By online survey

2 August 2018

ICSA response to the Scottish Governance Code for the Third Sector

On behalf of ICSA, I am pleased to respond to your consultation on the above document. ICSA: The Governance Institute is the international professional body for governance, with more than 125 years' experience and with members in all sectors. Our purpose is defined in our Royal Charter as 'leadership in the effective governance and efficient administration of commerce, industry and public affairs' and we work with regulators and policy-makers to champion high standards of governance, providing qualifications, training and guidance.

We are the professional membership and qualifying body supporting chartered secretaries and governance, risk and compliance professionals in all sectors of the UK economy. Members are educated in a range of topics including finance, company law, administration and governance, which enables them to add value to any organisation.

ICSA has an extensive pedigree in the governance arena, advising governments and regulators on company law, charity law and governance issues. The breadth and experience of our membership enables ICSA to access their practical knowledge in order to provide insights into effective practices across a range of organisations. This, together with detailed understanding of charity and company legislation and regulation, has informed our response.

General comments

As one of the initial organisations behind the original code of governance for voluntary and community organisations in England and Wales in 2005 and being still involved in the current Charity Governance Code, ICSA welcomes this consultation on a specific code of governance for non-profit making organisations in Scotland. We are delighted to see the draft code has incorporated aspects from various codes in different parts of the UK. We particularly welcome the recognition that good governance can only be built on a strong foundation of compliance with legal and regulatory requirements.

To help reinforce that message of compliance, it would be useful to include in the final version a signpost to the different guidance available to readers covering their legal duties, such as OSCR's *Trustee duties,* Companies House guidance for limited companies, partnerships and other company types, or guidance for social enterprises, community benefit societies or bona fide co-operatives. Defining the 'third sector' and to whom the code applies would be helpful to users.

ICSA has been at the forefront of governance developments in the UK for many years. We originally championed and consulted on the development of a code for the charity sector and NHS clinical commissioning groups and have worked closely with the FRC on the UK Corporate Governance Code and provided expert input to codes at home and abroad, for many different sectors. We would be delighted to offer our ongoing help in your efforts to create a relevant, proportionate and effective governance code for Scotland beyond the comments detailed below.

Specific questions
Do the five different principles of the draft Code cover all the areas you would expect?
The five core principles of organisational purpose, leadership, board behaviour, control, and effectiveness reflect the themes most common in governance codes across all sectors in different countries and jurisdictions. Good governance, however does not occur in a vacuum and as such a sixth principle committed to accountability would close the good governance loop.

While the draft code dedicates a paragraph to diversity and equality, the importance of diversity to good governance is not fully articulated. At a time when boards and organisations across the UK, and within different sectors, are being asked to demonstrate better diversity, it would be timely and opportune for the code to reflect these demands. A specific principle may, or may not, be appropriate but the code would reflect modern governance themes if it contained more provisions relating to the importance of diversity in the boardroom.

Not every organisation adopting the code will have paid staff, but where there are the code should cover the role of the chair and the board in appointing, appraising and removing the senior paid member of staff (such as the chief executive). The relations between the chair/board and the chief executive can have a profound impact on the success or failure of an organisation, and the board has an integral role to play in ensuring that proper oversight is provided to make the relationship a positive one for the organisation and the people it represents.

There is little reference in the draft code to financial management, internal controls, risk, audits and formal reporting. Robust financial management is a cornerstone of good governance and is one area where any organisation can come unstuck. This is a missed opportunity, both for the board who need strong internal financial reporting in order to make sound decisions, and to other stakeholders as many people interested to know more about an organisation will refer to annual reports, accounts and regulatory returns.

Governance codes in different sectors and jurisdictions usually include principles about the composition of the board, the management and frequency of meetings, and the importance of the role of the chair in ensuring the board is effective. Specific recommendations within the final version of the code would be beneficial to those new to governance or wanting to understand what good governance looks like.

Specific comments about each of the principles are below.

Organisational purpose:
Although not relevant to non-charitable non-profit entities, the code should reference the fact that charities in Scotland must deliver charitable objects and pass the public benefit test. These legal duties will consequently inform the board's deliberations on the organisation's vision, mission, values and culture.

The first bullet point should be expanded to cover the need for an organisation to continue to be relevant to modern societal conditions. This would lead into a further point about the importance of boards reviewing the organisation's work and impact in relation to other organisations operating in the same sphere, benchmarking and considering the options of joint-working, collaboration, partnership, merger and dissolution. No organisation has a right to exist in perpetuity, and good governance will enable the board to decide and manage an organised and planned change in condition.

Leadership:
The first bullet point alludes to the importance of vision and values underpinning decisions and activities. For charities, it should be noted that all decisions and activities should be made in furtherance of the charitable objects and public benefit test. The current wording suggests that an organisation's vision and values take primacy, when in fact they should support the organisational purpose.

The second bullet point requires further expansion or clarification. It is unclear to which 'separate and collective responsibilities and functions' of the board the point refers. If the sentence is meant to cover

the additional leadership role of the chair, then we recommend adding one or more specific points on the importance of the chair to enabling good governance.

The final bullet point should include the need for delegations to be agreed by the board, written down, monitored and reviewed regularly to ensure they are effective and being used appropriately. This bullet point might sit better within the principle on control.

Board behaviour:
The importance of boardroom behaviours to good governance is critical and we welcome the inclusion of the principle in the draft code. In other codes, since the Cadbury review of 1992, there has been the inclusion of the need for boards not to be influenced by one or more individuals. A similar statement within this principle would be helpful along with a reminder that board members should be independent in their decision making and constructively challenging in their decision making.

The second bullet point covering the best interests of the organisation should be moved to be the first point as it covers a legal duty.

