

## Suggested answers and examiner's comments

# Health Service Governance

November 2015

### Important notice

When reading these answers, please note that they are not intended to be viewed as a definitive 'model' answer, as in many instances there are several possible answers/approaches to a question. These answers indicate a range of appropriate content that could have been provided in answer to the questions. They may be a different length or format to the answers expected from candidates in the examination.

### Examiner's general comments

This was a reasonable cohort of scripts, with 57% of candidates passing the exam in total. Those achieving high marks demonstrated a very good understanding of the issues and gave detailed and well-structured answers to the questions posed. They used good practical examples of the points being made and showed a practical application of governance principles in their answers. They also demonstrated a perceptive understanding of the issues raised in the scenarios set out in the questions.

All of the scripts were legible and demonstrated that candidates had considered previous comments from the examiner in both their legibility and structure of answers.

Of the scripts which did not achieve a pass standard, they were spread fairly equally across all of the A-D grade bands. These scripts either did not answer all four questions required, answered all six questions or the candidates did not use the handbook study material and instead relied purely on their knowledge from their current role. Very often the content of the answer did not reflect the marks awarded for that part, for example, writing 8 lines for an answer scoring a possible 14 marks and then writing a whole page for an answer scoring a possible 6 marks.

- 1 One aspect of best practice in governance is that the board should decide on certain areas in which the executive directors are excluded from the decision-making or monitoring responsibilities. This is achieved by delegating certain responsibilities to committees of the board.

### **Required**

- (a) With reference to the relevant guidance documents, describe the role and composition of the main standing committees which relate to succession planning and board appointments in NHS providing and commissioning organisations.

*(12 marks)*

### **Suggested answer**

In the UK, two committees are recommended by the UK Corporate Governance Code in relation to succession planning and board appointments, namely the nomination committee and the remuneration committee.

Guidance for the NHS can be found in the Department of Health (DH) publication 'The Intelligent Board', which recommended that all NHS trusts should have a nomination committee and remuneration (and terms of service) committee as part of their governance arrangements, reporting to the board of directors.

Nowadays, the model standing orders for NHS trusts requires a remuneration and terms of service committee and, in line with its role as a corporate trustee, the board should also establish a charitable funds committee to enable it to administer any funds held in trust, either as charitable or non-charitable funds in accordance with any statutory/legal requirements or best practice required by the Charities Commission.

The Monitor Core Constitution for FTs requires the board to establish a committee consisting of the chair, the chief executive and the other non-executive directors (NEDs) to appoint or remove the other executive directors (nomination committee) and a committee of NEDs to decide the remuneration and allowances, and the other terms and conditions of office, of the chief executive and other executive directors (remuneration committee).

According to the Monitor Code, FTs may choose to have two nomination committees, one dealing with NEDs and one dealing with executive directors. The Monitor Core Constitution also requires the trust to establish a committee of NEDs as an audit committee to perform such monitoring, reviewing and other functions as are appropriate, and requires the council of governors to approve the appointment of all NEDs including the trust chair.

For CCGs, the remuneration committee is required by statute (see section 14M(1) of the NHS Act 2006, as inserted by section 25 of the 2012 Act). The guidance 'Towards establishment: Creating responsive and accountable clinical commissioning groups' also recommends that CCGs consider the establishment of a quality committee to provide assurance on the quality of services commissioned and to promote a culture of continuous improvement and innovation with respect to safety of services, clinical effectiveness and patient experience.

The nomination committee gained a higher profile after the publication of the Higgs Report. Its remit covers the review of the structure, size and composition of the board, including the oversight of the board's succession planning requirements for both executive directors and NEDs (and the company secretary), the identification and assessment of potential board candidates and makes nominations to the board for its approval as appropriate.

The UK Corporate Governance Code recommends that the remuneration committee determines an appropriate balance between fixed and performance-related, immediate and deferred remuneration; that performance conditions should be relevant, stretching and designed to promote the long-term success of the company and that incentives should be compatible with risk policies and systems.

The committee should also consider whether the directors should be eligible for annual bonuses and/or benefits under long-term incentive schemes.

In any eventuality, boards should ensure that they delegate authority to these committees in line with their constitutional documents and set out clear terms of reference for them including the composition and quoracy requirements as well as a clear statement of the remit of the committee. These committees do not absolve the board of its responsibility in their respective areas of scrutiny, rather they should support the board in carrying out its responsibilities of strategic leadership and holding to account.

A board committee might consist entirely or mostly of NEDs, and have the responsibility for dealing with particular issues and making recommendations to the full board. The full board is then usually expected to accept and endorse the recommendations of the relevant board committee. Despite this, the committees only have delegated authority from the board and do not have the capacity to act independently of the board.

According to the Walker Review, the optimum size for a sub-committee is between five and nine members: “at five a group becomes more of a team, at seven thinking is optimized; above nine the ability of the cognitive limit of the group is exceeded”.

(b) When the nomination committee of an FT appoints new non-executive directors, outline the governance principles and the process undertaken.

*(13 marks)*

### **Suggested answer**

A key governance issue for any board is effective succession planning for the eventual replacement of board members, and it is particularly important that there should be long-term succession planning for the most important board positions. Succession planning is necessary to ensure that the board remains effective and the Monitor Code makes it clear that the governors are responsible at a general meeting for the appointment, re-appointment and removal of the chair and the other NEDs.

In FTs, there may be one or two nomination committees. If there are two committees, one will be responsible for considering nominations for executive directors and the other for NEDs (including the chair). Where an FT has two nomination committees, the nomination committee responsible for the appointment of NEDs should consist of a majority of governors. If only one nomination committee exists, when nomination for NEDs, including the appointment of a chair or a deputy chair, are being discussed, there should be a majority of governors on the committee and also a majority governor representation on the interview panel. The chair or an independent NED should chair the nomination committee(s). At the discretion of the committee, a governor can chair the committee in the case of appointments of a NED or the chair. It is important to note the governance principle that no individual should be involved in the process to identify their successor and therefore should not be a member of the nomination committee.

The council of governors should already be sighted on the forthcoming ends of terms of office for the NED appointments to the board and should have agreed with the nomination committee a clear process for the nomination of a new NED. Indeed good networking by governors and board members may have identified potential candidates for consideration, with the possibility that a governor with the appropriate background and experience may be interested in applying. Once suitable candidates have been identified, the nomination committee should make recommendations to the council of governors.

A person may only be appointed as a NED if they are a member of the public constituency (or the patient constituency if there is one). Where the trust has a university medical or dental school, a person may be appointed as a NED if they exercise functions for that university.

It is likely, however, that the NED will be appointed from outside the trust, and the nomination committee should initiate a search. To do this it may appoint a firm of head-hunters, whose task would be to identify a small number of potential candidates for consideration or it might advertise the position and might conduct its own private search. The committee will then undertake a formal interview process in an open and transparent manner, which might also include some level of stakeholder engagement with executive board members (for example, the CEO), patient and staff groups.

When the nomination committee eventually identifies a preferred candidate, who would be willing to accept the position of NED, it should make a recommendation to the council of governors. Upon receiving such a recommendation the council of governors should consider the qualifications, skills and experience required and the time commitment required. The Monitor Code stipulates that “No individual should hold, at the same time, positions of director and governor of any NHS foundation trust.”

