Better Governance Reporting

A practical framework

With the support of

ACCA

INDEPENDENT AUDIT LIMITED

WHO WE ARE

Independent Audit specialises in helping boards strengthen strategic leadership and control.

ACCA is a leading global professional accountancy body, and has kindly sponsored this publication.

FOREWORD

Considerable progress has been made in strengthening corporate governance in UK companies in the past decade. The introduction of the Combined Code and its subsequent updating has provided an effective framework without the burden of statue and detailed regulation. Whilst some frustrations remain – and no system will ever be perfect – most companies and stakeholders in the UK recognise that its flexibility is highly preferable to a more prescriptive system.

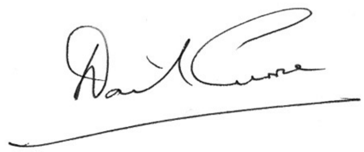
Flexibility inevitably results in variability. Companies take different approaches to applying the Code's principles. This is how it should be: governance structures and processes should be designed to meet the specific needs of the business. But variability in approach also means variability in quality. So there is an onus on companies to provide an insight into how they are applying the principles of sound governance.

For "comply or explain" to work, clear and well-supported explanations are needed, with the users of reports taking these explanations into account and not demanding a box to tick. In reporting, companies need to remember its overriding purpose: to communicate the nature and quality of the strategic leadership and control exercised by the board.

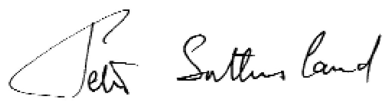
The board is at the heart of value creation and it is what investors and other stakeholders want to read about. But, in the eyes of the users, few companies manage to report effectively on governance and board performance. A sizeable expectation gap remains. With the revised Combined Code now having been in place for over two years it is time for this gap to be bridged.

This framework does not aim to introduce a set of standards or requirements. As with governance itself, reporting must remain flexible and fitted to the needs of each company. Instead it highlights the questions that companies should take into account in their governance communications.

We hope that it will prove to be a further step towards bringing issuers and users of information closer together and promote a better understanding of how boards perform their crucial role of guiding companies to success.



Lord Currie of Marylebone
Chairman, Independent Audit Limited



Peter Sutherland, KCMG
Chairman, BP plc

Tim Breedon
Group Chief Executive, Legal & General Group Plc

January 2006

WHAT THIS IS ABOUT

The purpose of this document

The purpose of this document is to help companies report more effectively on how they:

- Are using governance in the strategic management of the business.
- Have applied the Combined Code principles.

And where companies are using "comply or explain", it should help them provide better explanations.

The report is in two parts:

- A review of what companies, shareholders and other market participants are saying about governance reporting – how they use it, what the issues are, and the common ground.
- A practical framework which companies can use to help bring the general principles of governance reporting to life.

The framework is not prescriptive and is not meant to be used as a checklist. We do not want it to lead to the development of yet another "silo" within the annual report; on the contrary we want to encourage the linkage of reporting on governance to the discussion of strategic performance.

Governance reports are mainly analysed by shareholders, particularly institutional investors, so we use the term "investors" when referring to the users of reports. But the content of reports based on the framework is valuable to rating agencies and to other counterparties and stakeholders who refer to the annual report to get an impression of how a company is managed.

The themes captured in the framework are equally applicable to all boards, whatever the ownership structure or size of the business. After all, good governance is about leading and controlling an organisation well and the core principles, as reflected in both the Combined Code and this framework, apply universally.

WEB RESOURCES

Examples of good reporting, with the relevant links to annual reports, are drawn together at www.independentaudit.com/goodreporting. These will be updated as new reports come through.

Reporting continues to evolve, so we expect to revisit this work and we welcome your comments. You can send them via email to comments@independentaudit.com.

CONSULTATION

Our approach to this initiative has been to look at the expectation gaps and find the common ground between the suppliers of governance information and the users. As well as reflecting the requirements of the users of reports, the framework needed to recognise the constraints applying to reporting companies.

So we have consulted representatives from a range of companies, investment institutions, investor representative bodies, the FRC and other users of corporate governance reporting.

Given the diversity of requirements and views, the framework cannot capture all of the different opinions or needs of each of those involved. Inevitably, therefore, the suggestions made in the framework remain those of Independent Audit. However, we hope that the end result goes a long way towards capturing a consensus view.

