



BoardWorks

Criterion-based Monitoring: second-guessing the board's needs is out!

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Monitoring is at the heart of the board's job. In essence, it is the means by which the board discharges its accountability to provide assurance that the criteria it has set for the carrying out of certain actions and the achievement of certain outcomes have been met. Bearing in mind that, in the first place, the board set these criteria for a purpose – to protect and enhance the organisation on behalf of its owners/key stakeholders – it is beholden upon the board to then ensure that its instructions have been followed.

But monitoring can be problematic for boards. It has been our experience that, in the absence of a clear understanding of the purpose of monitoring and an agreed process based on sound governance principles, this board task, perhaps more than any other, can inhibit the creation and maintenance of a sound board-CEO relationship and reduce overall governance effectiveness. Among the inhibitors to effective monitoring are.

- The board has no criteria against which to monitor the CEO's actions and reports
- Board members bring their own subjective interpretation of the board's criteria and judge CEO compliance on the basis of how they would have met the criteria themselves if they were in the CEO's shoes
- The reporting submitted by the CEO either does not address the board's criteria or the CEO presents too little or too much data.

Monitoring should be systematic

Reporting to the board is the bane of many CEOs' lives. Our experience over the years, and with hundreds of boards, tells us that few boards give explicit instructions to their CEO about what is to be reported and thus what will be monitored. Many, if not most, CEOs are left having to second-guess their board's requirements. In the absence of a clear prescription for reporting, we regularly witness CEOs trying to cover all the bases so that they will not be caught out. Unsystematic reporting leads to unsystematic monitoring. This does not work for either the CEO or the board.

We strongly commend the following short set of principles to guide the board and the CEO in determining what is to be monitored and therefore what is to be reported:

- The board, in the first instance, must determine what results or actions it wants to monitor and capture these in policy as performance criteria to be met
- When the board has set criteria for what must or must not be done, and what must be achieved, the CEO is obliged to report against these criteria
- The board should make clear to the CEO *how* (i.e., in what form) specific matters should be reported.

Monitoring criteria made clear

One of the reasons why so few boards make clear to the CEO their monitoring requirements is that, in many cases, directors do not know what they need to monitor, other than in the most general terms. They know that they need to monitor the organisation's finances, but exactly what financial information should they monitor? They know that certain operational elements are critical to the achievement of the desired outcomes, but which of these are relevant to the board and which are strictly management matters? They know that they should be adding value to the work of the CEO and staff, but how can they when they don't know enough about the work to be done or when, in some instances, the issues are so technical that only specialist staff members understand the issues? So, what is it that they should monitor, and how?

Understanding the business

One of the common misconceptions about governance is that it requires a highly detailed knowledge about the business being governed. While it is true that all directors must understand, in a general sense, the business of their organisation, they do not need to be experts in that business in order to be an effective director - at least not in the sense that staff are, or are expected to be, experts.

The role of the board is to govern the organisation, not manage it and to this end, directors should be experts in governance not operations. However, the application of governance skills requires a sound backdrop of organisational knowledge. This knowledge will typically result from past or current experience in the organisation's business, reading and research or, most commonly, from reading, interpreting, questioning and monitoring the content of many CEO reports. The dual processes of reporting and monitoring not only keep directors informed about the organisation's performance but are also excellent mechanisms for creating and growing a bank of organisation knowledge relevant to the board's governance role.

Monitoring based on policies

When the board establishes a policy framework it has the basis for systematic monitoring. Policies make clear what is, or is not to be done, and what is to be achieved. Monitoring is then made simple; has the CEO complied or hasn't he/she, have the results been achieved or not, is the board working to its own policies or not?

There are essentially four main categories of governance policy. These provide an excellent basis for board monitoring. Governance Process policies define the governance practices and processes and are the basis for the board's monitoring of its own performance. Board-CEO Linkage Policies enunciate the nature and extent of the board's relationship with the CEO and the operations of the organisation. CEO Limitations policies define the boundaries within which the CEO must work, providing the basis for the board's monitoring of the CEO's actions and choice of means to achieve the expected outcomes. Ends policies, the final category of policies, identify the results to be achieved by the organisation and thus form the basis for monitoring overall organisational performance. Policies provide a criterion reference from which all board and CEO action and decisions flow. CEOs should work from the maxim that if the board has developed and adopted a policy that relates to his/her work, then there is an obligation to report to the board on the carrying out of that policy.

Quite simply, board monitoring is a criterion-referenced activity. Boards that grasp this concept suddenly find their monitoring role to be not only much easier to define and carry out, but also much more effective.

The board determines the 'what' and 'how'

In monitoring compliance with policy, the board must ensure that the data it receives from the CEO is presented in a way that enables understanding and interpretation. This requirement too should be presented as a criterion. Typically, boards address specific areas of operational risk by developing issue specific policies, e.g., in the various areas of finances, personnel, protection of assets etc. In addition to these policies, we recommend that the board develop a policy that speaks directly to its

own needs for information and support. This policy might be called *Communication & Support to the Board* and, using a limitations format, could look something like the example (figure 1) below.