In accordance with the FT’s constitution, appointment is by a majority of the governors attending the relevant meeting.

If more suitable candidates than required are identified, the council may consider appointing the individual as an associate NED so that the board can still benefit from their expertise. This option is only possible if such an appointment is permissible under the Constitution. Alternately the candidate can be encouraged to apply when the next available NED vacancy arises.

The Monitor Code states that at least half the board of directors, excluding the chair, should comprise of NEDs determined by the board to be independent. The nomination committee should ensure therefore that the candidate being recommended for appointment is unlikely to be influenced by someone else, in particular by the senior executive management or by a major stakeholder. A current employee (such as the CEO) would not be considered independent.

### **Examiner’s comments**

This question tended to be answered very well, or not well at all. The answers which achieved higher marks demonstrated a good overview of all three types of board committees with a clear understanding of the NED composition of these committees. They explained the delegation from the board or governing body as appropriate and included both the nomination and the remuneration committees. Those that scored less well focussed solely on the role of the nomination committee and gave an unclear view on the membership of the committee, with executive directors also being members. Apart from question 3, this was the least popular question.

- 2 Neelson County Clinical Commissioning Group ('Neelson') has a newly appointed lay member for governance and audit, Mike Ruperts ('Mike'), who will be assuming his responsibilities as chair of the audit committee on appointment. Mike is a professionally-qualified accountant from the commercial retail sector and this is his first appointment in the NHS.

Neelson's governing body is currently exploring a possible merger or integration of services with its neighbouring CCG and Neelson's external auditors have put themselves forward for consideration as the lead advisors to the joint integration board overseeing the negotiations. Their role will include providing advice on how information about Neelson will be presented, including restating past audited results to remove items no longer relevant to an assessment of cash flow. Mike is concerned about the independence of the auditors if they take on this role.

### **Required**

Write a briefing note for Mike setting out, with reference to Neelson:

- (a) The role of the audit committee and its work on the board assurance framework, annual governance statement and the annual report and accounts.

*(11 marks)*

### **Suggested answer**

#### **Briefing note**

##### NHS audit committees

As you will be aware from your retail background, the FRC Guidance on Audit Committees states that the "audit committee has a particular role, acting independently from the executive, to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control". Furthermore, a "frank, open working relationship and a high level of mutual respect are essential, particularly between the audit committee chair and the board chair, the chief executive and the finance director.

The audit committee must be prepared to take a robust stand, and all parties must be prepared to make information freely available to the audit committee, to listen to their views and to talk through the issues openly." Indeed, at times it may also be necessary for the committee to challenge the position of the external auditors or other professional advisers. These principles are also reflected in NHS Audit Committee Handbook published by the Healthcare Financial Management Association (HFMA) in 2014. It does, however, go on to explain a broader role for the audit committee specifically in the context of the NHS.

As you would expect from your commercial background, the HFMA Handbook stipulates that the chair of the governing body should not chair the audit committee or indeed be a member of the committee and that the committee should summarise its work during the year and submit an annual report to the governing body promptly after the year-end but before it considers the CCG's annual report and statutory declarations.

The Handbook, however, goes on to describe the committee as playing a key role by critically reviewing and reporting on the relevance and robustness of the governance structures and assurance processes on which the governing body places reliance. In particular, this requires the committee to understand and scrutinise the organisations overarching framework of governance, risk and control.

You will need to take this into consideration and take into account this wider role, which goes beyond the traditional role of financial scrutiny, envisaged by the UK Corporate Governance Code and which has resulted from the broad range of complex stakeholder requirements that exist in the NHS and in particular for CCGs.

As chair you should ensure that the three key areas that the audit committee provides assurance to the governing body on are the board assurance framework (BAF), the annual governance statement (AGS), and the annual report and accounts.

Risk has a much higher profile within NHS organisations with the active involvement of the audit committee in the BAF and the regular scrutiny of principal risks as part of the quality and/or governance agenda. The BAF provides the CCG with a method for the effective and focused management of the principal risks to meeting its objectives. It also provides a structure for the evidence to support the AGS.

The AGS is the annual review of the effectiveness of the systems of internal control and risk management, which also makes reference to quality governance and discloses any significant control issues or weaknesses. Assurance required in respect of ongoing internal audit reports into internal controls and risk management.

With regard to the annual report and accounts, you and the audit committee have an essential role in reviewing these prior to approval by the governing body. You should be satisfied with the strength of the processes and the quality of data, which has been relied upon to produce the statements. The relationship with, and work by, external and internal auditors is vital in supporting you and the committee in scrutinising the assurance provided by these documents.

You will be familiar with the requirement to produce an annual report and accounts, however, you may want to familiarise yourself with NHS accounting principles. The Director of Finance should be able to assist you with the technical aspects and I can provide further support on the reporting requirements.

(b) The purpose of the board assurance framework and its relationship to risk management processes.

(6 marks)

### **Suggested answer**

It identifies which of the CCG's objectives are at risk because of inadequacies in the operation of controls or where the organisation has insufficient assurance about them. At the same time it provides structured assurances about where risks are being managed effectively and objectives are being delivered. This allows the governing body to determine where to make efficient use of resources and to address the issues identified to improve the quality and safety of care.

The FRC Guidance on Risk Management, Internal Control and Related and Business Reporting (2014) resulted from the economic recession and the high profile failures of risk management in the corporate sector. Many boards outside of the financial sector had delegated most risk matters to the audit committee and then only in a limited fashion – as you will appreciate this had become outdated and untenable.

The FRC's challenge is to include behavioural and organisational risk into the risk management systems as the FRC recognises that the root causes of most crises lie in human behaviour and in the way that organisations are led, structured and managed. The guidance recommends that boards should evaluate their skills as to understanding risk as part of the annual board evaluation process so ignorance of risk will cease to be an excuse.

The guidance aims to bring together elements of best practice for risk management; prompt boards to consider how to discharge their responsibilities in relation to the existing and emerging principal risks faced by the organisation; reflect sound business practice, whereby risk management and internal control are embedded in the business process by which an organisation pursues its objectives; and highlight related reporting responsibilities.

The guidance is primarily aimed at companies subject to the UK Corporate Governance Code but provides useful best practice benchmarking for NHS organisations and would be a good starting point for your work as chair of Neelson's audit committee.

The BAF is a framework that Neelson needs to develop to take these recommendations into account so that it can identify the key risks to the achievement of its strategic objectives and how these risks are being managed. In documented form this would include:

- the CCG's strategic objectives;
- the key risks to achieving the objectives;
- the controls in place to manage the risks;
- the assurances that the CCG has used to provide evidence that the controls are operating effectively;
- any gaps in the assurances; and
- an action plan to address the gaps.

The gaps in assurance can be used to inform the audit programmes for the following year, both internal audit and clinical audit programmes.

You and the audit committee should not be responsible for creating the BAF, instead you have a key role in satisfying yourselves that the BAF is being created appropriately by line management and that the processes and format are valid, relevant and effective. The committee needs to be satisfied that it contains the high risk areas pertinent to the organisation.

