HIGGS ENGAGING FINANCE DIRECTORS WITH DETAIL

Much has been written about the requirements in the Higgs report for at least half the board of directors to be independent, non-executive directors. But there is plenty in the detail of Higgs to engage the interest and involvement of the finance director.

The board Higgs makes clear in chapter 4 that the purpose of a board is "to provide entrepreneurial leadership... within a framework of prudent and effective controls which enable risk to be assessed and managed". It adds that the board should set the strategic aims, ensure the necessary resources (financial and human) are in place, and review management performance. It should also set the company's values and standards, and ensure that obligations to shareholders and others are understood. But the first point detailed in the "Role of the board" is that it is collectively responsible for promoting the success of the company by directing and supervising the company's affairs.

The chairman Despite the media emphasis on the senior independent director, the chairman has the pivotal role in creating the conditions for individual director and board effectiveness. In particular, chapter 5 and annex D set out that the chairman is responsible for ensuring the provision of accurate, timely and clear information to the directors, particularly about company performance, and for ensuring effective communication with shareholders.

In guidance for chairmen in annex D, Higgs notes that the board agenda should be forward-looking and concentrate on strategic matters, not "formulaic approvals of proposals" that ought to be delegated to management. There must be sufficient time for the board to discuss complex or contentious issues, perhaps by using informal meetings before the formal board meeting. Non-executive directors must not be given unrealistic deadlines for decision-making.

It is also the chairman's responsibility (working with the company secretary) to take the lead in providing a proper, comprehensive and formal induction programme for new non-executive directors, and to take the lead in identifying and meeting the development needs of individual directors. Annex I contains an induction checklist, which contains a number of finance, KPI and risk-management components

Non-executive directors Chapter 6 and annex C spell out that the role of the non-executive director covers four areas: strategy, performance, risk and people. For the first three, this means that non-execs should (a) constructively challenge and contribute to the development of strategy; (b) should scrutinise the performance management in meeting agreed goals and monitor the reporting of performance; and (c) that they should satisfy themselves that information is accurate and that financial controls and risk management systems are robust and defensible.

Before accepting a board appointment, potential non-executive directors should carry out due diligence on the board and the company to satisfy themselves that they have the knowledge, skills, experience and time to make a positive contribution. Annex G provides a pre-appointment checklist, which includes a number of questions relating to the financial position and performance of the company. It also urges non-executives to enquire as to the availability of insurance cover and the company's policy on indemnifying directors. Useful sources of information include the annual report, analysts' reports, ratings agency reports and voting services reports.

Independence Higgs recommends that the Combined Code should state that all directors have to take decisions objectively in the interests of the company. This doesn't add anything to the current legal position, but is intended to make clear that the obligation to act in the company's interests applies to all directors equally, regardless of whether they are more or less independent than others. Chapter 9 also contains a definition of independence.

Remuneration Non-executive directors' remuneration may comprise an annual fee, a meeting attendance fee and an additional fee for chairing board committees.

Higgs says that non-execs "should have the opportunity" to receive their remuneration as shares, but should not hold options. If, exceptionally some payment is made in the form of options then shareholder approval should be sought in advance and any shares acquired on exercise should be held for at least a year after the departure of the non-exec from the board.

The annual report should say whether any executive director who has a non-exec directorship elsewhere is entitled to retain the remuneration from that post (rather than compensating the executive director's company) and, if so, how much it is.

Shareholders While the finance director plays a key role in investor relations, Higgs says that the senior independent director should attend sufficient regular management meetings with major shareholders so as to get a balanced understanding of their main issues and concerns. Other non-executive directors may also find it instructive to attend such meetings and should be allowed to do so. Such meetings should also form part of the induction process. Non-executives should also attend such meetings if institutional shareholders make such a request, but they should not expect non-executives to provide information on company performance.

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Useful links

- **The Higgs report is available at www.dti.gov.uk/cld/non_exec_review. Some of the background research for the report can also be found on the site.**
- **The Institute of Chartered Secretaries and Administrators has useful material at its website, www.icsa.org.uk**