

20 Questions

Directors Should Ask about
Building a Board

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The Canadian Institute
of Chartered Accountants

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Preface

The Risk Management and Governance Board of the Canadian Institute of Chartered Accountants has developed this briefing to help Corporate Governance Committees and others who are responsible for selecting members for Boards of Directors. The document addresses the factors that contribute to the creation of an effective Board and describes a process for recruiting directors. It is intended primarily for directors of companies that are listed on stock exchanges in Canada and the United States but the principles it describes are also, as good practice, appropriate for other organizations.

This briefing provides practical guidance for directors in the form of suggested questions for each of which there is a brief explanatory background and some recommended practices. We hope that directors will find it useful in assessing their present approach to building or adding to a Board and enhancing it where appropriate.

This publication is one of CICA's series of publications on governance for directors. The text includes references to other titles that expand on individual topics.

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Introduction

A strong, effective Board is a key contributor to the success of a company. The Board is responsible for establishing the strategic and ethical directions of the company. It recruits, compensates and evaluates the Chief Executive Officer and establishes a succession plan for senior management. The Board is also responsible for the oversight of risk management, internal control and corporate communications.

Meeting these responsibilities requires the Board to have an effective system of governance and to recruit directors who will work effectively together to meet the expectations of the owners, legislators and regulators. The directors must collectively have the experience, knowledge and skills needed to oversee the management of the company. They must work well together but there should be a creative and healthy tension that comes from the “constructive interaction” of people with different backgrounds.

The Boards of listed companies are required to appoint a nominating committee composed entirely of independent directors¹. The Nominating Committee, which may also be the Corporate Governance Committee, is responsible for identifying individuals qualified to become new Board members and recommending to the Board the new director nominees for the next annual meeting of shareholders.

This document groups the process of identifying and recruiting the best possible candidates for the Board in three sections:

- determining the Board positions to be filled;
- establishing director qualifications; and
- conducting the search process.

A key consideration in the nomination of prospective members to the Board of a public company is the company’s ownership structure. Some listed companies have shareholders with controlling interests or large blocks of voting shares which may include multiple-voting shares (a significant factor in Canada). Through their voting power these shareholders can influence the selection of individual directors or the entire Board. In these cases the challenge is to balance the interests of controlling and minority shareholders.

Institutional investors who manage pension and mutual funds are increasingly using their voting power and influence to ensure that the Boards represent the interests of all shareholders.

Major shareholders should respect the nominating process by electing directors who meet the criteria for Board membership.

“ An effective board of directors is a combination of the right people, the right structure, and the right procedures. **”**

*McKinsey & Company:
Investor Opinion Survey,
June 2002*

¹ See question 1 for an explanation of independence.

Determining the Board positions to be filled

The first step in director recruitment is to establish the positions that should be filled to meet the Board's needs. The positions are the Chair of the Board and the chairs and members of committees. Most directors will sit on at least one committee and some may serve on several.

A critical issue for Boards is the independence of directors — a factor that should be considered early in the nomination process.

Prior to nominating or appointing individuals as directors, the board should... consider what competencies and skills the board, as a whole, should possess. In doing so, the board should recognize that the particular competencies and skills required for one issuer may not be the same as those required for another.

National Policy 58-201

1. What are the independence requirements for directors?

The Boards of Directors of companies listed on major stock exchanges in Canada and the United States must meet regulatory standards and rules for independence. The requirements of the jurisdictions are generally the same but there are detailed differences in the wording and applications. As mentioned in "How to use this publication", readers should not rely on this document for specific requirements. They are encouraged to consult the current regulations for the jurisdictions under which their company is listed and ensure compliance.

Canadian regulators require listed companies (issuers) to disclose their corporate governance practices and to provide explanations and justifications if the company does not follow the following recommended best practices:

- The Board should be composed of a majority of independent directors.
- The Chair of the Board should be an independent director.
- The Board should appoint a nominating committee composed entirely of independent directors.
- The Board should appoint a compensation committee composed entirely of independent directors².

Independence Requirements

National Policy 58-201 defines independence as "independent within the meaning of [section 1.4], Amendments to Multilateral Instrument 52-110 Audit Committees." That is, ...independent if he or she has no direct or indirect material relationship with the issuer. ... "material relationship" is a relationship which could, in the view of the issuer's board of directors, be reasonably expected to interfere with the exercise of a member's independent judgement.

For full description of "material relationship" see OSC, Amendments to Multilateral Instrument 52-110 Audit Committees, Section 1.4, Meaning of Independence.

