GOVERNANCE

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UK SOX – what now?

'The UK consultation process has also indicated that implementation is likely to focus on additional areas such as cyber security and resilience, fraud identification, as well as ESG reporting.'

Simon Persin

You get what you pay for

'The role of the independent director is complex and often vaguely defined, this is particularly concerning when, nowadays more than ever, we need outstanding guardians of our institutions and sectors. We need higher calibre individuals to provide the necessary guidance and oversight as our non-execs.'

Gerry Brown

Content

Feature

You get what you pay for

Gerry Brown looks at the importance of having really good independent directors across all sectors and rewarding them accordingly.

The crisis of governance is a real problem that affects us all. Wherever you choose to look there is a crisis of governance with many challenges. The businesses we work for, the universities that teach us, the health services that guard the health of the nation, the sports we follow and play, the charities we rely on and fund as well as many other institutions we depend on are only as effective as their governance.

Of course, it is often said when justifying executive suite salaries, long-term incentive plans and bonus payments in both the private and public sectors that 'if you pay peanuts, you get monkeys'. While clearly it is important to take account of the competitive landscape whenever employers price products, services and remuneration, this common-sense opinion is still something of a canard. Especially when it comes to those non-executive directors (non-execs) who currently work without payment.

Independent directors get paid in business and the NHS but don't in a number of sectors including sports, charities and education. Given the time that doing this work effectively and professionally requires, recruiting a more diverse cadre of talented independent directors is often held back by the idea that this service should be voluntary for the love of the sector and the honour of just being a board member. These can be factors but it is also true that payment immediately improves recruitment from an availability and talent pool perspective. Doing so is also a long-term win when it comes to improving the quality of governance.

Irrespective of the sector or industry involved, lack of payment for services rendered by these existing non-execs is not a reflection upon their calibre, commitment, experience and professionalism – they are definitely not monkeys – but does immediately both circumscribe the talent pool drawn upon (pale, male and stale regularly predominates currently) as well as precludes participation. Given the prevalence nowadays of CEOs, executive boards and government ministers acting without effective counter-balance or reflection, truly independent and impartial non-execs are – arguably – the last remaining safety net and bulwark against capricious self-interested decision-making, cronyism and scandal.

Before moving on to discuss this further, I would like to highlight that I prefer to call non-execs 'independent directors' in order to recognise their vital importance and function in holding executive teams to both the straight and narrow as well as to actual (verifiable) account. All too often, as the ongoing litany of scandals and bankruptcies in the public, private and third sectors shows, governance is being challenged and sometimes failing. And often failing badly. The role of the independent director is complex and often vaguely defined, this is particularly concerning when, nowadays more than ever, we need outstanding guardians of our institutions and

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used for multiple purposes, thereby helping track and future-proof any controls information. Re-using controls (by testing them and sharing the results with interested parties) where possible removes duplication of effort and makes significant cost savings.

Automation of controls removes the human error factor and improves accuracy, increases their reliability through scheduling, and reduces the execution effort. Personnel involved need only to react to system-driven alerts or insights, rather than rely on proactive searching (and good fortune) to uncover an issue. This avoids a significant increase in compliance headcount and improves the operational control environment. Automated controls also automatically build up evidence that nothing is suspicious for management and independent assurance providers, avoiding further traditional costs of compliance.

Templates and accelerators are available for this phase of the controls improvement programme but the specifics of each organisation's culture, assets and application estate will be more meaningful than a generic control.

The exact scope of the control improvements required will be unknown until the discovery and scoping phases have been completed. There will also be a delta between what has been self-scoped and the final requirements of UK SOX. However, concentrating on the areas identified makes the likelihood of rework low.

And by focusing implementation work on smart, right-sized controls that do not increase complexity and operational undertakings, the organisation is spending in the areas that contribute to total compliance – also safe in the knowledge that it is a wise investment of time and effort.