We would like to express our thanks to all who have participated in the consultation, especially the members of the working group (comprising the individuals asterisked in the list of participants below) who were particularly generous with their time. We are very grateful for the insights and guidance provided by all.

Paul Moxey*	ACCA
Sir Derek Higgs	Alliance & Leicester
Dick Olver	BAE Systems
Ben Mathews*	BG Group
Elizabeth Hobley*	BHP Billiton
Marian Collins	Barclays Global Investors
Jeremy Booker*	BP
Alan Scott*	BT
Richard Lapthorne	Cable and Wireless
Thomas O'Malley	Capital International
Murray Steele	Cranfield School of Management
Gavin Grant	Deutsche Bank
Trelawny Williams & Donald Cassidy	Fidelity International
Richard Singleton	F&C Asset Management
Tom Keevil	Gallaher
Harry Baines* & Virginia Porter	HBOS
Rob Lake & Antony Marsden	Henderson Global Investors
Alastair Ross Goobey	Hermes Focus Asset Management
Ian Greenwood* & Jennifer Morris	Hermes Investment Management
Jay Kantaria*	HSBC Halbis Partners
Anne Simpson	ICGN
Giles Peel	ICSA
Craig Mackenzie & William Claxton-Smith	Insight Investment
David Rough	Land Securities
Andy Banks*	Legal & General Investment Management
Alastair Michie*	Lloyds TSB Group
Anita Skipper* & Iain Richards*	Morley Fund Management
Martin Murray	Old Mutual
Steve Cowden*	Reed Elsevier
Rosemary Martin*	Reuters
Graham Staples*	Schroders
George Dallas*	Standard & Poor's
Sir David Lees	Tate & Lyle
Daniel Summerfield*	Universities Superannuation Scheme

* Working group members

TIME FOR A CHANGE: A SHIFT TO BETTER REPORTING ON BOARD PERFORMANCE

At times, standing still can seem the best approach. But when it comes to governance reporting, this may not be an option, or at least not a very good one.

The overall quality of large companies' reporting is improving, with signs of a move away from boilerplate, compliance-driven reports. As also reflected in the FRC's recent consultation on the Combined Code, institutional investors are paying more attention to what companies are saying about their governance. Although often still weak, the influence on investment decisions is growing. And although the OFR will not now be a statutory requirement, the lengthy discussion on its value and content has changed expectations, bringing focus to the question of how the board is performing.

At the same time, investors and companies are increasingly keen to try to understand each other's reporting needs and to make an effort to find common ground. There's a big gap. Investors have not always communicated well what they would like to see and why. Companies, who get little comment until a storm is brewing, have remained sceptical as to the value of going the extra mile. Quite reasonably, they have questioned whether what they report makes any difference. But there are now clear signs of willingness to try to bridge this gap.

With this framework we've set out to suggest some answers to the fundamental questions:

Why does it matter?

What do investors want?

What's the way forward?

We have aimed to:

- Draw out how, when it's pared back to core principles, corporate governance is all about corporate performance and value maximisation.

- Go back to the basics of good governance: the framework is aimed at helping ensure that reports tell the user how the company has made sure that it has good leadership, direction and control.

- Explain how, by adapting their reporting to capture the essence of the Code rather than simply reporting compliance, companies can provide more useful information on their governance without adding significantly to the reporting burden or the length of their reports.

In doing this we have aimed to align the framework with the core principles of the Combined Code and have taken an approach that actively supports the UK's principles-based system as a cornerstone of sound governance.

WHY DOES IT MATTER?

Companies may often wonder why they bother. When there are few questions from investors and the link between governance and investor decisions is not very visible, it's understandable that some see little benefit in investing time and effort in moving their reporting forward.

But there are benefits, and these will increase as investors begin to use governance information more effectively in their assessments of board and management performance.

The extent of the benefits of improved reporting depends on how investors use insights into board performance and what companies want to achieve.

How do institutional investors use the information?

The common perception is that investors don't use governance reporting in their investment process: their governance assessment (if they make one) isn't joined up to the investment decision. This, for now at least, has to be acknowledged as a well-founded view.

But it doesn't apply universally and investment analysis isn't standing still.