- (c) The main threats to auditor independence and the difficulties of setting a partial restriction on non-audit work as a means of protecting such independence.

*(8 marks)*

### **Suggested answer**

Five types of threats to auditor independence can be identified:

- (i) Self-interest threats, which arise in situations where it is in the auditor's own interests to accept the views and opinions of the client's management and not to challenge them vigorously. The auditors in the scenario carry out a lot of non-audit work for the company, and this may create a self-interest threat. This is because the audit firm may be reluctant to lose the non-audit work and fee income, and so may be less rigorous than it should be in the conduct of the external audit.
- (ii) Self-review threats, which arise when the auditors are required to check the validity of work that has previously been carried out by employees of the audit firm. Auditors might be reluctant to report failures in the work of their own staff.
- (iii) Familiarity threats, which can develop as members of the audit team become more familiar with a client company and its management, and so become more willing to accept the accuracy and validity of their opinions and what they do.
- (iv) Advocacy threats, which arise when the audit firm actively promotes the interests of a client company, for example, in a legal dispute between the company and another party.
- (v) Intimidation threats, which arise when the auditors accept the views of a client's management because of threats or domineering personalities.

Threats to auditor independence must be identified, and measures should be taken to limit the threat to an acceptable level of risk. The current proposal for the external auditors to advise the joint integration board poses the threat of self-review and advocacy threats, which needs to be reviewed

and managed. Non-audit work potentially poses a threat to auditor independence and there has been a debate about whether it should be prohibited or restricted.

The difficulty with a partial restriction on non-audit work is that rules would have to be devised and agreed as to what permissible and non-permissible non-audit work should be, or what the maximum amount of non-audit fee income should be. In the UK, the audit profession is governed by ethical principles rather than rules and regulations about non-audit work for audit clients. The Institute of Chartered Accountants in England and Wales (ICAEW) has made the following statements about non-audit work:

‘The most effective way to ensure the reality of independence is to provide guidance centred around a framework of principles rather than a detailed set of rules that can be complied with to the letter but circumvented in substance.’

The ICAEW has, however, also recognised that a blanket prohibition on the provision of non-audit services to audit clients could be inefficient for the client and was neither necessary to ensure independence, nor helpful in contributing to the knowledge necessary to ensure the quality of the audit.

The need for auditor independence when the audit firm does non-audit work is recognised in the UK Corporate Governance Code. This Code includes a provision that:

‘The annual report should explain to stakeholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded.’

As chair of the audit committee, I would suggest that you consider evidence from a number of sources in order to assess the ongoing independence of the external auditors, namely:

- (i) The reports prepared by the auditors for management and the audit committee/board may indicate the extent to which the auditors challenge management views and identify control system weaknesses. The audit committee should meet at least once a year with the head of the audit team, and discuss the issues that arose during the audit. The information obtained from this meeting, and the auditor’s letter to management about control weaknesses, should provide useful evidence about the auditors’ judgement.
- (ii) The audit committee should seek assurances from the audit firm about the procedures that the firm has in place for monitoring the continuing independence of its audit team. For example, the audit committee should seek assurance that none of the audit team is related to a senior manager in the client CCG or that they advise any of the individual directors in relation to their other declared interests.
- (iii) Reports by the internal auditors on control system weaknesses may help with an assessment of the opinions of the external auditors.
- (iv) It is unusual for the auditors of a CCG to write a qualified audit report, or to challenge the going concern statement by the governing body. However, any such disputes between the auditors and the governing body (and/or management) should be an indication of auditor independence.

### **Examiner’s comments**

Question 2 had a wide range of responses, although a majority of candidates answered this well. However, many answers were not set out as a briefing note and many did not show an understanding of the basics of the audit committee in relation to its role and composition and independence. Many scripts did not distinguish that this question related to a CCG with references to the FT Code of Governance and non-executive directors.



- 3 The management structure of Sesame Hospital NHS Trust ('Sesame') is being revised, with three large divisions being split into six business units. This decision has been made to support greater devolvement of decision-making within Sesame and to encourage greater ownership of service redesign and cost improvement programmes.

### Required

As company secretary of Sesame, prepare a paper for the audit committee in which you:

- (a) Describe how each of the main elements of an internal control system contributes to its effectiveness.

(15 marks)

### Suggested answer

#### Audit committee paper

November 2015

Author: Company Secretary

#### Internal control systems and their effectiveness

##### Background

A requirement for good health service governance is that an NHS trust should have an effective system of internal control. NHS organisations rely upon the provisions in the UK Corporate Governance Code and FRC Guidance on Risk Management (2014) which stipulate that the board should maintain sound risk management and internal control systems and at least annually it should conduct a review of the effectiveness of the system and report to stakeholders that it has done so. The UK Corporate Governance Code also states that a function of the audit committee should be to review the internal financial controls and (unless a risk committee of the board or the full board carries out the task) should review the whole internal control system. The approach therefore provides guidelines, but does not provide specific rules; for example the Turnbull Guidance on internal control and reviewing effectiveness.

The Turnbull Guidance requires it to be embedded within the business and its operating systems and the controls must remain relevant to the requirements of the organisation. This means they must be regularly reviewed to take account of changing circumstances.

##### Five elements

An internal control system, as defined by the US Committee of Sponsoring Organizations of the Treadway Commission (COSO), has five main elements:

(i) Control environment

A control environment describes the awareness of (and attitude to) internal controls in the organisation, shown by the directors, management and employees generally. It therefore encompasses corporate culture, management style and employee attitudes to control procedures.

(ii) Risk identification and assessment

The system should also provide for the identification of risk and its impact on the trust. The system will then monitor continually these risks and any changes in those risks. The significance of each risk should be assessed, and control measures should be devised for the risks that are considered material. The continual assessment of risks is essential because circumstances change: new risks emerge and existing risks change in character. It is important to look for changes in the nature of risks, so that new controls can be introduced or existing controls amended.

Internal control risks can therefore be categorised into three broad types:

- Financial risks: risks of errors or fraud in the accounting systems and accounting and finance activities.
- Operational risks: risk of losses incurring as a consequence of inadequate or failed internal processes, people and systems, or external events.
- Compliance risks: risk that important laws or regulations will not be complied with properly. Failure to comply could result in legal action against the organisation and/or fines.

An internal control system is the system that an organisation has to provide assurance. It identifies the internal control risks for each of those areas and then seeks to apply controls to reduce the risk of losses from these risks and taking corrective action when losses occur.

(iii) Controls

Controls should be devised and implemented to eliminate, reduce or control risks. There should be controls to ensure that the organisation, its systems and procedures operate in the way that is intended, without disruption or disturbance and that these risks are managed. Internal controls are the controls that are devised and implemented to prevent risk events from occurring or identifying and correcting control failures that occur. Controls are fundamental to any control system, and they must be well designed and properly applied. The controls generally relate to the risks being managed.

Financial controls: There should be controls to ensure that assets are safeguarded. For example, there should be controls to ensure that money received is banked and is not stolen, and that operating assets such as items of equipment and computers are not damaged or lost. They should also include measures to reduce the risk of fraud. Controls should ensure the completeness and accuracy of accounting records, and the timely preparation of financial information.

