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The Essentials of Boardroom Evaluations

By Ron Kral, CPA, CMA, CGMA
Partner of Kral Ussery LLC

Board evaluations are not just for big-public companies, but rather an important activity for all boards and committees regardless of size or industry. The board of directors and its committees serve as the foundation of corporate governance in providing oversight of the CEO. Governance is a process led by people and enabled by technology. Like any other process, it should periodically be evaluated relative to board and committee objectives. This means taking an objective and candid look at the process, the people, the technology, and the results of boardroom activities. Unfortunately, boardroom evaluations are one of the more negligent and divergent areas of governance practices as organizations struggle to define them in terms of why, who, when, what, and how, these evaluations should be conducted. This article is inspired by a chapter I co-authored in a book entitled "The Board of Directors and Audit Committee Guide to Fiduciary Responsibilities: Ten Critical Steps to Protecting Yourself and Your Organization," published by AMACOM in July, 2013.

Why should an evaluation be considered?

Effective boards and committees need to keep in mind their ultimate obligation to serve shareholders, or their organizational purpose in the case of non-profit organizations, to the best of their abilities. Like any other part of the organization, they need to be held accountable through performance evaluations. While many tools exist for evaluating boards and committees, many of them simply evaluate whether the organization is meeting basic fiduciary or regulatory requirements. Compliance with legal regulations is a must, but boards wishing to make a real difference need to set the bar much higher in preparing themselves for challenges, including unexpected ones.

Incorporating performance evaluation routines to assess the performance of boards and committees has several benefits including:

- promoting accountability;
- confirming an understanding of duties;
- verifying independence between the audit committee, management, and external auditor;
- identifying the need for additional skills or expertise on the board;
- helping to prioritize responsibilities;
- providing candid assessment of what is working and what is not;
- creating awareness for reasonably expected challenges;
- enhancing the ability to attract qualified audit committee members;

- promoting comfort levels with investors and creditors thus reducing cost of capital; and
- sending a message to shareholders that the board takes its duties seriously.

Without evaluation efforts, the risk of falling into an abyss of the status quo in simply going through the motions can become a quick reality.

Who is best positioned to conduct the evaluation?

This is a difficult question that has as many answers as possibilities. However, the potential for biases creeping into the process when utilizing internal resources is a real threat due to the lack of actual or perceived independence. It is for this reason that many companies go to great lengths to hire a vendor to administer the evaluation tool. This helps to mitigate the risks of tainted results since the directors themselves are not processing the surveys, questionnaires, or any other documents used for the evaluation. They simply complete what is asked of them, generally on-line through an Internet site, and have an independent party process the results. This is the easy part, but who is left to do the analysis and report the conclusions is where the real risks lie?

Viable options for on-site analysis and reporting back to the board and its committees include general counsel, outside counsel, the chairman of the board, or a third party vendor. All of these have their pros and cons. One important consideration is confidentiality. Whoever has the responsibility to conduct the evaluation will be privy to very sensitive information. Very tight non-disclosure agreements will need to be in place when using outside resources. Even when utilizing in-house resources, they should be reminded of the highly sensitive nature to the project.

An even more important consideration is objectivity. It is paramount that an unbiased mental attitude exists in performing the evaluations. This means no quality compromises are made in terms of the eventual conclusions in the spirit of obtaining the absolute truth. Objectivity requires that those gathering and interpreting the performance evaluation results do not subordinate their judgment for any reason. In reality, this is often difficult to accomplish when strictly using internal resources. While there is no absolutely correct answer for all organizations, one thing is certain - without “objectivity” the evaluation is critically weakened.

When should evaluations be performed?

The answer depends on the organizational needs, risks, and operating characteristics of the board and its committees. That said, companies should adopt a periodic performance evaluation timeframe, such as annual or biannual, and follow it. Otherwise, it is too easy to postpone the evaluation in lieu of other priorities.

Special circumstances, such as a merger, acquisition, divestiture, or aggressive expansion into new markets, should also trigger consideration of an unplanned evaluation to assess their readiness for the new activity. These evaluations can be tailored and streamlined to meet specific needs of what lies ahead. A successful evaluation can help the organization identify needs and resources that might otherwise not be considered under normal operations.

What should be evaluated?

Companies have a lot of latitude on what to evaluate, but it should reconcile to what is required of the board and its committees as formalized in their applicable charters. Of course this assumes that committee charters are comprehensive in adequately defining all expectations and requirements to investors and other stakeholders. For example, audit committees need to be deeply aware of legal requirements applicable through credit agreements, stock exchange listing requirements, regulatory regulations, and governmental filings.

While evaluation areas will differ from company to company based on their operating environments and needs, the following areas should be considered for evaluation purposes:

- governance structure
- code of conduct
- culture
- expertise of directors
- independence of the board, its committees, and its auditors
- access to information and dissemination
- management oversight
- management relationship
- orientation and training of directors
- overall performance in terms of reaching objectives and fiduciary duties
- risk awareness
- shareholder & stakeholder relations

How should the evaluation be performed?

It is too easy to have good governance practices on paper, yet poor practices in motion. Thanks largely to Sarbanes-Oxley, Dodd-Frank and other massive pieces of federal legislation; some companies have gravitated into a checklist mentality rather than focusing in on behavioral matters that lie at the core of strong boardroom activities. Do not get caught up in a frenzy of preparing checklists and generating documentation in the name of “getting-it-done”, but rather utilize a robust evaluation tool to evaluate the more substantive aspects of performance. This will involve assessing culture, independence, data sources, and relationships, as opposed to simply assessing meeting frequency, attendance, and charter compliance through meeting minutes.

There is a great deal of scalability and flexibility of regarding specific boardroom evaluation tools. A popular avenue is to utilize an anonymous, web-based survey of all audit committee members, followed by analysis culminating in a final written report. The anonymous component helps to protect the identities of respondents, which can also facilitate more open responses.

In conclusion, remember that many tools for evaluating boards are designed with a mentality of simply evaluating whether the company meets basic regulatory or committee charter requirements. Compliance with regulatory and charter requirements is a must, but boards wishing to make a real difference need to set the bar higher with more substantive tools that include open-ended questions and deeper analysis to conclude upon the more difficult cultural aspects of the board and its committees. This is often where the more significant value of the evaluation rests, but getting there involves a robust tool and objective analysis. Keep in mind that the conclusions from boardroom assessments are only as good as the tool to gather the information and the independent interpretation of results.

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Ron Kral is a partner of Kral Ussery LLC, a public accounting firm delivering advisory services, litigation support and internal audits. Ron is a highly rated speaker, trainer and advisor. He is a member of 4 of the 5 COSO sponsoring organizations; the AICPA, FEI, IIA, and IMA. Contact Ron at Rkral@KralUssery.com or www.linkedin.com/in/ronkral.

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