There are differences in approach

Some investors don't use governance information (or indeed much qualitative information at all) and don't intend to. They view it as compliance-driven with little direct impact on returns. Some do actively use it, although the link to the decision-making varies from case to case. Others don't use it *but would do if reports were more useful.*

For most investment houses, the qualitative factors which may be conveyed in governance reporting play at best a subsidiary role within investment models. But it would be a mistake to dismiss them:

- For some investors, governance is taken into account in some shape or form. If companies work to the lowest common denominator they risk being wrong-footed.

- Beyond the investment decision itself, investment houses often use their assessment of governance, based on reports, as a basis for dialogue with companies.

- Institutional investors pay attention to what companies are disclosing and saying about governance issues before making voting decisions. Given the time and information to do so, they will consider explanations carefully before acting – although the immediate evidence for this is not always visible, given the common mutual preference for engagement behind closed doors.

For some other users, such as rating agencies, governance reporting is becoming a more visible part of the equation and can have an impact on a company's risk profile.

Also, things are changing

Most long-term investors do think seriously about governance. They are increasingly recognising that good governance is about good leadership, direction and control, and should be taken into account in the assessment of management performance. The Code is helping that process, as are initiatives aimed at integrating qualitative measures into the valuation process (such as the Enhanced Analytics Initiative).

Investors are also increasingly concerned to ensure that the overall message they give companies from across their investing, research and governance teams is consistent. They are aware of the scope for lack of alignment, and are looking to make sure that a common view is set out.

Best practice is increasingly for boards to consult with shareholders on potentially contentious and high profile voting issues, and these often get escalated to senior decision-making levels within the investment house. Our consultation also confirms that fewer investment managers and pension funds, in terms of market weighting, still have blanket policies which result in an automatic no-vote or abstention for non-compliance.

As internal co-ordination on governance issues improves and qualitative factors are taken more into account, the importance of perceived governance quality is increasing. As these changes take place, investors need to communicate more actively what information they would like from investee companies in reporting and meetings, and how they use the information within their own voting and investment processes.

It's important to manage engagement risks proactively. One way companies can do that is to continue to deepen their relationships across the investment house, bringing in the senior investment decision-makers.

How do companies benefit from better reporting?

The linkage with valuations and investment decisions, although becoming more visible, is often likely to remain weak, in many cases for some time to come. But there are other good reasons for improving reporting on governance and board performance.

Stronger governance – and performance

Reporting focuses the mind, particularly in a document which is on the public record. Many companies say that carefully thinking through what they report on their approach to governance and the linkages they have made between its different aspects does help pinpoint what works well for the business, what may need strengthening and what can be simplified.

And once this thinking and reporting draws out the links between governance performance and strategic performance, the value of good governance becomes more evident. This helps shift perceptions away from the erroneous position of "governance is all about compliance" to one where it's seen as an integral part of making sure the business is successful.

Better dialogue

Companies can use governance disclosures to encourage debate internally and to anchor the foundations of the dialogue with investors on the important investment and voting issues, which often have governance-related challenges at their heart. Better reporting can also reduce over-reliance on meetings to gain insights into governance, and might mean some meetings aren't needed.

Effective communication on board performance is central to developing supportive and long-term investing relationships, based on a mutual understanding of objectives. It's not just a question of reporting because it's expected or required. It needs to be part of a process of two-way education. Investors need to provide feedback on what information they want more regularly, not concentrated into a short window of a few weeks. And companies need to recognise that users of the information (along with the media) need to be helped to understand how a board operates: few will have experience of boardrooms on which to base their judgements.

So better reporting should result in better dialogue. In turn, a convincing and consistent demonstration of good governance should, in the long run, lead to a reduction in the cost of capital. And in the shorter term, it generates goodwill which is invaluable if difficult issues arise.

WHAT DO INVESTORS WANT?

With limited resources in both companies and the users of reports, it's essential that changes to reporting reflect genuine needs and also that they don't lead to longer reports.

The annual report, announcements, circulars and the web are all important opportunities for the company to communicate its governance message. The annual report is seen as the key document on the record, so the consistency and quality of information need to start at this point. Inevitably investors (and other users) have differing needs and are looking for different things. But there are some important unifying themes.

Quality not length

It's understandable that "boilerplate" does occur. Legal considerations will always need to be factored in, especially for SEC registrants. Companies will want to make sure that they have covered the many main and supporting principles of the Combined Code. And some clear compliance statements are still needed. For example, voting agencies need to be able to quickly flag compliance and explanations which investors may want to consider further.