National Policy 58-201

² National Policy 58-201 Effective Corporate Governance. Sections 3.1, 3.2, 3.10 and 3.15.

In addition, every listed company must have an audit committee whose members are independent directors.

A director is independent if he or she has no direct or indirect material relationship with the issuer. A material relationship means a relationship which could, in the view of the issuer’s Board of Directors, be reasonably expected to interfere with the exercise of a member’s independent judgement.³

The Canadian Regulations on Audit Committees provide detailed definitions and examples of material relationships.

Some directors who have no material personal relationship with the company may potentially have conflicts of interest because of their involvement with other companies. In such cases the directors would declare their conflict and abstain from participating in discussions and voting on the issues involved. If this happens too often it may not be appropriate to nominate them for reelection. Nominating committees should also consider this possibility when evaluating new candidates.

2. How many directors should we have?

The effectiveness of Boards depends on the ability of directors to discuss issues knowledgeably and openly. A Board should have enough members to meet its needs for committee membership and expertise, and provide a good diversity of views and experience. It should also be small enough to encourage lively, informed discussion and facilitate decision-making.

How many?
The Boards of large publicly traded companies have between five and fifteen members with an average of ten.
Patrick O’Callaghan & Associates Governance Review 2003.

The present practice is to have three or four committees, each with between three and five members — a majority or all of whom must be independent. Independent directors typically sit on two committees. Non-independent directors may sit on one or none.

Calculating a Board size for a typical widely-held company	
Chair	1
Committee membership (independent directors)	
3 committees with 4 members. Directors average two committee memberships	6
Non-independent directors	2
	<hr/>
Total	9

- Other criteria for determining Board size include:
- legal and regulatory requirements for a minimum Board size;
 - the complexity and geographical scope of the company’s activities;
 - the range of knowledge and experience required from Board members;
 - the difficulty of achieving a quorum; and
 - the cost.

³ Ammendments to Multilateral Instrument 52-110 Audit Committees.

3. How do we select the Chair?

A strong and competent Chair is the single most important factor in Board effectiveness. The Chair should have the time and ability to lead the Board and act as a liaison with the CEO and senior management. Board meetings are the forum in which directors do much of their important work of debating issues before giving their approval, direction and advice to the CEO.

The majority of large Canadian companies separate the roles of Board Chair and CEO and this practice is growing steadily. They also avoid appointing former CEOs and others who have prior connections with the management group.

The Corporate Governance Committee should have the formal responsibility for developing a process for appointing the Chair that involves the entire Board. The committee may consult the CEO on the selection but should not allow the CEO to make the decision.

CAUTION:

Controlling shareholders are in a position to use their voting power to secure the appointment of their own choice of Chair and CEO. If the selection is unacceptable to the independent directors they may need to meet independently to discuss their concerns and decide how to proceed.

The Chair should have:

- integrity;
- demonstrated strengths in communication and leadership skills;
- strong facilitation skills;
- empathy for fellow directors;
- a forward-looking perspective;
- clear strategic vision;
- the intellectual capacity to understand complex issues and the options for handling them;
- an appreciation of accountability and the need to set and monitor standards of performance;
- the ability to assess priorities and focus on what is important;
- the willingness and ability to prepare agendas with clear objectives and to chair productive Board meetings;
- political skills and the ability to use power;
- the strength of character to deal effectively with a competent but strong-willed CEO;
- the ability to recognize and manage the creative tension between the Board and the CEO;
- the ability and knowledge to challenge views and opinions;
- the ability to manage strong minded or intimidating members; and
- the willingness and ability to take charge in times of crisis.

[See also Crisis Management for Directors]

The Chair must also have the time to do the job properly. The demands and complexity of the position are increasing and may require as much as 50% of the Chair's time — more in times of crisis.

Some Chairs now meet one-on-one with individual directors at least once a year.

The Corporate Governance Committee and Board are faced with a very sensitive situation when the Chair has failed to perform acceptably and should not be re-elected. Traditionally Chairs have enjoyed a built-in cultural right to keep their positions as long as they wish. Re-election of Chairs has often been a rather perfunctory process as Boards have been reluctant to remove Chairs who refuse to resign.

Boards that have had the courage to address this issue have made the Corporate Governance Committee responsible for developing and implementing processes that:

- limit the Chair's term of office to one year with a vote for reappointment;
- establish a maximum number of terms;
- base re-election on satisfactory performance;
- require a complete annual evaluation of the Chair's performance; and
- address the issue of the continued Board membership of a Chair who is not re-elected.

