appendix B highlights the overlaps for both this section and wider overlaps with the Code in the LR and DTR.

119. All directors should familiarise themselves with the relevant Principles and Provisions of the Code, the related *Guidance on Audit Committees* and *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting*, and any relevant regulatory requirements.

120. Companies in some sectors may be required to create a separate risk committee with responsibility for ensuring risk is effectively managed. Where this is not a requirement, the board may wish to consider having a separate risk committee, particularly if it has concerns about whether the audit committee has sufficient time to deal with both issues or whether the composition of the audit committee is suitable.

121. Regular risk assessments and reviews of the risk management systems including information on 'close calls' and 'near misses' will help the board determine whether the systems in place are robust enough to deal with a wide range of risks.

122. Risks can emerge and crystallise rapidly, the systems in place to monitor risks should include procedures to elevate any concerns to the board's attention as quickly as possible. Processes for doing this and agreed triggers should be clear and be implemented quickly.

Questions for audit committees

- Are you satisfied that the company has adequate internal controls over risk?
- Is sufficient time allocated on the board agenda to enable a full discussion of the work of the audit committee?
- How has the board assessed whether the audit committee has a balance of skills and competencies necessary to fulfil its remit?
- How is the audit committee managing and monitoring the non-audit work the company's auditors deliver across the group?
- Are there clear procedures and triggers in place to elevate risks to the board quickly?

Viability statements

123. The long-term success of a company is dependent on the sustainability of its business model and its management of risk. Decisions made by the board will have a direct impact on the viability of the company, over differing time periods. It may be useful to discuss with investors their information needs to help inform the period selected.

124. The period selected for the viability statement often appears to be based on the company's medium-term business plan. However, the *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting* suggests that other factors should be taken into account, for example, investment and planning periods, the board's stewardship responsibilities, the nature of the business and its stage of development, as well as previous statements made, especially in raising capital.

125. The factors considered will clearly depend on the circumstances and maturity of the relevant company and the industry in which it operates. Industries such as mining and property investment companies typically have longer-term investment strategies and funding arrangements. Companies should tailor their approach to their specific circumstances and planning cycles.

126. Companies should consider developing their viability statements in two stages; firstly, by considering and reporting on their longer-term prospects, taking into account the company's current position and principal risks, and then by stating whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their viability assessment, drawing attention to any qualifications or assumptions as necessary.

127. Good practice examples clearly explain the underlying analysis that supports the statement. They should also include proper explanation of how the company has carried out its analysis.

128. The audit committee may wish to refer to the Financial Reporting Lab report on risk and viability reporting for a helpful summary of where improvements in transparency can give greater meaning.[19]

[19] Risk and viability reporting: Financial Reporting Lab, November 2017

Questions for boards

- Does the viability statement differentiate between the directors' assessment of long-term prospects and their statement on the company's viability?
- Have we considered previous statements that have been made, especially in raising capital, the nature of the business and its stage of development, and investment and planning periods?
- How have we dealt with any relevant qualifications and assumptions when explaining the directors' reasonable expectation of the viability of the company?
- Is the link between the viability statement and principal risks clear, particularly in relation to the scenario analyses?
- Are the stress and scenario analyses explained in sufficient detail to provide shareholders with an understanding of the nature of those scenarios, and the extent of mitigating activities?
- Is the analysis underpinning the viability statement consistent with the board's statement on going concern?
- Are the prospects of the company set out in the viability statement consistent with any statements made on financial covenant and commitments given to pension fund trustees?

5 REMUNERATION

ROLE OF THE REMUNERATION COMMITTEE

129. The remuneration committee has delegated responsibility for designing and determining remuneration for the chair, executive directors and the next level of senior management.[20] It is vital that the remuneration committee recognises and manages potential conflicts of interest in this process.