But investors want *less* boilerplate. They are concerned, as the companies are, to keep reporting costs down: this means going for quality, not length.

Boilerplate takes up space which could be better used. The web is a good home for standing information such as terms of reference, and with the right quality controls it is an increasingly accepted and cost effective source of corporate information.

Rather than writing the entire report around compliance, companies can use summaries or an index to help agencies and other readers quickly identify relevant compliance information. And companies may want to think about taking compliance statements and standard information (such as summaries of the terms of reference) out of the main narrative, putting them in a clearly marked section of the governance report so as to avoid breaking up the flow.

Using examples to bring it to life

Giving examples that illustrate the approach, rather than just stating policy, can add colour and give real insight into how the board works. Their use is also an indicator of the board's attitude to communicating with all investors on its governance approach.

Investors don't expect sensitive information on, for instance, the specific findings from the board evaluation. But they do want to understand how the approach taken by the board has added value and what is different as a result. And they're not looking for a long list of examples: a little can go a long way.

Governance reporting which reflects the business

Every business and every board is different. Investors want a company to use its report to reflect its specific approach to governance.

The reporting is most valued when it reflects the company's strategy and culture and when it shows how the board's thinking joins up across the different parts of the report. This may not be easy to do, given the silo approach that has developed as reporting requirements have evolved. But investors are hoping for greater integration of the themes and main messages.

Keeping it fresh

Companies might want to focus on a few specific themes each year. If nothing's changed in certain aspects of the governance approach, a short reference to the previous year's report can leave room for a fuller, more informative discussion of specific aspects of governance or of developments during the year.

This can also help avoid the report getting stuck in the same groove from year to year. Annual repetition with little change in the text can leave users with a feeling that not much effort has gone into the report. When they can see that the business has changed, they want to understand how governance activity has responded.

Giving insights into the board's role and linking it to performance

Investors find little value in a standard description of what a board does, or the reserved matters. What they would like is an explanation of what role a particular board plays and examples of what the board did to support the achievement of the business's strategic goals.

They would also like to see that the linkage to strategy and performance extends to the board committees. So, for example, the audit committee needs to show how it adds to the strengthening of financial reporting, risk management and internal controls, and the nomination committee should explain how it makes sure the board has the skills for successful implementation of the company's strategy.

Investors are very keen to see rewards linked to strategic performance. This means they want to understand better how the remuneration committee has ensured a strong link during the year and how it goes about monitoring the continued relevance of remuneration policies. The detailed information on policy application will appear in the remuneration report, but this doesn't usually explain what the committee has been doing to provide active oversight.

A focus on board membership and skills

Investors have consistently highlighted their desire to understand better how the skills and experience of the board, and top executive management, fit with the company's strategy. They want the work of the nomination committee to be visible, in how it plans ahead and matches board skills with strategic needs over both the short and the long term.

Showing the value brought by the non-executive directors

Investors want to understand whether and how the board's objectives and culture encourage healthy boardroom challenge between the non-executives and the executive management. And how the non-executives' skills complement those of the executive directors.

They're interested in how the company and management help the non-executive directors to be effective through information, access to the business, and training and development, and how the executive directors are supported in their board responsibilities as well as in their functional roles.

WHAT'S THE WAY FORWARD?

This information is not necessarily easy to communicate. But companies can go a long way towards meeting investor requirements without unduly increasing the length of reports or raising concerns over confidentiality or legal exposure.

Inevitably change will be gradual and not uniform. Companies will feel their way and be more comfortable in some areas than in others. A dialogue to help investors understand how a board operates will take time. And investors will need to get into the habit of giving more regular feedback on their needs and concerns. We hope that this framework will provide companies and investors with ideas on how to move forward.

For those companies who intend to continue with their plans for the OFR, there is a good opportunity to rethink governance reporting. Companies may find it most effective to report on performance in terms of the way it is monitored and guided by the board, as was proposed in the OFR reporting standard. Put this together with investors' desire for governance reporting to be linked to strategic performance, and the convergence – and the opportunity – is clear.

THE REPORTING FRAMEWORK

Institutions recognise there are constraints that companies face in reporting. They are not looking for lengthy reports, or expecting detailed explanations of boardroom discussions or decisions. But they are looking for reports that discuss a company's approach to the key aspects of good corporate governance.