4. Do we need a lead director?

When the CEO is Board Chair it may be difficult for the Board to freely exercise its oversight roles of monitoring CEO performance and reviewing and approving proposals from management. Generally, companies whose Chair is the CEO appoint an independent lead director to lead the Board when it deals with issues that affect the CEO. The lead director also leads and chairs meetings of the independent directors. Appointing a lead director may solve the

immediate difficulties associated with a Chair/CEO but can result in a complex and inconsistent governance process.

The chair of the board should be an independent director. Where this is not appropriate, an independent director should be appointed to act as "lead director". However, either the independent chair or independent lead director should act as the effective leader of the board and ensure that the board's agenda will enable it to successfully carry out its duties.

National Policy 58-201

In the case of 100% subsidiaries where the Chair represents the parent company, an independent lead director may be appointed to represent the independent directors.

It is essential to define the lead director's role, responsibilities and relationships with the Chair and CEO.

5. What committees should we have?

Board committees handle detailed aspects of governance and report their recommendations and decisions to the Board. Committees deal with issues that require more time than is usually available at Board meetings and members may need to have special knowledge or expertise.

A director is independent if he or she would be independent within the meaning of Section 1.4 of Multilateral Instrument 52-110 Audit Committees, i.e., has no direct or indirect material relationship with the issuer.

National Instrument 58-101

Committees of the Board of Directors should generally be composed of independent directors although some Board committees may include one or more inside directors. Most committees work well with three to five members.

The general guideline is to have as few Board committees as possible. The trend is to have Audit, Compensation and Corporate Governance Committees (listed in alphabetical order, not by importance). In addition, some companies may have committees to address issues specific to their industry. Examples include Environment, Health and Safety committees for companies in energy, biomedical and other industries with high levels of physical risk; and Conduct Review and Risk committees for financial services companies.

Audit Committees review financial statements and internal controls and recommend the appointment of the external auditors. They may also be given responsibility for risk management and fraud prevention.

Percentage of Boards with types of committees

Audit	100
Compensation/HR	92
Governance	80
Nominating	33
Executive	18

Patrick O’Callaghan & Associates Governance Review 2003

Compensation (or Human Resource) Committees are responsible for making recommendations to the Board on the hiring, firing,

evaluation and remuneration of the CEO, and for overseeing the compensation of senior executives and the management succession plan.

Corporate Governance Committees are responsible for developing the corporation’s approach to governance issues and for the corporation’s response to regulatory requirements. They also serve as **Nominating Committees** to set criteria for Board membership, develop a recruitment process, identify and recruit candidates to serve on the Board of Directors, and evaluate the performance of the Chair, the Board and individual directors.

Executive Committees are becoming less common as Board sizes shrink. The delegation of authority to make decisions on behalf of the Board can create a powerful in-group that is divisive. Urgent Board decisions can often be handled by directors using conference phone calls or e-mail.

When other committees are appropriate, the Board should establish clear terms of reference and ensure that the value of the committee is regularly assessed. The most common committees are Environment/ Safety (23%), Pension (9%) and Risk/Loan (8%).⁴

The criteria for selecting committee members may include planned rotation of selected members among committees to increase their knowledge of the business and maintain their interest. This is not appropriate in all cases and care should be taken to respect the interests and abilities of individual directors.

⁴ Patrick O’Callaghan & Associates. *Corporate Board Governance and Director Compensation in Canada: A Review of 2003*.

Establishing director qualifications

Finding the right people for a Board involves defining the qualifications of potential directors. These fall into two groups:

- specific skills and experience that meet the needs of the Board and its committees; and
- personal qualities that are desirable in any Board member.

The Corporate Governance Committee should consider these qualifications along with such considerations as Board and industry experience and potential disqualifying factors. The committee may seek the CEO’s advice on the best combination of skills and experience required on the Board and thus the attributes of individual nominees.

Prior to nominating or appointing individuals as directors, the board should ... assess what competencies and skills each existing director possesses. It is unlikely that any one director will have all the competencies and skills required by the board. Instead, the board should be considered as a group, with each individual making his or her own contribution. Attention should also be paid to the personality and other qualities of each director, as these may ultimately determine the boardroom dynamic.

National Policy 58-201

The results can be used to develop a “skills matrix” for the Board and each Board position. (See appendix.) The matrices will need to be reviewed and updated regularly, to ensure they meet the changing needs of the organization.