Operational controls set out to reduce the risk of failure of processes, people or systems. Such controls could include, for example, maintenance and cleaning audits, surgical checklists, or mandatory training registers.

Compliance controls should be in place to ensure compliance with key regulations, such as CQC regulations, Monitor regulations, or health and safety regulations.

Such controls will include a culture of risk awareness, with a strong lead provided and an example set by the board and senior management. A strong control culture creates an awareness of risks among the management and work force, and an understanding of the need to ensure that controls are properly applied and effective.

(iv) Information and communication

All employees who are responsible for the management of risks should receive information that enables them to fulfil this task. Information must be produced about risks, controls and control failures, and this information must be communicated to the relevant people, including senior management. People within an organisation need to be made aware of the risks and the controls that should be applied to manage the risks. They should also be informed when there are failures in risk control. Information, including feedback about failures, is essential to a control system.

(v) Monitoring

The effectiveness of risk controls and the internal control system generally should be monitored regularly to ensure that the system remains effective and that measures are taken to remove any weaknesses that are identified (including weaknesses in risk assessment and in internal controls). Internal audit is one method of monitoring the internal control system. Internal controls are also monitored by executive management and (as part of their annual audit) by the external auditors. The board of directors also has a responsibility to review the effectiveness of the system.

All five components of the internal control system must function for an effective internal control system. A serious failure or weakness in any component will make the system ineffective and inadequate.

(b) Explain, with reference to Sesame, why internal controls need to be reviewed regularly.

(10 marks)

### **Suggested answer**

#### Reviewing and monitoring effectiveness

If internal controls are not monitored regularly, they are likely to become less effective over time. This is for two reasons. First, the nature of the risk may change so that a control that was established to deal with the risk may no longer be appropriate and so fail to fulfil its intended purpose. Second, there may be a tendency over time to ignore controls and circumvent them, unless compliance is regularly monitored. Monitoring has the effect of helping to ensure that internal controls remain relevant and are applied effectively, or to identify control weaknesses where the controls are no longer appropriate or no longer applied. When weaknesses in the system are identified through monitoring, measures can be taken to deal with them.

At Sesame, considerable changes have been made within the management structures and all three risks may be present, that is, financial, operational and compliance. As a result not only has the nature of the risk changed but so too have the staff involved in the processes as a result of the management restructure.

The internal audit control team may, therefore, be asked to focus its attention on financial and operational controls in the business units. It will want to check that the controls are appropriate and embedded. It may want to test the impact on quality arising from these new controls. It may also want to test the implementation of the new governance structures and the manner in which concerns/incidents are reported and escalated within the new structures. The business units may also have new responsibilities and will need support in establishing controls to manage compliance risks; ensuring that the legal and regulatory responsibilities are fulfilled within each unit.

The internal audit team is part of the internal control system, with a key role in the monitoring of internal controls. An internal audit function can contribute to the monitoring of the internal control system by conducting tests of the effectiveness control. At a detailed level, this will involve audits into specific aspects of operations to check whether financial, operational and compliance controls are properly applied and to identify control weaknesses where existing internal controls do not deal adequately with the significant risks.

To contribute effectively to monitoring of internal control, internal auditors must be individuals with appropriate capabilities, objectivity and authority. The information they produce needs to be persuasive about weaknesses or failings in key controls, and the management responsible for the operations must act on their reports and recommendations.

Internal audit is not the only way in which the effectiveness of an internal control system may be monitored. The audit committee can obtain reports from management and the external auditors about controls and control weaknesses or control failures. Supervisors may be given responsibilities for checking the effectiveness of controls within their area of operations. There may also be reporting measures embedded in the management reporting system that will signal possible control failures that occur.

The work of internal audit in monitoring the effectiveness of the internal controls feeds directly into providing assurance to the audit committee in its consideration of the annual governance statement. The work of the internal audit team throughout the year should be planned according to the key risks faced by the trust. The external auditors will place reliance on the work of the internal audit team in the production of their audit report.

## **Examiner's comments**

Question 3 was the least popular question and was also not well answered. Answers did not demonstrate the key elements of an internal control system, namely; the control environment, risk identification and assessment, controls, information and communication, and monitoring. Answers generally focussed entirely on types of internal controls or the mnemonic SPAMSOAP. The answers to part (b) were slightly better but many did not link their answers to the scenario set out for Sesame.

- 4 The NHS Trust Development Authority (TDA) has indicated that, as part of its appointment process for new non-executive directors (NEDs) to NHS trust boards, all candidates wishing to be considered for appointment must be issued with guidance on the role before their appointments commence. This guidance will include information on duties and liabilities applying to all directors, as well as NHS-specific content.

The TDA is proposing to issue introductory information sheets along with the respective information packs for each post being advertised. All successful candidates will be asked to confirm that they have read and understood the guidance and its implications for their appointment.

### **Required**

Set out the following introductory information sheets, explaining:

- (a) The full range of directors' duties.

*(12 marks)*

### **Suggested answer**

#### Concept of duty to organisation

It has been said that the board forms the "controlling" mind of the organisation and as such directors act as agents of their organisation. They have certain duties, which are to the organisation itself, but not to its stakeholders, its employees or any person external to the organisation, such as the general public. Although an organisation is a legal person in law, it is not human which means that the relationship between the directors and the organisation is by its very nature impersonal.

The concept of duty is not easy to understand, and it is helpful to make a comparison with the duties owed by other individuals or groups. Examples of individuals owing a duty to something inanimate are not common, although personnel in the armed forces have a duty to their country. It is more usual to show loyalty to something inanimate than to have a duty. For example, individuals might be expected to show loyalty to their country, and they might voluntarily show loyalty to their sports team or group of friends or work colleagues. Arguably, solicitors have a duty to their profession to act ethically, although the solicitors' practice rules in the UK specify that solicitors owe a duty of care to their clients. Similarly, doctors have a duty to act ethically, but their duty is to their patients. Duty is normally owed to individuals or a group of people. It might therefore be supposed that directors should owe a duty to their stakeholders and possibly to the organisation's employees, but this is not the case.

- Accountability and responsibility should not be confused with duty.
- Directors have a responsibility to use their powers in ways that seem best for the organisation and its shareholders or major stakeholders.
- They should be accountable to the owners of the organisation, for the ways in which they have exercised their powers and/or the performance of the organisation.
- They have duties to the organisation.

If a person is guilty of a breach of duty, there should be a process for calling him to account. There might be an established disciplinary procedure, for example, in a court or before a judicial panel, with a recognised set of punishments for misbehaviour.

#### Common law duties of directors

Until the Companies Act 2006, the main legal duties of directors to their organisation were duties in common law: a fiduciary duty and duty of skill and care to the organisation. The Companies Act 2006 has now written the common law duties of directors into statute law. It states that these general duties 'are based on certain common law rules and equitable principles as they apply to directors, and have effect in place of those rules and principles as regards the duties owed to an organisation by a director' (Companies Act 2006, section 170). The Act goes on to state that the statutory general duties should be interpreted in the same way as the common law rules and equitable principles.

