Approaches to Documenting the Board's Delegation to the CEO

Terry Kilmister and Graeme Nahkies

First published in Good Governance 26, March – April 2002

We continue to be surprised at the number of boards that neglect to make the exact nature of their delegation to their CEOs clear. Given the crucial importance of this delegation, to merely assume the content and extent of the delegation is to take a large risk. And time and time again, when we put it to the test, we find that there are widely differing assumptions and expectations among directors about what has been delegated to their CEO.

A paradox

It is not uncommon for directors to assert that a board shouldn't have to spell out its expectations of its CEO - that any CEO worth his or her salt should not need to have their delegation defined telling them what they can do. Yet numerous CEOs express exactly the opposite opinion. They bemoan the lack of an explicit delegation, commenting that a lack of clarity creates uncertainty and vulnerability for them. Among other things it ties them to a need to regularly 'check in' with their board about a wide range of matters that are mostly operational.

Directors just want the CEO to 'get on with it'

Most directors want their CEO to simply 'just get on with it'. Most CEOs want to do just that, without having to seek the board's endorsement for operational initiatives. Hampering this ideal, however, is a commonly found uncertainty about exactly what is to be 'got on with' and what limits the board might wish to place on the 'getting on with it'. No board, conscious of its duty of care to the organisation and key stakeholders, should offer to its CEO an unbounded delegation. The risks entailed are simply too great for the organisation, for the board and especially for the CEO. The development of a written document, therefore, is an important tool for the board to use to assert some control over the risks associated with its delegation to the CEO. It is also an important safeguard for the CEO because it requires the board to spend some time explicitly clarifying its expectations of him or her and to 'speak with one voice' on those expectations.

Defining the delegation to the CEO

There is 'no one right way' to define such a delegation. It is our experience, however, that certain approaches provide greater clarity than others. Using a sample governance-level policy example – in this case elements taken from a financial management policy – we outline four alternative ways to write a delegation policy.

Underpinning principles

Before outlining the four approaches, it is worthwhile identifying some basic principles that apply to this delegation and, therefore, underpin whatever approach is used.

- Directors are required to exercise a 'reasonable level of control' over management necessary to meet their duty of care requirement. At the same time the CEO needs to be granted a 'reasonable level of freedom' necessary to facilitate the achievement of the required organisational outcomes.
- The CEO can reasonably expect that the delegation, once completed and agreed, is the basis for all managerial responsibility and accountability.
- The delegation documentation should be as comprehensive as is required for the CEO and the board to be clear about what is expected, recognising that new elements might be added, and others renegotiated.
- The delegation should make clear the organisational 'outcomes' or 'ends' to be achieved and specify any limits to the CEO's freedom to select operational 'means'.

The prescriptive approach

The most commonly used approach to policy writing is the development of a prescription. This is typically true for both governance level and operational level policies. Policies written using a prescriptive approach typically establish what 'must', 'should' or 'can' be done by the delegate. A board policy designed to address the CEO's delegation for operational financial management using a prescriptive approach might look something like:

Policy

The CEO is responsible for the day-to-day financial management of the organisation. In carrying out this duty he/she must ensure that all financial actions and circumstances are designed to protect the organisation's financial integrity. Accordingly, the CEO must:

- *Ensure that organisational funds, contracts and other liabilities are incurred only for the furtherance of board-approved purposes and priorities.*
- *Expend no more funds than have been received in the financial year unless offset by approved borrowings or approved withdrawals from reserves.*
- *Pay all undisputed invoices from suppliers of goods and services within trade credit terms agreed with those suppliers.*

And so on …

This commonly used approach two major flaws. Firstly, while the board has established a list of actions that must or could be done, there still exists a myriad of further actions that the CEO might choose to apply in order to meet the essence of the delegation, i.e., protection of the organisation's financial integrity. When these are not included in the board's prescriptive list the CEO is left with uncertainty. Did the board omit them because it intended that such actions should be disallowed? Did directors simply forget to include these other options or were they unaware of the need to include them? The CEO is left having to make his or her own judgement call and risk breaching the board's (unstated) policy.

The alternative is to play safe by going to the board to seek permission to take the desired action. We have witnessed many board meetings at which, as the result of the CEO's uncertainty about the limits of his or her authority, a large amount of board time is taken up with discussions around proposed CEO actions. Understandably, the CEO has chosen the safe route and sought board approval before acting. Almost without exception the CEO's proposed actions are deemed to be perfectly reasonable and permission is granted. When such a process becomes the norm the board, in essence, is saying to its CEO: "do what we tell you to do as per this policy and check everything else with us before acting". From the Board's perspective this can also encourage an ineffective CEO to 'delegate upwards' decisions he or she should really make.

The second flaw is that such a prescriptive list can be unending. The reality is that there is an almost unquantifiable array of choices that a CEO can take in order to achieve many of the outcomes sought by the board. To try to prescribe all, or even most, of these is an impossible task. To the extent that the board comes close to success in this it has, in effect, designed the CEOs job to such an extent that there is little room for his or her to exercise professional and personal judgement. The job is likely to be over-prescribed.

The Limitations approach

Note on limitations language

Since this article was written the language used in the Carver Policy Governance framework has been updated.