Some of these instructions are completely clear, others are more generally stated and require a CEO interpretation of what the board requires. When, for example, the board states that it requires “...data relevant to agreed benchmarks and board-agreed measures, e.g., financial ratios” there can be no doubt as to exactly against what criteria the board will base its monitoring. The board, ahead of time, will have established such measures and benchmarks and the CEO will report against these.

However, other statements are less specific. For example, point 1 in the sample policy states, “The CEO must not neglect to ensure that all monitoring information presented to the board is timely, accurate and meets the board’s requirements for presentation standards, and understandability”.

This implies that the board has made clear or will make clear its ‘requirements’ regarding ‘timeliness’, ‘presentation standards and understandability’. The board has the choice of accepting the CEO’s interpretation of these broadly stated criteria or could take the policy statement to a further level and state exactly what it means by ‘timeliness’, ‘accuracy’, ‘understandability’ and the board’s ‘presentation standards’. Another approach would be to refer to another document in which these criteria are specified.

Respecting the CEO’s choices

Many boards we have worked with are blessed with board members with extensive skills and experience in relation to the business of the organisation, but these same board members become a curse when they try to superimpose their own version of appropriate actions over those of the CEO. In doing this, these board members judge CEO compliance not against the outcomes achieved within the limitations imposed, but rather in terms of how *they* would have approached the same issue themselves. It makes little sense that the board should hire a competent CEO and then tell him/her exactly what actions or decisions to take.

As has been stated, board monitoring should be defined by the criteria stated in the policies. If the board wants to narrow down the CEO’s choices to the point of proscribing particular behaviours or actions, this should be made explicit in one or other of the policies.

Allowing the CEO to make the operational choices can be hard for some board members to accept especially those with relevant expertise. But they must do so, or they risk taking over the CEO’s decision-making responsibility and undermining the board’s ability to hold him/her accountable.

Given that the board has developed a policy framework which provides a clear set of performance expectations for the CEO, a board must allow the CEO to exercise a reasonable interpretation of those policies. By this statement we mean a reasonable *CEO* interpretation, not a reasonable *board* interpretation.¹ If the board has not been sufficiently clear in its policy making – and it is unhappy with the outcome of the CEO’s actions because of that – it is the board’s responsibility to amend the policy accordingly.

Even when the whole board does not like the CEO’s choice of action, the criteria for judgement must still be whether or not in choosing the action, the CEO made a reasonable interpretation of the board’s policy as it stood at the time.

Boards should not fear this freedom of interpretation given to the CEO for, in the end, they control the policy which determines the extent of freedom. The board, then, is the ultimate controller. However, it must exercise that control in an ethical and fair manner. Having placed the policy ‘goal posts’, the board must accept the CEO’s efforts to achieve the desired outcomes. The goal posts should not be moved without making clear to the CEO, ahead of time, that this is to occur and why. The ‘reasonable interpretation’ concept, then, is consistent with principles of natural justice.

Too much or too little monitoring data

Too much data can be as inhibiting to effective monitoring as too little. We have witnessed boards poring over pages of often irrelevant information feeling that because the CEO has presented it all, it must all be read. One of the competencies found among good boards is that they have made clear to the CEO not only what they want reported and how, but how much reporting data is necessary to enable effective monitoring.

Monitoring Ends policies

The board should adopt the same approach for monitoring its Ends policies as it uses to monitor compliance with the CEO Limitations policies, that is, against pre-stated board criteria. Having specified the results to be achieved, the CEO is required to report against these as stated.

We have worked with many boards that require regular updates on the progress towards the achievement of the stated results, others are happy to hear such reports less frequently. Where the Ends policy monitoring is more frequent, the content will likely be less detailed. After all, if the CEO is required to provide detailed reports on a month-by-month basis, they will have trouble finding time to do their other work. Always be conscious of the workload you are creating for the CEO and their staff.

One approach used quite successfully by a number of boards we have worked with sees the CEO presenting a meeting-by-meeting bullet point summary of progress towards the achievement of the board stated results. This is presented pro forma with the regular report building to provide a continuous record of progress at a quite general level. These running bullet point reports are variously known as 'running ends reports', or 'continuous ends reports'.

To supplement this more general reporting, the board develops a schedule covering, say, a twelve-month period, outlining their requirement for in-depth reporting against the Ends policies, one per meeting. In this way the board is presented with an ongoing summary of general progress towards the attainment of its stated results to be achieved and, meeting-by-meeting, drills deeper into the Ends policies, one-by-one. This schedule is planned for in the board's annual twelve-month agenda.

The information provided by the CEO in his/her in-depth report not only informs the board in detail about progress towards the achievement of results, but also provides the basis for a broad strategic conversation around the boardroom table.

To conclude, we come back to the principles stated at the beginning of this article: it is the board's responsibility to ensure that everything is as it ought to be. The board must determine how things ought to be. Policies are the most effective means for saying how things ought to be and, monitoring is the method by which the board enacts these principles.

Without effective monitoring a board cannot guarantee to meet its 'duty of care' and its 'duty of diligence' responsibilities and thus cannot assure its owners and key stakeholders that it is doing its job on their behalf. Such a board cannot demonstrate good governance.

ⁱ Carver, John. In Board Leadership. Number 46, Nov – Dec. 1999.