As far as the legislation is concerned, a 'company' means a company formed and registered under the companies legislation and, therefore, NHS organisations that are not registered companies but organisations created by statutory instrument are not bound by this legislation. Good practice, however, would require an understanding of the general principles of company legislation and the nature and origin of common law duties.

### Fiduciary duty of directors

'Fiduciary' means given in trust, and the concept of a trustee (as established in US and UK law) is applicable. The directors hold a position of trust because they make contracts on behalf of the organisation and also control the organisation's property. Since this is similar to being a trustee of the organisation, a director has a fiduciary duty to the organisation (not its shareholders).

If a director were to act in breach of his fiduciary duty, legal action could be brought against him by the organisation. In such a situation, 'the organisation' might be represented by a majority of the board of directors, or a majority of the shareholders, or a single controlling shareholder.

### A director's duty of skill and care

Directors are also subject to a duty of skill and care to the organisation. This was a common law duty that became a statutory duty with the Companies Act 2006. A director should not act negligently in carrying out his duties, and could be personally liable for losses suffered by the organisation as a consequence of such negligence.

A director is expected to show the technical skills that would reasonably be expected from someone of his experience and expertise. If the finance director of a scientific research organisation is a qualified accountant, he would not be expected to possess the technical skills of a scientist, but would be expected to possess some technical skill as an accountant.

However, the duty of skill and care does not extend to spending time in the organisation. A director should attend board meetings if possible, but at other times is not required to be concerned with the affairs of the organisation. This requirement is perhaps best understood with NEDs, who might visit the organisation only for board or committee meetings. The duties of a director are intermittent in nature and arise from time to time only, such as when the board meets. If a director holds an executive position in the organisation, a different situation arises, because he is an employee of the organisation with a contract of service. This contract might call for full-time attendance at the organisation or on its business. However, this requirement arises out of his job as a manager, not out of his position as a director.

It is also not a part of the duty of skill and care to watch closely over the activities of the organisation's management. Unless there are particular grounds for suspecting dishonesty or incompetence, a director is entitled to leave the routine conduct of the organisation's affairs to the management. If the management appears honest, the directors may rely on the information they provide. It is not part of their duty of skill and care to question whether the information is reliable, or whether important information is being withheld.

### Statutory duties of directors

Although NHS organisations are not registered companies but organisations created by statutory instrument, they are not bound by the Companies Act 2006. Good practice, however, would require an understanding of the general principles of the Act, which are set out here. The duties of directors in common law and equity to their organisation were introduced into UK statute law by the Companies Act 2006 (sections 171–177). These consist of a duty to:

- act within powers;
- promote the success of the organisation;
- exercise independent judgement;
- exercise reasonable care, skill and diligence;
- avoid conflicts of interest;
- not accept benefits from third parties; and
- declare any interest in a proposed transaction or arrangement.

There is also a responsibility to fulfil the criteria of the fit and proper persons test, as set out below.

(b) The criteria for the 'fit and proper' persons test (FPPT).

(5 marks)

### **Suggested answer**

The FPPT is part of the regulatory requirements of the Care Quality Commission (CQC), the independent regulator of health and adult social care in England. The FPPT for directors came into force on 27 November 2014 and it plays a major part in ensuring the accountability of directors of NHS bodies. The CQC intends to use these new powers to encourage a culture of openness and to enable providers and directors to be held to account.

The NHS Trust Development Authority (TDA) has a duty to ensure that the chairs and NEDs it appoints meet the requirements of the 'fit and proper' persons regulations. They must:

- be of good character;
- have the necessary qualifications, skills and experience;
- exhibit appropriate personal behaviour and business practices;
- have the relevant experience and ability (including an appropriate level of physical and mental health, taking account of any reasonable adjustments);
- supply certain information (including a Disclosure and Barring Service (DBS) check and a full employment history); and
- have not been involved in, known of, or facilitated, any serious misconduct or mismanagement in carrying on a regulated activity.

Upon appointment, each appointee will need to make a declaration as above and will then be asked to re-sign the declaration annually.

As a consequence, before appointment, the TDA will carry out a number of checks to ensure that these requirements are met. They include:

- DBS checks;
- Occupational Health Assessment;
- photographic proof of ID;
- proof of qualifications, where appropriate;
- search of insolvency and bankruptcy register;
- search of disqualified directors register; and
- check with relevant regulators, where appropriate.

While every effort will be made to minimise the impact these new arrangements will have on timescales for recruitment exercises, inevitably some checks may take some time. In the future, therefore, it is likely that some offers of appointment will be conditional on the satisfactory completion of the necessary checks.

(c) The liability of directors.

(8 marks)

### **Suggested answer**

The starting point for considering the liabilities of individual directors is understanding the role of the board and the corporate nature of the trust. Any such trust will be a corporate entity in its own right and will take decisions as such, that is, as a unitary board. This has implications for the role of directors, who are collectively responsible for all decisions. However, the corporate nature of the organisation will mean that, in most instances, even if a decision is open to criticism, individual directors will not be legally liable. There is specific statutory protection where they are acting in good faith (section 265 of the Public Health Act 1875). However, you need to be aware that personal liability can arise in the following circumstances:

### Criminal liability

An individual who, in the course of his or her activities as a director, commits a criminal offence will of course carry personal responsibility and liability. Perhaps more significantly a director can, in some circumstances, be held to have committed a criminal offence where the offence arises under statute that includes explicit provision to hold a director liable. Examples are the Health & Safety at Work Act, the Environmental Protection Act and the Data Protection Act.

With regard to corporate manslaughter, the law remains that it is necessary to show that a 'controlling mind' within the organisation (usually a director) is also guilty of manslaughter, that is to say, has been guilty of gross negligence that directly caused the fatality. In practice it has proved very difficult to convict either large corporations or their directors on this basis.

### Civil liability to third parties

This generally relates to the payment of compensation. Liability in contract will only occur if the contract is entered into in the personal name of the director rather than that of the trust, or where a contract entered into by the trust is found to be *ultra vires* and the director has given a personal warranty or representation that the trust has appropriate powers. Directors therefore need to be careful about what assurances they give about the powers of the organisation.

The more usual risks are for the individual to have a claim for negligence or defamation. Negligence arises where an individual acts without due care towards a person to whom they owe a duty of care, and causes foreseeable loss. Usually, as with clinical negligence claims, the claim is pursued against the trust, not the individual, and the NHS Litigation Authority will provide cover. Indeed, the Liabilities to Third Parties Scheme includes cover for directors similar to that available in the commercial market by way of directors' and officers' liability insurance.

Defamation is a potential risk, and while some degree of protection is afforded where public officers are acting honestly and in the course of their business, there are risks if they step outside the strict parameters of the role. A potential threat is misfeasance in public office, but in practice this is very rare, and requires the establishment of deliberate malice, targeting the individual or a limited class of people who has/have suffered loss.

### Claims by the trust

A final area of risk is that of claims by the trust. All directors owe a duty of care and skill to the trust, and breaches could give rise to claims. In this area there is a material difference between the position of executive directors and NEDs. The latter are protected by the terms of the standard Treasury indemnity unless they have been reckless. However, executives could in theory be the subject of claims even if they have only been negligent.