6. What specific skills do we need on the Board?

Companies are dynamic. They begin, grow, mature and, sometimes, decline and fail. The composition of the Board and its involvement in operational issues must be compatible with the current status of the company and its future directions. Boards need directors with skills that contribute to achieving the Board’s compliance and strategic responsibilities.

Status

- Start up
- Growth
- Consolidation
- Expansion
- Contraction
- Turnaround
- Liquidation
- Sale

Leading companies perform a complete assessment of their company’s governance needs as the first step in their annual director nomination process. This typically includes evaluating the performance and contribution of individual directors, including the Chair, identifying the “gaps” and developing profiles for the directors to be recruited.

The Board recruitment process should recognize the specific needs of the company and establish the respective powers and responsibilities of the Board and senior management. Boards of well-established companies typically delegate responsibility for management to an experienced CEO and focus on oversight. All companies need strategic input from the Board. Some companies also need input from the Board on operational issues. In less mature companies, the Board may supplement management capabilities by providing advice and coaching to the CEO.

It is critically important for Board members and management to be clear about their respective roles because they directly affect their activities and relationships. The Board should determine how engaged it should be in the company's destiny. This will define what kind of directors should serve and their degree of commitment and engagement.

Corporate success comes from having a good strategy that is well executed. The Board plays a key role in establishing strategic directions by selecting the CEO and participating in the strategic planning process. To do this effectively the Board must include directors who have the appropriate strategic skills, knowledge and experience to identify, validate and monitor the company's strategy. These skills should include those appropriate to all the countries and regions in which the company has current or prospective business interests.

All listed companies must have an Audit Committee whose members should have the appropriate skills and experience

Strategic skills

Experience

- Industry experience
- Entrepreneurial experience
- Management experience

Knowledge

- Business case analysis
- Environment
- Finance
- Financing
- Human resources
- Investment
- Internal control
- Law
- Marketing
- Privacy
- Risk management
- Corporate law
- Strategic planning
- Taxation
- Information technology
- Executive compensation
- Mergers and acquisitions
- Geographic: political and cultural
- Regulatory issues

for reviewing financial disclosures and internal control. The Audit Committee members may be required to meet regulators' criteria for "financial literacy" and "financial expertise", but to be effective, all directors should have the "financial acumen" to read and understand financial statements.

The need for skills in other areas varies with the industry and the company's operations. The Corporate Governance Committee should consider the relative importance of these areas to the company and determine what level of knowledge and skill the Board needs.

7. Do directors need to have experience in our industry?

Some of the Board members should have industry experience but a mix of experience is usually appropriate to provide a broad business perspective.

Directors need to understand their company's industry so they can participate in developing strategy and monitoring results. The Board should include directors with many years of experience working in the industry. These industry experts bring a depth of knowledge of the workings of the business, its suppliers, customers and competitors, and understand the risks and opportunities.

There may also be value in including individuals with little or no industry knowledge who have demonstrated their value as Board members and have the capacity to quickly learn and understand how any business works. The generalists can offer a breadth of experience and an ability to compare the company's practices with those of other industries.

8. What personal qualities should directors have?

The qualities of good directors include:

- **Integrity** — they have personal integrity and insist that the company behaves ethically.
- **Courage** — they have the courage to ask tough questions and to voice their support of or opposition to management proposals and actions. Their loyalty to the shareholders' interests may demand that they express dissent and persist in demanding answers to their questions.
- **Good judgement** — they focus on the important issues and base their decisions and actions on sound business and common sense.
- **Perspective** — they have broad knowledge and experience which they apply to discussions and decisions.
- **Commitment to learning** — they are prepared to take the time to get to know their company, know their job and stay up to date. They take responsibility for their own education in areas of their contribution to the Board and participate in educational sessions offered by the company.

Leading such a group is challenging and calls for a Chair who can manage the debates at Board meetings in a way that achieves the best outcome for the shareholders — not necessarily the wishes of management or particular Board members.

9. What behavioural skills should directors have?

The culture of a Board is as important as the skills, experience and knowledge of its members. The directors should have the behavioural skills to function and work effectively together as a collegial team.

These skills include:

- **Ability to present opinions** — they are able to present their views clearly, frankly and constructively.
- **Willingness and ability to listen** — they listen respectfully and make sure they understand what they have heard.
- **Ability to ask questions** — they know how to ask questions in a way that contributes positively to debates.
- **Flexibility** — they are open to new ideas and responsive to the possibility of change.
- **Dependability** — they do their homework and attend and participate in meetings.