130. The remuneration committee is also tasked with reviewing workforce remuneration and related policies.[21] The purpose of this review is to:
    - ensure the reward, incentives and conditions available to the company's workforce are taken into account when deciding the pay of executive directors and senior management;
    - enable the remuneration committee to explain to the workforce each year how decisions on executive pay reflect wider company pay policy; and
    - enable the remuneration committee to feedback to the board on workforce reward, incentives and conditions, and support the latter's monitoring of whether company policies and practices support culture and strategy.[22]

131. The remuneration committee's review is limited to workforce remuneration and related policies in respect of persons engaged under an employment contract or a contract, or other arrangement to do work or provide services personally.[23]

132. The review will include matters such as any pay principles applied across the company, base pay, benefits, and all incentives and aspects of financial and non-financial reward that drive behaviour – for example, sales compensation – regardless of where this is managed in the business.

[20] Provision 33

[21] Provision 33

[22] Provision 2

[23] The use of 'workforce' is for Code purposes and not meant to align with legal definitions of workforce, employee, worker or similar.

Questions for remuneration committees

- How is executive remuneration aligned with wider company pay policy?
- How do workforce incentives support our culture and encourage the desired behaviours?
- What have we done to explain to the workforce how executive pay arrangements align with wider company pay policy?
- How do the company's pay policies address pay gaps and pay ratios between the different quartiles of the workforce?
- What interaction have we had with the nomination committee regarding the structure of the workforce and the company's plans for reducing its gender pay gap?

Remuneration Policy

133. The design of remuneration policies, structures and schemes is a crucial part of the remuneration committee's role. Remuneration committees are expected to focus on the strategic rationale for executive pay and the links between remuneration, strategy and long-term sustainable success.[24]

134. It is important to avoid designing pay structures based solely on benchmarking to the market, or the advice of remuneration consultants, as there is a risk this could encourage an upward ratcheting effect on executive pay.

135. It is important that the remuneration committee takes steps to counteract the risk of incentives that are detrimental to the long-term success of the company. Packages that are structured to ensure exposure to the long-term share value, including for two to three years after leaving the company, can support alignment with shareholders and encourage executive directors to focus on the impact of their decisions over the long-term.

136. Remuneration committees are encouraged to be innovative and to work with shareholders to simplify the structure of the remuneration policy.[25] Simpler remuneration structures may help reduce the reliance of the remuneration committee on consultants and also improve communication with shareholders and the workforce. Simpler structures will also free up time for the remuneration committee to review workforce remuneration and for shareholders to engage with the company on other matters.

[24] Principle P

[25] The options in the final report of the Investment Association's Executive Remuneration Working Group may be helpful here.

Questions for remuneration committees

- How are we innovating and updating our executive remuneration policy, for example, to strengthen the incentives for long-term thinking?
- How does executive remuneration link to our strategy and KPIs?
- How have we addressed the factors in Provision 40 of the Code?
- Do we need to interact with any other parts of the governance structure in respect of risks arising from remuneration?

137. Where performance-based incentive plans are used, the choice of performance measures is important. Using a range of financial, non-financial and strategic measures can help ensure that targets are aligned with how the company will deliver value over the long-term in line with company purpose. Metrics need to be reliable and credible to satisfy shareholders, and their purpose should be explained.

Questions for remuneration committees

- How will any financial and non-financial performance measures support long-term thinking and delivery against strategy?
- Have we considered how the choice of any particular measure may encourage negative behaviour and what steps have we taken to manage such risks?
- Have we consulted the audit committee on performance measures?
- What steps have we taken to make sure that any performance measures are stretching?

138. The remuneration committee is expected to exercise judgement when determining remuneration awards. It needs to be mindful of the possible monetary outcomes and of external perceptions arising from its decisions. Remuneration schemes should provide or the use of discretion to override formulaic outcomes.[26]

139. One approach to discretion might be to assess the overall reasonableness of the total rewards and recommend adjusting pay awards, for example, where the outcome would otherwise not be aligned to individual performance and results achieved or would not deliver the policy intention. An active decision on whether to exercise discretion would become a normal part of the annual process to determine remuneration outcomes. It will be important to ensure that the terms of individual contracts and scheme rules do not prevent such adjustments.