The previous form of The CEO shall not fail to .... is out

"shall not fail to …" does not describe the condition which is unacceptable to the board and thus should be avoided.

The change is from: Shall not fail/neglect to protect intellectual property, information, and files from loss or significant damage.

Now expressed as: Shall not allow the organisation to operate without adequate safeguards to protect intellectual property, information and files from loss or significant damage.

The new format defines the circumstances that must be avoided rather than the CEO's actions.

The template governance charter available through SportNZ reflects this new approach

When applying this approach, originally advocated by US governance theorist John Carver, rather than defining what *must* be done, the board instead defines what must be *achieved* (ends, outcomes, results) and then sets *limits* on the CEO's freedom to choose the means to achieve those ends. Hence the common use of the term 'executive limitations' policies. The wording, while felt by some to be rather clumsy, establishes boundaries within which the CEO is deemed to have operational freedom. Whereas the previous approach is described as a ***pre***scriptive approach, this approach is ***pro***scriptive. It is our experience that, with assistance, most boards can identity almost all of the limitations they wish to place on their CEO. Even if few boards could write an adequate CEO job prescription, most can develop a more than adequate proscription because the proscription (defining what should not happen) goes to the heart of their duty of care.

The same policy written using this approach might look something like:

Policy

The CEO is responsible for the day-to-day financial management of the organisation. In carrying out this duty he/she must ensure that nothing is done, or authorised to be done, that could in any way cause financial harm or threaten the organisation's financial integrity. In managing the financial affairs of the organisation, the Chief Executive must not:

- *Use any organisational funds, enter into any contracts or incur liabilities other than for the furtherance of board-approved purposes and priorities.*
- *Expend more funds than have been received in the financial year unless offset by approved borrowings or approved withdrawals from reserves.*

- *Allow undisputed invoices from suppliers of goods and services to remain unpaid beyond trade credit terms agreed with those suppliers.*

And so on …

The Limitations approach has the disadvantage of using language that is often perceived as counter intuitive. Many directors that we work with have difficulty in accepting the negative language. Paradoxically, however, this approach is the most empowering from the CEO's point of view. Having stated what actions and circumstances are unacceptable or unallowable, i.e., are limited, the CEO can then manage with the assurance that all other actions are acceptable or allowable. In essence, if the board has not said "No", the answer is "Yes".

Using other language to determine the limitations

If the negative and, at times awkward, language in the Limitations approach is a barrier to using this effective delegation system there are two other ways that the delegation might be expressed.

Constraints placed on the CEO's prerogatives approach

Policy

The CEO is responsible for the day-to-day financial management of the organisation. In carrying out this duty he/she must ensure that nothing is done, or authorised to be done, that could in any way cause financial harm or threaten the organisation's financial integrity. While recognising the necessity for maximising the CEO's decision-making parameters, the board's delegation imposes the following constraints on the CEO's decision-making prerogatives. The CEO's prerogatives do not extend to:

- *Use of organisational funds, the entry into contracts or acceptance of liabilities, other than for the furtherance of board-approved purposes and priorities.*
- *Expenditure of more funds than have been received in the financial year unless offset by approved borrowings or approved withdrawals from reserves.*
- *Allowing undisputed invoices from suppliers of goods and services to remain unpaid beyond trade credit terms agreed with those suppliers.*

And so on …

This approach retains the Limitations principles while doing away with the overtly negative language. While, for some, the difference may feel semantic, this small change in style might facilitate wider acceptance of the Limitations approach.

Powers reserved to the board approach

This approach is commonly used, particularly in commercial enterprises. While few would adopt the same format used in the example below, most adhere to the fundamental principle that certain powers belong with the board and, as such, the CEO does not have decision-making prerogatives in any of these matters. The financial policy example written using this approach might look something like the following:

Policy

The CEO is responsible for the day-to-day financial management of the organisation. In carrying out this duty he/she must ensure that nothing is done, or authorised to be done, that could in any way cause financial harm or threaten the organisation's financial integrity. While recognising the necessity for maximising the CEO's decision-making parameters, the following powers are reserved to the board:

- *Authority to use organisational funds, to enter into contracts or accept liabilities other than for the furtherance of board-approved purposes and priorities.*

- *Authority to expend more funds than have been received in the financial year.*
- *Authority to defer payment of undisputed invoices from suppliers of goods and services beyond trade credit terms agreed with those suppliers.*

And so on …

This approach also has the advantage of avoiding the negative language used in the Limitations approach. The board has assumed the authority to make certain decisions, thus asserting necessary controls by denying the CEO certain freedoms. The principle that unless the board has said “No” the answer is “Yes” still applies. The CEO’s freedoms are defined by the powers that board retains.

Summary

The relationship between a board and its CEO is put at considerable risk when the board does not adequately specify the components of its delegation. CEO accountability, reporting expectations and initiative taking can be hampered by the lack of a clearly defined delegation. Additionally, by failing to define the extent and nature of the delegation, the board runs the risk of failing in aspects of its duty of care. While there is no ‘one right way’ to document the delegation we have found that the Limitations approach, or one its variations that we have described, offers particular value for ***both*** board and CEO.