10. Should directors have previous Board experience?

Boards benefit greatly from experienced directors but cannot always find the people they need on the terms they can offer. Recruiting directors with little or no experience is a way to renew and invigorate Boards provided that the newcomers have the right qualities. CEOs, CFOs and other executives and professional advisors to Boards who have been exposed to Board practices can be good prospects for directorships.

Experience on Boards of well-governed smaller companies can be a useful stage in a progression to directorship of a large public company. Service on leading not-for-profit society and government Boards can be valuable ways to gain practical experience as a Board member, provided that the organizations have high governance standards and practices.

Companies should be prepared to provide director orientation to new Board members. Chairs should recognize the need to offer clarification at meetings.

Orientation and Continuing Education

The board should ensure that all new directors receive a comprehensive orientation. All new directors should fully understand the role of the board and its committees, as well as the contribution individual directors are expected to make (including, in particular, the commitment of time and energy that the issuer expects from its directors). All new directors should also understand the nature and operation of the issuer's business.

National Policy 58-201



Conducting the search process

The most effective Boards are teams whose members all contribute their skills and experience to the challenging task of governance. Nominating good Board members requires as much time and care as assembling a strong management team, and many of the same recruitment practices.

Attracting good directors involves considering what would motivate them to join the Board. The goal is to find individuals whose interests and objectives fit the company's needs.

If the company is facing significant challenges, the Board should look for directors who enjoy problem solving and have the skills to help the company. The Corporate Governance Committee should have Board approval to speak frankly with prospective Board members to make sure there are no misunderstandings about the company's situation and expectations. The committee should be prepared to provide information on:

- the mission, vision and strategy;
- the major challenges; and
- suggestions on how individual directors can contribute.

Before approaching prospective directors, the Corporate Governance Committee should develop a recruitment package that provides background information on the organization and addresses:

- the job description;
- the time commitment;
- compensation;
- term of service; and
- other factors including share ownership and insurance.

Is there a shortage of qualified Canadian directors?

Some companies can experience difficulty in recruiting directors because:

- Independence rules disqualify certain individuals from acting as directors.
- The time demands on directors cause them to reduce the number of directorships they hold.
- Companies restrict service on other corporate Boards by their CEOs.
- The present "diversity pool" is small and overused.
- Liability concerns make Board membership less attractive to some individuals.

There need not be a shortage if companies:

- accept the reality that they may have to include some "first-time" directors on their Boards and recruit on potential rather than on experience;
- broaden their search to include more qualified women, minorities, older people, etc.;
- encourage executives on their way up to sit on Boards of other organizations for experience.

The Corporate Governance Committee should seek the views of the CEO in defining recruitment criteria, and, in turn, involve the CEO in discussions with ranked candidates.

11. What are the best sources of directors?

Traditionally the primary sources for Board members have been the personal contacts of the CEO, Chair, other Board members, corporate secretaries and senior management. Many fine directors have been recruited this way but there are risks in drawing from such a limited pool of candidates. The resulting Board may be too much a group of friends who hesitate to question and challenge the CEO and other Board members. The approach also potentially limits the range of talent and experience that is available to the Board.

// There are good people out there who are not in the pool. **//**

A member of the Directors Advisory Group.

Boards should actively seek out competent, qualified individuals who can help them understand diverse viewpoints from a wide cross section of the community. This often requires one or more champions of diversity who will make sure that the search for candidates is actively pursued until suitable candidates have been recruited.

The search need not be confined to Canada. Experienced directors from other countries can bring a wealth of governance, management, industry and geographical knowledge to the Board. It is, however, important for Board morale that the principle of equal pay for work of

equal value is observed. Foreign directors should be compensated at the same rate as Canadians.

There are growing pools of individuals who have taken steps to qualify themselves as directors. A combination of education and relevant business experience may be as valuable as extensive Board experience. Consideration should be given to the graduates of director accreditation programs such as those offered by universities, often in collaboration with other organizations like the Institute of Corporate Directors and the Conference Board of Canada.

12. How should we approach prospective directors?

CAUTION:

Approaching prospective directors is a delicate process that should respect the status and circumstances of the individuals under consideration. Experienced Corporate Governance Committees and professional recruiters generally favour an indirect approach. They:

- begin with a generic conversation about being on a Board — without naming the company;
- prepare a list of those who are interested;
- rank the candidates before approaching them;
- develop a short list of individuals of interest; and then
- contact them to discuss specifics — including naming the company.