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Feature

sectors. We need higher calibre individuals to provide the necessary guidance and oversight as our non-execs. Indeed, many boards are failing to be effective. Additionally training for non-execs is sparse. Thirty-three per cent of non-execs in the charities sector received NO training at all, not even induction into their organisations. Ten per cent of non-execs in sports also received NO induction. How are these directors meant to learn their jobs or even get up to speed? There is a serious and ongoing lack of diversity. Few boards truly represent the people they are intended to serve. They are also not cognitively diverse. In their 2021 summary analysis of FTSE 100 Corporate Reporting Trends, Black Sun plc note, 'Cognitive diversity is essential for companies to become agile and innovative in a way that enables them to remain resilient in a fast-changing world'. Obviously, this factor is important at board level outside the FTSE 100 too. To compound matters further, there is a lack of understanding or recognition of risk; while understanding of digital economy issues and grasp of data are also poor. How can non-execs be expected to do their jobs without the necessary data and information? Given all this, it is fair to ask: what contribution to governance are these directors actually making?

'Cognitive diversity is essential for companies to become agile and innovative in a way that enables them to remain resilient in a fast-changing world'

Looking at the university sector as a specific example – though the points raised are equally applicable elsewhere in the sports and charities sectors – it is clearly the case that NOT paying non-executive council members both limits the cadre of talent available as well as the time spent doing the work. The obvious but also the most important point is to make sure that the people who have the skills, the experience and the knowledge to be good university independent council members are attracted to commit to doing so and not put off because they can't afford to give the time to the role that it both requires and deserves.

Even when people are paid properly for their independent directorship work, it doesn't magically solve the structural issues they face holding boards to better account. It does, undoubtedly, start to address other endemic and structural issues. Of course, this may be down – using the education sector as an example – to the culture of universities themselves. University councils tend to be large, as they are required to represent a wide range of stakeholders including staff, students, the university senate and so on, and this can make them unwieldy. This tends to create a culture of stewardship, a culture of 'we're all in it together', and that can be very good. On the other hand, independent members of the council can easily get drawn into that culture and lose their independence.

It is also the case that powerful vice-chancellors (or chief executives elsewhere) sometimes throttle independence on university councils. It is not uncommon for any governor who showed real independence to find themselves removed from the board. Of course, information asymmetry between the non-execs and the executives is a well-known constraint throughout business life. Its impact is to prevent independent directors from scrutinising and raising questions confidently and effectively. In any organisation the odds are stacked in favour of the executive because they have more information and knowledge. The executive have a disproportionate power because they can reveal what they wish to reveal and keep hidden what they don't to predetermine the outcome of a discussion. It can be very difficult for a non-exec to get behind that, unless they already have pre-existing expertise and experience in the higher education sector. The council members need to spend a lot of time assimilating an enormous volume of paperwork (much more than in a company) in an attempt to rectify the information asymmetry. Clearly, they can't catch up with information built up over 20 years in one hour and then make a decision.

The best practice model for evidence gathering, in my view, is the dual assurance model practiced, for example, where I am a Council Member at the University of Exeter. In this model, each executive function has two leads, one a member of the executive team and the other an independent director from the university council. This obviates the danger of having all information channelled through the vice-chancellor/CEO, who can then act as an information gatekeeper. Instead, independent members of Council are obliged to go out to different parts of the university, meet with faculty, staff and students and hear their views. Armed with sufficient knowledge, the independent lead then reviews with the executive lead their findings to discuss and analyse what they know, before reporting jointly to the council.

In turn, because everybody feels more informed and confident to speak up, there is robust challenge and discussion at various levels, including during council meetings. People feel that the process works. Proposals put before the council receive a level of scrutiny that would not be possible under a more classical model of governance.

Last but by no means least, one further crucial area to consider in the context of diversity is age. For some reason, while it is fairly well known that the vast majority of board members are of a certain age, age diversity does not seem to attract the same attention as other forms of diversity. Again, data is scarce, but it is believed that the percentage number of independent directors under 50 is in single figures. PwC's research into

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the US market shows that just 6% of directors are in this age bracket in the S&P 500.

This seems a ludicrous dichotomy since we know Generation Z (those born between 1996 and 2010) are keen to volunteer and, as we've already seen, employers are opening up opportunities to do so via Employer Sponsored Volunteering. Does it matter? Well, yes, it does. Don't forget, either, that many of their customers and stakeholders will be from this generation.

It makes sense to have people in positions of authority who are closer to their experiences and speak their language.

Gerry Brown is the author of 'Making a Difference: Leadership, Change and Giving Back the Independent Director Way' (De Gruyter), co-author (with Andrew Kakabadse and Filipe Morais) of 'The Independent Director in Society: Our Current Crisis of Governance & What To Do About It' (Palgrave Macmillan) and Chairman of private equity firm Novaquest Capital Management.

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