The reporting framework is a set of questions that a chairman might use with the other directors to look at the board's approach to governance. The questions cover the main issues that investors want to obtain insights into and also address the principles underlying the Combined Code.

Summary of the Reporting Framework

Purpose	***The overriding purpose of a company's governance reporting is to communicate the nature and quality of the strategic leadership and control exercised by the board.***
1	**What is the board's role and what did it do?**
2	**What gives the board confidence it has the right people?**
3	**How did the board work together?**
4	**How did management support the workings of the board?**
5	**How did the board make sure it was fully effective?**
6	**How did the dialogue with shareholders help the board meet its objectives?**

How to use it

The questions should not be used as a checklist.

The framework suggests questions for companies to consider when communicating their governance approach. It aims to draw out the main themes that companies may wish to cover.

Companies will want to use the structure of the overall framework in the way that best suits them. Each company needs to consider what questions are relevant and work out how best to structure the messages they want to give. They should consider how to report on governance in an integrated way and not simply use this framework to create another "silo" that appears disconnected from other parts of the annual report.

Some aspects of governance crop up in more than one part of the framework. This overlap can be addressed as a company develops the content and structure of its own report.

Investors say that reporting is most effective when it focuses on what was done during the reporting year, uses the past tense and, where possible, gives examples.

See www.independentaudit.com/goodreporting for useful examples.

1 What is the board's role and what did it do?

Think about…

What is the board's role in practice and how is it changing?

How did the board reach an understanding of its role and objectives?

What was the board's focus during the year and how did this change?

How did the board work with management in agreeing on the strategy?

How was progress in meeting strategic goals monitored and discussed?

What key decisions did the board reach to support strategic success?

How did the board make sure risks were managed?

How did the board ensure the right values were developed?

The board has a significant impact on corporate performance. So investors want to get an understanding of its approach and how it went about meeting its responsibilities during the year.

Setting the strategic direction, providing entrepreneurial leadership and then monitoring performance is at the heart of its role and work. But its approach to identifying risks and overseeing their management is also seen as important and should be explained as an integral part of board activity, not pushed into the small print on internal controls.

Corporate values and ethics are crucial to building success and avoiding failure. This means that investors also want to understand the board's role in establishing standards of behaviour and how it sets the right tone at the top.

…and for the committees

Committees increasingly have an important part to play in this and usually it's in the committees that independent directors can exercise oversight most effectively. A good explanation of the way the board uses its committees provides a useful insight for investors into how the board operates.

Committees vary considerably in the thoroughness of their work. What's important, both for the board and for shareholders, is understanding what each committee is actually doing and how it's doing it.

Is its role clear across the board and the committee itself? What did it do outside formal meetings and how did this help? How did the number and timing of meetings mean that it could do its job? How did it help the business manage its risks? And, crucially, how did the committee's work help the business achieve its goals?

Investors generally seem to welcome having the committee terms of reference available on the web, rather than forming a central part of the governance report.

The Code looks for a description of…

…how the board provides entrepreneurial leadership, setting strategic aims, ensuring resources are in place and reviewing performance. Also on how it makes sure this happens within a framework of sound controls, standards and values (Principle A.1).

2 What gives the board confidence it has the right people?

Think about…

How does the make-up of the board meet the needs of the business?

What skill sets were useful to address specific strategic developments and challenges during the year?

How will the mix of experience need to change as the strategy is implemented?

How did the board ensure that its members' knowledge and experience remained relevant as the business changed?

How did it assess and plan for future needs against long-term strategy?

How did it determine whether it has the right management team?

Investors place considerable and increasing emphasis on the experience and profiles of individual directors and how they meet the needs of the business.

They want to understand why the current mix is right for overseeing and managing the successful implementation of strategy, both today and going forward. Tied in with this is the question of how the non-executive directors bring skills and experience that complement (and possibly supplement) those of executive management.

The discussion of the board's individual and collective experience is most meaningful if it demonstrates relevance to the strategic challenges and risks facing the business.

…and for the committees

The membership of committees is of separate interest. What relevant skills do committee members specifically bring in relation to each committee's responsibilities? And where technical knowledge such as accounting issues or remuneration practices is required, how do members keep up to speed with developments?

The Code looks for a description of…

… how the company has adopted a rigorous approach to appointing directors based on merit and against objective criteria, maintaining an appropriate balance of skills and experience and their availability; and has planned for the future (Principles A.3 and A.4), keeping the board refreshed through re-election at regular intervals (Principle A.7).