140. The exercise of discretion may also be necessary as a result of unexpected or unforeseen circumstances, in order to ensure the remuneration outcome for individual directors is reasonable and reflects the individual's contribution. Circumstances where it may be appropriate to exercise discretion include taking account of share price growth and currency fluctuations, and the impact of a share repurchase scheme or a government support initiative. Any exercise of discretion should be clearly disclosed and explained.

[26] Provision 37

Questions for remuneration committees

- Can we explain how we expect to exercise discretion over remuneration outcomes?
- Have we made sure that there are no impediments to the exercise of discretion, for example, in the contract terms of individual directors or in the scheme rules?
- Do we understand the amount that is potentially being awarded, under what circumstances, and do we need a monetary limit?

141. The remuneration committee may wish to consider setting a limit in monetary terms for what it considers is a reasonable reward for individual executives. This could be helpful in addressing the need for a degree of predictability over outcomes, both for the individual director, the company and shareholders, and for guiding the exercise of discretion in some circumstances. It should be prepared to explain the rationale behind its decision.

142. Schemes should also include malus and clawback provisions in certain specified circumstances.[27] Such circumstances might include payments based on erroneous or misleading data, misconduct, misstatement of accounts, serious reputational damage and corporate failure.

143. The Code recommends that pension commitments for executive directors, or payments in lieu, should be aligned with those available to the workforce.[28] While it may not be practical to alter existing contractual commitments in this regard, remuneration committees will need to ensure future contractual arrangements heed this.

144. Compensation commitments due to directors under their terms of appointment in the event of loss of office should be proportionate and variable by discretion, so that the remuneration committee can vary compensation where appropriate to the circumstances and to reflect departing directors' conduct and performance.[29]

[27] Provision 37

[28] Provision 38

[29] Provision 39

APPENDIX A OTHER SOURCES OF INFORMATION

FRC papers

- *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting*
- *Guidance on Audit Committees*
- *Guidance on the Strategic Report*
- *Corporate Culture and the Role of Boards*
- *The UK Stewardship Code* – sets out good practice for institutional investors on engaging with the companies in which they invest.

These can be downloaded from the FRC website: www.frc.org.uk or obtained free of charge from FRC Publications via the following methods:

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Directors' duties

The legal duties of directors of UK companies are set out in sections 171-177 of the Companies Act 2006, which is available at:

www.legislation.gov.uk/ukpga/2006/46/contents

Other sources of guidance

Note: this is not a comprehensive list as other sources of information and advice are available.

- ICSA: The Governance Institute provides guidance on a wide range of board-related matters, for example, specimen terms of reference for board committees. This guidance can be found at: www.icsa.org.uk/knowledge/resources

- The Institute of Directors provides a wide range of guidance notes for directors, which are available at: www.iod.com/Home/Business-Information-and-Advice/Being-a-Director/

- ICSA: The Governance Institute and The Investment Association guidance, The Stakeholder Voice in Board Decision Making (published September 2017) is available at: www.icsa.org.uk/assets/files/free-guidance-notes/the-stakeholder-voice-in-Board-Decision-Making-09-2017.pdf

- Institute of Business Ethics guidance, Encouraging a Speak-Up Culture (published November 2017) is available at: www.ibe.org.uk/userassets/pubsummaries/summ_gpg_speakup2.pdf

APPENDIX B DISCLOSURE OF CORPORATE GOVERNANCE ARRANGEMENTS AND OVERLAP WITH THE FCA HANDBOOK

Listed companies must disclose certain information in order to comply with the Financial Conduct Authority's (FCA) Listing Rules (LR) and Disclosure Guidance and Transparency Rules (DTR).