The third, fourth and fifth bullet points could be expanded to include information about how feedback from third parties will inform decisions of the board. It should be clear that the board has a duty to make decisions in the best interests of the organisation, members, beneficiaries and other stakeholders, and as such will not and should not blindly follow the recommendations of a specific group. That said, if third party engagement is to be encouraged and welcomed, then the board should demonstrate how that information is used. Reference to promoting equality and diversity would benefit from being more explicit here.

The final point covering conflicts of interest should be moved further up the list as it is a legal duty to avoid conflicts of interests. Good governance would ensure that there are effective written policies and procedures in place to recognise, record and manage conflicts of interests and loyalties at the board level and beyond. Good governance requires clarity of purpose, robust policies and procedures and the right people at the right level (from the board down). The code will not ultimately be successful if due regard is not given to each of these factors, strengthening this section with regard to the policies and procedures would help those readers with little understanding of the issues.

Control:
This section requires more thought and additional information. Strong and effective internal controls are fundamental to delivering and demonstrating that an organisation is well-led and run. In many cases of organisational failure there are clear indicators that the board did not have a grip of the financial situation and saw the warning lights too late to avoid a crisis. More detailed information about what good internal control looks like would add value to the document and help readers to understand what is expected of board members. Please refer to principle four of the Charity Governance Code for a general overview of what could be included in this section.

The first bullet point requires some clarification as it is unclear as to what the organisation is committing.

The fourth bullet point states that the board will make 'certain that partners and third party suppliers or services carry out their work in the interests of our organisation and in line with our values'. It is unclear as to how this could be enforced and does not take into account the legal duties of the third party. We suggest that you redraft this sentence to more accurately reflect the powers the organisation has to encourage third parties to deliver services in a manner that is congruent with the values and culture of the purchaser.

The fifth point is confusing and should be looked at again to ensure it conveys the intended message. What sort of protection and for what, and/or whom? Surely the structure of an organisation will depend on many factors including its purposes, activities, size, complexity and membership requirements (if any)? The protection required by board, members, staff and stakeholders could be further assured by good internal controls, systems, processes, oversight and review.

Effectiveness:
The first bullet point covering board reviews should include the recommendation that boards publicly report on any review findings along with any actions the board will be taking to address any areas for improvement.

The third point relating to trustee recruitment should include a specific comment about diversity and ensuring recruitment practices are broad and proportionate to ensure a sufficiently large pool of talent is encouraged to apply. This should be supported by clear role descriptions that support open, evidence-based selection criteria for board positions.

Are there any sections of the draft Code that you found difficult to understand?
There are some points that are a little unclear and would benefit from more attention. These have been detailed above.

Are there any sections of the draft code that you think should have more detail?
Depending on the overall aims of the development group, it could be argued that the entire document would benefit from more detail. We appreciate the document is aimed at a range of organisations – small to large, with or without staff, complex or single activity – and therefore a range of readers. Some will have more governance knowledge and understanding than others, as such the information currently contained in the code will be new to some but not all readers. This can create a situation where the guidance is not sufficiently detailed or stretching for those with a more thorough governance understanding. Perhaps the development group could consider producing two versions to meet the needs of both small and large entities? The version aimed at larger, complex entities could be more stretching, while the version for small entities could provide further detail as to how they could implement fundamental governance practices.

Each section would benefit from mirroring other governance codes by being more precise in the language used, providing detailed information about how each principle will help to deliver good governance, along with how the principle can be applied (practical examples). The draft code, in its current format, is a little vague in areas and underdeveloped in respect of good governance practice compared with other areas of the UK economy. This may be because it reflects the state of governance understanding and practice in the sector. However, where there is an appetite and ability for the sector to mirror leading governance practice from elsewhere this would be of benefit to the code and its overall aim to improve the sector's governance arrangements for the benefit of those the sector aims to help.

Is the language used in the Code easy to understand?
As mentioned above, the draft code would benefit from tightening up the terminology and rephrasing or expanding upon some of the bullet points. As the code is aimed at different types of non-profit organisations there can be some misunderstanding and confusion about words and terms used. If the code is to be adopted by as many third sector organisations as possible, the language must be accessible, meaningful and relevant to all it is aimed at. If the language does not easily relate to a specific sub-group of the sector it will be an easy excuse for them not to engage with the code, if that is what they want.

Furthermore, there may be some benefit to not using the first person, as it can give the impression that the code is an internal document rather than a sector-wide standard and call for good governance.

We will include a number of resources in the final online version, for example – templates, guidance, model documents. What particular resources do you think it would be helpful to have?
In England and Wales, there has been multiple requests for guidance on undertaking board evaluations, reporting on the application of the code, and tool kits to assess compliance with the code. There are a number of resources that have been developed to address these needs, and could be adapted for Scotland.

ICSA also has a number of guidance notes and documents that support good governance, and these can be accessed at https://www.icsa.org.uk/knowledge/charity-resources/charity-guidance-notes. Should any be suitable for being re-drafted for Scotland, we would be happy to discuss the opportunity with you further.

Is there anything we should consider to make sure the Code is accessible to everyone?
The code in England and Wales is only available as a download, as such we receive a number of requests for hard copies or printer-friendly versions (low resolution, black and white). A Welsh-language version of the code was also produced, and a Gaelic version may be of benefit for your audience. Some also prefer the document to be interspersed with graphics as text-heavy documents can be off-putting for some. It might be worth bearing this in mind when you come to the final design stage for the code.

I hope that these comments are helpful and contribute to your deliberations on the development of this code of governance. Should you wish to discuss them further or require any clarification, please feel free to contact me on lthomson@icsa.org.uk or on 0207 612 7040.

Yours sincerely,

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