### Indemnity

As indicated above, there is a degree of protection for directors. NEDs will typically have the benefit of the Treasury approved wording (HSG 1999/104):

'A chairman or non-executive member or director who has acted honestly and in good faith will not have to meet out of his or her own personal resources any personal civil liability that is incurred in the execution or purported execution of his or her board function. Save where the person has acted recklessly.'

This indemnity may be extended to members of those committees that have delegated powers to make decisions or take actions on behalf of NHS boards. This covers the director for acts carried out in good faith in the execution or purported execution of the functions of the trust, short of recklessness. It does not cover criminal liability, and no indemnity could do so. There is some doubt about the position where the director is in fact acting outside the powers of the trust, particularly where to enforce the indemnity would be to allow a collateral enforcement of an *ultra vires* obligation against the trust. Executive directors will generally be indemnified in relation to claims against them arising from third parties, but difficult issues can arise when staff make allegations of harassment, and trusts will need to tread carefully in such cases.



## **Examiner's comments**

Question 4 was, on the whole, not well answered and there were very few high scores. This was a question about NEDs and yet many answers referenced the Director of Finance or Medical Director. There was confusion expressed between general statutory duties (for example, Companies Act 2006), common law duties (for example, fiduciary) and specific statutory duties (for example, H&S, Bribery and Data Protection).

- 5 The company secretary of Crossbridge NHS Foundation Trust ('Crossbridge') has recently supported the chair in conducting a self-assessment performance review of the board, its committees and its directors. The review has highlighted concerns from board members about the lack of challenge and scrutiny by the non-executive directors (NEDs) and, in particular, some poor board behaviours such as lack of preparation for meetings and taking calls during meetings.

In discussion with the chair of Crossbridge it is also clear that the NEDS are increasingly dissatisfied with the behaviour of the CEO. In private meetings, which exclude the chair, the NEDs are clear that the lack of a professional relationship between the chair and the CEO is a key part of the problem. Any attempt by the chair or the NEDs to challenge or scrutinise a board recommendation is met with terse and defensive comments and demands from the CEO to be "trusted to get on with it."

The chair is keen to improve the work of the board, but is unsure about what needs to be done, and he has asked for your views and advice.

### **Required**

Write a private briefing paper for the chair which addresses the following:

- (a) Discuss the factors that may lead to poor performance of NEDs and recommend measures that should be taken by the chair and the board to improve the performance of the board in relation to these specific concerns.

*(11 marks)*

### **Suggested answer**

To: The chair of Crossbridge  
From: Company Secretary  
Date: November 2015

#### Scrutiny and challenge by non-executive directors

There are a number of factors that may lead to the poor performance of NEDs in their role of scrutiny and challenge.

The first area to consider is whether the NEDs are independent. A NED is deemed not to be independent if their opinions are likely to be influenced, in particular by the senior executive management of the organisation or by a major stakeholder. The FT Code of Governance states that each board of directors should identify in the annual report each NED it considers to be independent. The board is responsible for determining whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement. There is also a general view that the independence of a NED is likely to diminish over time, as the NED becomes more familiar with the organisation and executive colleagues. The risk is that the NED will take more of the views of executive colleagues on trust and will be less rigorous in his questioning. This is noted in the FT Code of Governance, UK Corporate Governance Code, and the King III Code. The board should therefore consider the independence of each NED and reflect on their length of service to ascertain whether this is impacting on their ability to scrutinise and challenge.

The ability to scrutinise and challenge also depends largely on the quality of information available to the NED. The FT Code of Governance states that the board as a whole should be 'supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties'. And this is true for NHS FTs too. However, the senior executives in the trust control the information systems, and so control the flow of information to the board. It is quite conceivable, for example, that the CEO and other executive directors might have access to management information that is withheld from the board as a whole, or that is presented to the board in a distorted manner. Lacking the 'insider knowledge' of executive managers about the business operations, and having to rely on the integrity of the information supplied to them by management and executive directors, can

restrict the scope for NEDs to make a meaningful contribution to board decisions. The lateness of papers at Crossbridge affects the ability of the NEDs to provide proper scrutiny and challenge.

NEDs often have executive positions in other companies and organisations, where most of their working time is spent. As a general rule, NEDs do not have an office at the trust headquarters and may spend at most two or three days a month on the trust's business. It could be argued, for example, that an individual cannot be an effective NED of a trust if he is also the CEO of another public organisation and holds four or five other NED positions in other companies. All directors should be able to allocate sufficient time to the trust to discharge their responsibilities effectively.

There should also be a majority of NEDs on a board since it is well known that if a difference of opinion arises during a meeting of the board, the opinions of the executive directors are likely to carry greater weight, because they know more about the organisation. As a result NEDs may be put under pressure to accept the views of their executive director colleagues and being in the majority is a key governance principle.

A further factor impacting on the NEDs effectiveness relates to boardroom behaviours. The ICSA report: Boardroom Behaviours (2009) suggested that the corporate governance problem in the banking crisis was partly attributable to inappropriate 'boardroom behaviours'. These behaviours had facilitated the lack of challenge and rigour required in the boardroom. The report findings could be used as a benchmark for Crossbridge to assess whether their boardroom behaviour is characterised by:

- (i) a clear understanding of the role of the board;
- (ii) the appropriate deployment of knowledge, skills, experience and judgement;
- (iii) independent thinking;
- (iv) the questioning of assumptions and established orthodoxy;
- (v) challenge which is constructive, confident, principled and proportionate;
- (vi) rigorous debate;
- (vii) a supportive decision-making environment;
- (viii) a common vision; and
- (ix) the achievement of closure on individual items of board business.

In relation specifically to the NHS, the ICSA research project 'Mapping the gap; Highlighting the disconnect between governance best practice and reality in the NHS (July 2011)' was initiated to examine the degree to which trust boards in the NHS understood issues of governance, and the extent to which actual boardroom behaviour reflected guidance on best practice. The resulting report stated that the boardroom behaviours observed suggested that more challenge was required to improve discussions and decisions. The project further identified that there were a number of behaviours that did not suggest that all board members were fully engaging with the business to be transacted, for example, using electronic devices, conversing with colleagues, interrupting colleagues, reading non-board papers, arriving late/leaving early, fidgeting, and generally not participating in the debate. Crossbridge might want to consider the findings of both of these reports and draw up its own code of acceptable boardroom behaviour.

- (b) Describe the impact on the quality of governance of Crossbridge caused by the CEO's behaviour.

(14 marks)

### **Suggested answer**

There is a general consensus among recently published reports and reviews in both corporate and health service sectors that the quality of governance depends ultimately on the culture and behaviour of individuals and, consequently, the ability of procedures and regulation to provide good governance is limited.

The point is particularly well made by the Walker Report, which argued that the main weaknesses in the boards of banks had been caused by behavioural factors and a failure to challenge.

‘The sequence in board discussion on major issues should be: presentation by the executive, a disciplined process of challenge, decision on the policy or strategy to be adopted and then full empowerment of the executive to implement. The essential ‘challenge’ step in the sequence appears to have been missed in many board situations and needs to be ... clearly recognised and embedded for the future.’