To ensure full compliance with these requirements, companies should consider the full text contained in the relevant chapters of the FCA Handbook. However, the summary below is a snapshot of the current overlaps and requirements.

LR 9.8.6 R through to and including LR 9.8.7A R contain reporting requirements relating to the Code and apply to companies with a Premium listing.

The DTR sections 7.1 and 7.2 apply to issuers whose securities are admitted to trading on a regulated market (this includes issuers with a Premium or Standard listing[1]).

LR 9.8.6 R (for UK incorporated companies) and LR 9.8.7 R (for overseas incorporated companies) states that in the case of a company that has a Premium listing, the following items must be included in its annual report and accounts:

[1] The application of these DTR provisions is restricted to issuers which are UK incorporated. However, DTR 7.2 is extended by the LR to apply to Premium listed overseas companies and companies with a standard listing of shares which, in either case, are not required to comply with corresponding requirements in another EEA State.

LR Requirements	UK Corporate Governance Code
A statement of how the listed company has applied the Main Principles set out in the Code, in a manner that would enable shareholders to evaluate how the principles have been applied.	Code Introduction The Code reiterates in the introduction the requirement of the Listing Rules and the application of the Principles.
A statement as to whether the listed company has: • complied throughout the accounting period with all relevant provisions set out in the Code; or • not so complied and if this is the case set out: - the provisions not complied with; - for those provisions whose requirements are of a continuing nature, the period within which it did not comply with some or all of the provisions; and - the company's reasons for non compliance.	The Code has a number of Provisions which have a specific reporting requirement. In the case of Provisions 5, 10 and 19, explanations are required in specific circumstances. All the reporting provisions must be provided, or a clear explanation given to be in compliance with the Code and LR 9.8.6 R and LR 9.8.7 R. Reporting obligations are generally met by inclusion in the annual report. In some cases, alternative arrangements can be made. Where information should be 'made available' this can be met by placing the information on a website maintained by or on behalf of the company. In other cases, information should be in papers for the shareholders.

DTR 7.2 concerns corporate governance statements. Issuers are required to produce a corporate governance statement that must be either included in the directors' report, or set out in a separate report published together with the annual report, or set out in a document on the issuer's website to which reference is made in the directors' report.

DTR Requirements	UK Corporate Governance Code
Section 7.2 Issuers are required to produce a corporate governance statement that must either be included in the directors' report (DTR 7.2.1 R); or set out in a separate report published together with the annual report; or set out in a document on the issuer's website, in which case there must be a cross-reference to this in the directors' report (DTR 7.2.9 R).	
DTR 7.2.2 R The corporate governance statement must contain a reference to the corporate governance code to which the company is subject.	For those companies with a Premium listing this is the UK Corporate Governance Code.
DTR 7.2.3 R When a company departs from that code it must explain which parts it departs from and the reasons for doing so.	See commentary in relation to LR 9.8.6 R in previous table.
DTR 7.2.4 G States that compliance with LR 9.8.6 R (6) will satisfy these requirements.	

DTR 7.2.5 R, DTR 7.2.6 R, DTR 7.2.7 R, DTR 7.2.8A R and DTR 7.2.10 R set out certain information that must be disclosed in the corporate governance statement:

- DTR 7.2.5 R states that it must contain a description of the main features of the company's internal controls and risk management systems in relation to the financial reporting process.
- DTR 7.2.6 R states that the corporate governance statement must now contain the information required by paragraph 13(2)(c), (d), (f), (h) and (i) of Schedule 7 to the Large and Medium-sized Companies and Group (Accounts and Reports) Regulations 2008 where the issuer is subject to the requirements of that paragraph.
- DTR 7.2.7 R states that it must contain a description of the composition and operation of the issuer's administrative, management and supervisory bodies and their committees;
- DTR 7.2.8A R states that that it must contain a description of:
  (a) the diversity policy applied to the issuer's administrative, management and supervisory bodies with regard to aspects such as, for instance, age, gender, or educational and professional backgrounds;
  (b) the objectives of the diversity policy in (a);
  (c) how the diversity policy in (a) has been implemented; and
  (d) the results in the reporting period.