3 How did the board work together?

Think about…

How did the chairman and CEO work together?

How did the independence of the NEDs contribute to the quality of strategic direction and oversight?

What is the role of the senior independent director?

How was management's performance reviewed?

How did the board work between meetings?

How did the board respond as a team to any crises?

How did each committee report back to the board?

How individual directors work together on the board is different from how the board itself is effective as a unit. Different individuals play different roles and these need to meld together. Investors value getting a sense of how the board members work as a team and why the balance of independent and other directors works well.

The relationship between the chairman and the CEO is of particular significance and is seen by investors as a good indicator of both how a board works and its effectiveness.

A specific focus on how the chairman and non-executives evaluated management performance (especially the CEO's) is seen by some as a useful indicator of the nature of the relationship between executive and non-executive directors.

The independent mindset and approach of individual directors is also regarded as key, so companies need to show that the directors were in a position to leverage their experience and independence to provide the necessary checks and balances. This means going beyond formal interpretations of independence.

…and for the committees

The committees' role in finding out whether checks and balances are working is increasing and report users are now looking to see how they do this. In assessing the committees' approach, it's useful to get an insight into how they interact with management: for example, who attends committee meetings and why. How the committees involved external advisors and worked with internal structures such as internal audit, compliance and HR gives an impression of how they oversee management and policy implementation.

The Code looks for a description of…

…how directors challenge and help develop strategic proposals, scrutinise strategic performance, satisfy themselves on the integrity of financial information and make sure that controls and risk management are robust (Principle A.1) through a balanced approach to decision taking based on a clear division of responsibilities between the board and the executive and independence of the non-executives (Principles A.2 and A.3).

4 How did management support the workings of the board?

The quality of information provided to the board is fundamental to the quality of corporate governance. No matter how competent, challenging or constructive a group of directors might be, without the right information the board's effectiveness will be reduced.

Information takes many forms and its timing and format are as important as the content itself. Too much can be as bad as too little. Describing the steps that management takes to ensure the board is well-briefed will help give investors an impression of the effort put into getting this right.

Induction and on-going skills development also provide opportunities for management to help the board. Companies often have plans in place but give little indication as to what, if anything, was actually delivered.

And, as with any relationship, it's a two-way street. If management gets value from the board and committees, the way in which it supports the board is likely to be more effective. A report which explains how the board made sure it gave value to the management will give an indication that the governance structures are working well and kept under review.

…and for the committees

The committees have specific information needs in terms of content, technical detail, timing and format. It's important that each committee makes its particular needs known and that management makes sure these are met. There can also be more scope on committees for obtaining information by inviting management representatives or external advisors to present.

A committee has an opportunity to challenge more directly the information provided to it – this is often an important part of its role. There may need to be a greater focus on the level of assurance over the information received by a committee.

Think about…

How did the board members ensure they got the answers and information they needed?

What was done to make sure that the administrative processes helped the board to be effective?

What induction and development support was provided?

How were board members given opportunities to learn about changes in key performance drivers?

What contact was there with managers below the board?

What value did management get from the board and committees?

The Code looks for a description of…

…how the board is supplied in a timely manner with information that enables it to discharge its duties; how induction and other support helped directors become familiar with the business and maintain the necessary skills and knowledge and how the board is supported (Principle A.5).

5 How did the board make sure it was fully effective?

Think about…

How did the board approach its own evaluation and self-improvement?

How is this approach developing over time?

What is the board going to do to strengthen its performance?

How did individual performance evaluations of the chairman and directors strengthen the effectiveness of the board?

How did the board, and the committees themselves, assess how well each committee did its job?

What do the committees feel is important for their further development?

There is always scope for doing things better. Effectiveness will change over time with changes in membership and chairmanship, even if there are no significant changes in the business or in legal or regulatory requirements. So investors are looking for insight into the board's attitude to its own development.

Without a clear explanation, investors are unable to distinguish between companies who are making a determined effort towards continuous improvement and those seeing the annual effectiveness review as a compliance exercise. If there is no clear description, or if it's the same from year to year, the inference may be that little was done or that the board is dismissive of the idea that there could be any room for improvement.

Investors don't expect details of sensitive matters, but they are looking for something that tells them about the board's attitude to evaluating and improving its own performance.