Earlier in 2004, Effective Boards in the NHS had identified the behaviour and culture of a board as key determinants of the board’s performance. From the interviews, the research identified four characteristics of effective boards:

- a focus on strategic decision-making;
- board members who trust each other and act cohesively/behave corporately;
- constructive challenge by board members of each other; and
- effective chairs who ensure meetings have clear and effective processes.

The behaviour of the CEO is removing the disciplined process of challenge and this will impact on the quality of governance in Crossbridge. This will impact on the board’s ability to make effective decisions in the best interests of the organisation and its stakeholders.

According to the FRC guidance on Board Effectiveness, the CEO is the most senior executive director on the board with responsibility for proposing strategy to the board, and for delivering the strategy as agreed. Consequently, the CEO’s relationship with the chair is a key relationship that can help the board be more effective. The role of the Company Secretary is facilitating this relationship is important. The CEO is also responsible for supporting the chair to make certain that appropriate standards of governance permeate through all parts of the organisation and will make certain that the board is made aware, when appropriate, of the views of employees on issues of relevance to the business. This will be difficult to achieve if the relationship is strained.

As the CEO leads the executive team, the CEO is responsible for the executive management of the organisation’s operations and is the senior executive in charge of the management team and to whom all other executive managers report. It is important that the CEO leads by example in their behaviour and the culture of the board. Ultimately, however, whilst other executive managers might also be directors of the organisation, the CEO is answerable to the board for the way the business is run and its performance and that includes the example they set for establishing a culture of openness and transparency.

This is particularly important as the CEO has, with the support of the executive team, primary responsibility for setting an example to the organisation’s employees, and communicating to them the expectations of the board in relation to the organisational culture, values and behaviours.

The UK Corporate Governance Code states that the differing responsibilities of the chair and the CEO should be set out in writing and agreed by the board. Particular attention should be paid to areas of potential overlap.

The Healthy NHS Boards Report identified boards as ‘social systems’ and summarised the techniques and practices that support and hinder the effectiveness of these social systems. The behaviour of the CEO clearly demonstrates that they are not building a crystal clear understanding of the roles of the board and individual board members, nor are they actively working to develop and protect a climate of trust and candour. With this type of behaviour it is difficult to see how Crossbridge can properly fulfil its duty of candour as it seems likely that the executive directors would find it difficult to challenge the CEO and this could be mirrored throughout the organisation.

The Healthy NHS Board report also suggests that all board members should be encouraged to offer constructive challenge and that they should share corporate responsibility and collective decision-making. The guidance concludes with the recommendation that neither chair nor chief executive should have the power and dominance to stifle appropriate participation in board debate.

## Summary

The board needs to consider the capacity issues raised by the executive team as well as seek help in improving the relationship between the chair and the CEO. Board behaviours also need to be considered with perhaps a board code of etiquette being agreed.

## **Examiner's comments**

Question 5 was not well answered overall. Answers which achieved a pass level gave good practical recommendations for action but most of the answers lacked reference to any source guidance, such as FRC Guidance or 'Mapping the Gap'.

- 6 Carrington Community Healthcare NHS Foundation Trust ('Carrington') is looking at the possible retirement of its current chair, Marion Smythe ('Marion'), in around 12 months' time. A couple of the existing board members, including the present CEO, have contacted Marion to express their interest in the role but it is clear that their understanding of the role of a chair is limited to chairing meetings. Marion has asked you, as the company secretary, to write a briefing paper which could be circulated to all board members and any others interested in applying for the role in due course. It will also be used as the basis for Carrington's web page on the trust board to help the public understand the role of chair and to support the council of governors in the forthcoming appointment process as well.

### Required

Write a briefing paper for parties interested in applying for the role of chair. The paper should set out:

- (a) The role of the chair and its key relationships.

(9 marks)

### Suggested answer

#### Briefing paper – introduction to the role of the FT chair

Date: November 2015

Author: Company Secretary

##### (a) The role of the chair

The chair's responsibilities relate primarily to managing the board of directors, and ensuring that the board functions effectively. To do this, a chair needs to ensure that the board discusses relevant issues in sufficient depth, with all the information needed to reach a decision, and with all the directors contributing to the discussions and decision-making. This is in contrast to the role of the CEO, who is responsible for the executive management.

The UK Corporate Governance Code states that:

'The chair is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.'

'The chair is responsible for setting the board's agenda and ensuring that adequate time is available for discussion of all agenda items, in particular strategic issues.'

'The chair should also promote a culture of openness and debate by facilitating the contribution of non-executives in particular and ensuring constructive relations between executive and non-executive directors.'

'The chair should ensure that communications with shareholders are "effective".'

Whilst an FT is not the same as a company, which is bound by the UK Corporate Governance Code provisions, the Code contains principles which the FT should consider. It emphasises the role of the chair in trying to ensure that all directors, and in particular NEDs, contribute effectively to board discussions. There is always a risk that individuals who do not work full time for the organisation may have difficulty in challenging the views of full-time executive directors. The chair should make sure that this does not happen. These provisions are echoed in the Monitor Code of Governance for FTs (Monitor Code).

In addition, the National Health Service Act 2006 established that the chair of the board of directors of an FT would also be the chair of its council of governors. Provisions for this are therefore included in the Model Core Constitution for FTs and within the Monitor Code.

The FRC Guidance on Board Effectiveness states that: 'The chair creates the conditions for overall board and individual director effectiveness.' It emphasises that an effective chair is a team-builder, developing a board whose members communicate effectively and enjoy good relationships with each other. They should develop a close relationship of trust with the CEO, giving support and

advice while still respecting the CEO's responsibilities for executive matters. They should also ensure the effective implementation of board decisions, provide coherent leadership for the organisation and understand the views of the stakeholders. It also provides a detailed list of matters for which the chair is responsible, which include:

- (i) setting the board agenda, which is primarily focused on strategy, performance, value, creation and accountability, and ensuring that issues relevant to these areas are reserved for board decision;
- (ii) making certain that the board determines the nature, and extent, of the significant risks the organisation is willing to embrace in the implementation of its strategy, and that there are no 'no-go' areas that prevent directors from operating effective oversight in this area;
- (iii) making certain that the board has effective decision-making processes and applies sufficient challenge to major proposals;
- (iv) encouraging all board members to engage in board and committee meetings by drawing on their skills, experience, knowledge and, where appropriate, independence;
- (v) fostering relationships founded on mutual respect and open communication between the NEDs and the executive team;
- (vi) developing productive working relationships with all executive directors, and the CEO in particular, providing support and advice while respecting executive responsibility;
- (vii) taking the lead on issues of director development, including thorough induction programmes for new directors and regular reviews with all directors, and acting on the results of board evaluation; and
- (viii) ensuring effective communication with all stakeholders and, in particular, that all directors are made aware of the views of those who provide the organisation's capital.

There are specific people that the chair needs to be able to build good positive working relationships with. These include:

- the CEO;
- the Company Secretary;
- the deputy chair;
- the Senior Independent Director;
- the Lead Governor;
- chairs of key stakeholders such as CCGs, other providers, Monitor relationship manager.