  If no diversity policy is applied by the issuer the corporate governance statement must contain an explanation as to why this is the case.
- DTR 7.2.10 R states that an issuer which is required to prepare a group directors' report within the meaning of Section 415(2) of the Companies Act 2006 must include in that report a description of the main features of the group's internal control and risk management systems in relation to the financial reporting process for the undertakings included in the consolidation, taken as a whole.

DTR Requirements	UK Corporate Governance Code
DTR 7.2.7 R The corporate governance statement must contain a description of the composition and operation of the issuer's administrative, management and supervisory bodies and their committees.	This requirement overlaps with several Code Provisions: Provision 10 Identification of independent non-executive directors. Provision 14 Responsibilities of the board members and committees should be clear, set out in writing, agreed by the board and made publicly available. The annual report should set out the number of board and committee meetings and the attendance by each director. Provision 23 The annual report should describe the work of the nomination committee. Provision 26 The annual report should describe the work of the audit committee. Provision 41 There should be a description of the work of the remuneration committee in the annual report.
DTR 7.2.8A R The corporate governance statement must contain a description of the diversity policy, its objectives, how it has been implemented and the results in the reporting period. If no diversity policy is applied, the statement must contain an explanation as to why this is the case.	Provision 23 The annual report should describe the work of the nominations committee, including: the policy on diversity and inclusion, its objectives and linkage to company strategy, how it has been implemented and progress on achieving the objectives; and the gender balance of those in the senior management and their direct reports.

Overlap with FCA Handbook rules related to audit and risk (Section 4 of the Code)

LR Requirements	UK Corporate Governance Code
LR 9.8.6 R (3)[2] Requires statements by the directors on: (a) the appropriateness of adopting the going concern basis of accounting (containing the information set out in provision C.1.3 of the UK Corporate Governance Code[3] and (b) their assessment of the prospects of the company (containing the information set out in provision C.2.2 of the UK Corporate Governance Code); prepared in accordance with the 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' published by the Financial Reporting Council in September 2014.	Provisions 30 and 31 These replicate C.1.3 and C.2.2 of the 2016 Code. Provision 30 deals with the appropriateness of adopting the going concern. Provision 31 is an assessment of the prospects of the company.

[2] These requirements apply specifically to UK incorporated companies but all Premium listed companies are also subject to the requirement to 'comply or explain' against the related Code Provisions.

[3] These references are to the 2016 edition of the Code.

DTR Requirements	UK Corporate Governance Code
DTR 4.1.12 R States that Responsibility statements must be made, what it must refer to and set out in relation to the financial and management statements.	Provision 27 States that directors should explain in the annual report their responsibility for preparing the annual report and accounts.
DTR 7.1.1 R, 7.1.1A R and 7.1.2A R Sets out minimum requirements on composition of the audit committee or equivalent body.	Provision 24 Sets out the recommended composition of the audit committee.
DTR 7.1.3 R Sets out minimum functions of the audit committee or equivalent body	Provision 25 Sets out the main roles and responsibilities of the audit committee.
DTR 7.1.5 R The composition and function of the audit committee or equivalent body/bodies must be disclosed to the public. This disclosure can be included in the corporate governance statement required by DTR 7.2.	Provision 14 States that the responsibilities of committees should be clear, set out in writing, agreed by the board and made publicly available. Provision 26 States that the annual report should describe the work of the audit committee.
DTR 7.2.5 R The corporate governance statement must contain a description of the main features of the issuer's internal control and risk management systems in relation to the financial reporting process	Provision 28 That board should carry out a robust assessment of the company's emerging and principal risks and this should confirm this in the annual report. Provision 29 The board should monitor the company's risk management and internal control systems, review their effectiveness and report on this review in the annual report.

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