…and for the committees

As investor attention to reporting, controls, pay and board membership increases, there's more focus on committee effectiveness. The qualities that make a board committee work well are not always the same as those which make the main board effective. The requirements of members, the underlying processes, the information needs and the role of advisors can be quite different. These differences need to be reflected in the evaluation approach and the report should explain how these were factored in.

The Code looks for a description of…

…how the board undertook a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors and how the chairman acted on the results by addressing the weaknesses (Principle A.6).

6 How did the dialogue with shareholders help the board meet its objectives?

Think about…

How did the board take soundings of shareholder opinion and factor this into its decision-making?

What is the board's view of the way its main shareholders communicated with it?

To what extent were committee members involved in consultations with shareholders?

How did the board stay informed of the other main stakeholders' views?

How was investor and other stakeholder feedback shared and debated across the board?

Investors' attitudes to a board are influenced by their perception of the board's attitude to them. So it is helpful to describe what the board does to maintain a dialogue with its shareholders.

The Combined Code also places a responsibility on shareholders to enter into a dialogue with companies. There's an onus on investors to listen to explanations, to provide feedback and to vote responsibly. So, as well as providing a description of the efforts made by the company to help institutions do this, companies might want to report on their experience of investor feedback and dialogue.

…and for the committees

The level of contact between committees and investors is changing, and therefore should be explained as it cannot be assumed. Remuneration and nomination committee chairmen are increasingly involved in consulting major shareholders over remuneration policy and succession issues. Committee chairmen are often now available for questions at the Annual General Meeting.

The need for separate reporting on the committees' dialogue with shareholders is limited, but should be taken into account when reporting on the board's overall dialogue.

The Code looks for a description of…

…how the board ensures that a satisfactory dialogue with shareholders takes place and keeps in touch with shareholder opinion (Principle D.1), and how it uses the AGM to communicate with investors (Principle D.2).

Plus… some specific questions about committees

In addition to the key questions included in the framework, reports from committees should address some specific questions reflecting their particular responsibilities. As with the main questions, it's important to explain *how* the committee did what it needed to do, not just report that it did it.

How did the committee…

Audit	Remuneration	Nomination
Assess how far internal controls and risk management were working effectively?	Assess the alignment of rewards with strategic goals?	Go about making appointment recommendations to the board?
Determine whether internal audit was meeting the needs of the business?	Monitor the application of agreed policies and their continuing relevance given changes in strategy?	Ensure that succession planning for executives and NEDs is in line with the company's long-term strategy and values?
Make sure the relationship with the external auditors was sound and their independence was maintained?	Ensure that financial and non-financial targets were appropriate, were based on reliable information and included enough stretch?	Canvass and take into account the opinions of the board, management and institutional investors, on a timely basis?
Evaluate the effectiveness of the external audit process?	Make sure the peer comparisons made sense for this company?	Make sure that contingency planning is thorough?
Respond to external changes that affected its responsibilities and, possibly, increased its risks?	Make sure it understood and monitored investor concerns?	Define job descriptions at the necessary level of detail?

The Combined Code specifically requires the audit committee (Principle C.3) and the nomination committee (Principle A.4) to describe their work. It is less explicit about the remuneration committee but given that the statutory remuneration reports do not usually include a description of what the committee did, a separate section should be included. The questions above either refer to specific responsibilities outlined in the Code or suggest issues that companies may wish to cover.

The authors

Richard Sheath	+44 (0)20 7220 6583	richard.sheath@independentaudit.com
Julia Land	+44 (0)20 7220 6587	julia.land@independentaudit.com

About Independent Audit

We help boards to strengthen their strategic leadership and control, and to make their reporting more useful. The type of work we do includes helping boards answer questions such as:

- How can the board improve its effectiveness and efficiency?
- Does the audit committee both add value and manage its own risk?
- Are audit and risk management meeting the business's needs and adding value?
- Do the different elements of our governance fit together coherently?
- Does our governance help to make a better business?
- How can we make our reporting more meaningful without adding to our risk?

Our clients range from FTSE 100 companies to smaller and public sector organisations. What they have in common is the belief that governance matters because it's about running a good business, not about putting ticks in boxes.

If you would like to know more about how we can help you, please contact one of the authors of this report, or our Chief Executive:

Jonathan Hayward	+44 (0)20 7220 6582	jonathan.hayward@independentaudit.com

www.independentaudit.com