- (b) The governance issues for the CEO taking on the role of chair and the criteria of independence that is required for a chair upon appointment.

*(10 marks)*

### **Suggested answer**

As a general rule, the chair should be independent when first appointed. This is a provision of the UK Corporate Governance Code for listed companies and of the Monitor Code for FTs.

It follows that the CEO of an organisation should not subsequently become the chair; a former CEO will not be independent. If one of the board members considering the role is the CEO then this is a significant governance problem as the incoming CEO may find it difficult to run the organisation as they wish because the former CEO is still on the board, monitoring what they are doing. Even so, there have been several cases where a CEO has gone on to become the chair, for example, Monitor itself which had an executive chair in Bill Moyes and again with Dr Bennett. However, this was challenged by the National Audit Office which recommended that the DH appoint a permanent chair of Monitor as soon as possible as an independent chair was needed to boost the capacity of Monitor's senior team, hold the executive management to account and strengthen Monitor's accountability to Parliament. Baroness Hanham was appointed in September 2014.

When the same person holds the position of both chair and CEO, there is a possibility that they could become a dominant influence in decision-making in the organisation. As leader of the executive management team, a chair-cum-CEO may be reluctant to encourage challenges from NEDs about the organisation's performance or to question management proposals about future business strategy.

When an individual holds the positions of chair and CEO, they could exercise dominant power on the board, unless there are strong individuals on the board, such as a deputy chair or a SID, to act as a counterweight. If the individual also has a domineering or bullying personality, the situation will be even worse, because a chair-cum-CEO who acts in a bullying manner will not listen to advice from any board colleagues, and the board would not function as an effective body.

A problem with non-executive chairs (as with NEDs generally) is that the individual may not have enough time to devote to the role because of a large number of other commitments. For example, the chair of a large company may also be the chair of another organisation so that they do not have enough time to fulfill all these roles adequately. Chairs need to be able to demonstrate that they have sufficient time to perform their role to the standards expected.

The National Association of Pension Funds (NAPF)'s Corporate Governance Policy and Voting Guidelines state that where a chair has 'multiple appointments', stakeholders will require a 'compelling explanation' of how they will be able to handle all the various appointments without any detriment to the organisation. The UK Corporate Governance Code is less specific on the amount of time that a chair should commit to the organisation. However, a provision of the Code is that when a chair is appointed, the nomination committee should prepare a job description, which should include an assessment of the amount of time commitment that should be expected and recognise the need for the chair to make themselves available in a time of crisis. The chair's other commitments should be disclosed to the board before their appointment and included in the next annual report and accounts. If there are changes to the time commitment required from or provided by the chair, these should be disclosed to the board and reported in the next annual report and accounts. FT chairs are usually expected to commit three days per week to the organisation.

The FT Code also sets out that the board of directors should not agree to a full-time executive director taking on more than one non-executive directorship of an NHS FT or another organisation of comparable size and complexity, nor the chairmanship of such an organisation.

The criteria of independence should be applied to the chair (on appointment) as well as other NEDs. A chair is not independent if their opinions are likely to be influenced, in particular by the senior executive management of the organisation or by a major stakeholder. What follows is an exploration of the importance of independence and the criteria for making that judgment.

The independence of a chair could be challenged, for example, if the individual concerned has:

- (i) been an employee of the organisation within the last five years;
- (ii) a material business relationship with the organisation (or has had such a relationship within the last three years). This relationship might be as a partner, shareholder, director or employee in another organisation that has a material business relationship with the organisation;
- (iii) received additional remuneration from the organisation other than a director's fee, or is a member of the organisation's pension scheme, or participates in the organisation's share option scheme or a performance-related pay scheme;
- (iv) close family ties with any of the organisation's advisers, directors or senior employees;
- (v) cross-directorships or has significant links with other directors through involvement in other companies or organisations. A cross-directorship exists when an individual is a NED on the board of Organisation X and an executive director on the board of Organisation Y, when another individual is an executive director of Organisation X and an NED on the board of Organisation Y.

Other challenges could arise if the chair represents a significant shareholder or stakeholder or has served on the FT board for more than six years since the date of their first election.



(c) The behaviours of an effective chair.

(6 marks)

### Suggested answer

The report 'What makes an Outstanding Chairman' by Directorbank Group set out the following as key characteristics of an effective chair:

- (i) Integrating the board's collective thinking. This is possible when a chair excels at seeking and sharing information; building ideas into concepts; analysing and considering multiple perspectives and different alternatives; and can subvert their individual needs for commitment to a common goal.
- (ii) Empathy and promoting openness in board members. The ability to listen at multiple levels is critical to successful chairship and team dynamics. Listening to what is not being said is as critical as listening to the words that are spoken. Only with this ability can a chair engender deep trust and respect.
- (iii) Facilitating interaction. This requires that a chair's behaviour move seamlessly depending upon who needs to be in the conversation, rather than 'managing' the process. It requires that skills and expertise (authority) are valued and respected regardless of hierarchy or power dynamics.
- (iv) Developing others. Undertaking active coaching, mentoring and development of talent within the board, in particular with new board members.
- (v) Communicating complex messages succinctly. Effective communication, through written and spoken means, reduces the cognitive load on the board freeing more time for analysis, exploration and learning.
- (vi) Collaborating across boundaries. The ability to identify boundaries and successfully navigate across and within them is critical to creating a culture of collaboration and efficiency.
- (vii) Continuous improvement. Good behavioural objectives include continuous evaluation against internal and external benchmarks. The continual focus on improvement is as much a mindset, as a behaviour.

The report goes on to say that outstanding chairmen, according to the directors they work with and by their own admission, are good all-round communicators; they listen in a non-judgmental and non-condemnatory way, taking views from all the board members, whilst remaining impartial and effectively drawing together the differing opinions around the table. Perhaps most importantly of all, they listen. On the contrary "an ineffective chairman is marked out by factors such as a tendency to dominate; weakness in keeping the board on course and making decisions; poor communication and listening skills; insufficient interest or involvement in the business; and poor leadership abilities."

As leader of the management team and leader of the board of directors, the CEO and chair are the most powerful positions on the board of directors. It is important, therefore, for the proper functioning of the organisation that the chair and CEO work well together. Acting in alliance, the chair and CEO can dominate the board and its decision-making, particularly if the chair also has executive responsibilities in the organisation's management.

More specifically, the NHS Healthy Board report sets out some pointers for chairs stating that they should not:

- be too operational, interfering with details of management;
- exceed part-time hours;
- take specific strategic decisions alone; or
- adopt a bullying or macho 'hire and fire' culture.

## Examiner's comments

Question 6 was the most popular question and was reasonably well attempted by a number of candidates. However, candidates again did not quote relevant guidance such as the UK Code/ FT Code/FRC Guidance/Healthy NHS Board, and so on. Very few scripts included the criteria for independence for the appointment of a chair and just listed the job role of the chair as opposed to the behaviour of a chair in part (c).

*The scenarios included here are entirely fictional. Any resemblance of the information in the scenarios to real persons or organisations, actual or perceived, is purely coincidental.*