13. What is the director's job description?

Potential directors will want to know how the governance process works in the company. A written Board charter or governance guidelines is a good way to set out the “deliverables” expected from directors, the responsibilities of the Board, Board operating procedures and any powers and restrictions that apply to directors. The charter should clearly define how responsibility is shared between the Board and CEO and the extent to which the Board is involved with the management of the company and the development of its strategy. There is a fine line between strategy, execution and Board advice. If this is not understood and recognized, it can create difficulties for the CEO and Board.

Material of potential interest to prospective directors includes job descriptions of the Chair, CEO and directors, terms of reference (charters) of committees, etc.

The board should develop clear position descriptions for the chair of the board and the chair of each board committee. In addition, the board, together with the CEO, should develop a clear position description for the CEO, which includes delineating management's responsibilities. The written mandate of the board should also set out: expectations and responsibilities of directors, including basic duties and responsibilities with respect to attendance at board meetings and advance review of meeting materials.

National Policy 58-201

14. What commitments do we expect individual directors to make?

The Board expects directors to attend meetings and to arrive prepared to participate actively and knowledgeably. In return, prospective directors want to know how much time and travel are involved in serving on the Board. The Corporate Governance Committee should be in a position to provide:

- dates, locations and durations of scheduled Board and committee meetings, with a minimum of one year — preferably two years — advance notice;
- an indication of the amount of time required to prepare for meetings and when directors receive the agenda packages;
- time commitments for committee service;
- additional time commitments for orientation, educational and strategic planning sessions; and
- expected availability for unscheduled meetings and phone calls.

15. What compensation should we offer to directors?

[See also 20 Questions Directors Should Ask about Director Compensation]

A good compensation system provides fair compensation for the services directors perform and aligns their individual interests with those of the company. Compensation should not be so high as to influence a Board member's decisions. The compensation package will typically include a cash component for attendance at meetings and a reward for longer-term performance as measured by the price of the company's stock.

CAUTION:

The level of director compensation is an extremely delicate issue and one of increasing economic significance as individuals hold fewer directorships than in the past. Compensation, once a relatively minor consideration, is now one of the top issues for prospective directors.

16. How long should we expect directors to serve?

[See also 20 Questions Directors Should Ask about Director Evaluation]

Although the permitted term of service for directors can vary by jurisdiction, most leading Boards elect Directors for a one-year term. They evaluate the performance of directors annually and re-nominate only those who are valuable to the company and willing to continue. This is not as easy as it sounds. The process requires a strong, courageous Chair and directors who are committed to it.

The board, its committees and each individual director should be regularly assessed regarding his, her or its effectiveness and contribution. An assessment should consider (a) in the case of the board or a board committee, its mandate or charter, and (b) in the case of an individual director, the applicable position description(s), as well as the competencies and skills each individual director is expected to bring to the board.

National Policy 58-201

At present, many companies have mandatory retirement ages for directors and employees. This practice is being increasingly challenged and seems unlikely to continue much longer.

A mandatory retirement age allows Boards to avoid the sensitive issue of director evaluation by letting the passage of time resolve the issue of directors who no longer make a useful contribution. It is, however, an inefficient approach that allows some directors to stay too long while denying companies the service of directors who continue to be valuable. There is no age limit to expertise and competence. Since annual nomination is the most common practice, there is no reason to retain underperforming directors for more than a year.

An alternative to mandatory retirement is the term limit. This is increasingly rare and has the same problems as mandatory retirement.

17. What other questions should we expect from prospective directors?

The Corporate Governance Committee should be prepared to answer questions and concerns from prospective directors. Particular areas of interest include:

- who else is on the Board;
- compensation;
- share ownership requirements;
- the value placed on contributions from directors;
- training programs available to directors, including financial support for attending director accreditation programs;

- leadership of the company — CEO and depth of management;
- strategic direction — why is it of interest to me?;
- time commitment — when, where, how long?;
- the annual report and financial statements;
- biggest areas of risk and opportunity;
- litigation; and
- directors' and officers' insurance coverage.

18. How should we interview prospective directors?

The Corporate Governance Committee should have a plan for interviewing candidates that covers the individuals' qualifications and interest in serving on the Board.

CAUTION:

Interviewing is a sensitive process that calls for skill, experience and situational judgement.

The traditional Canadian model is to select a finalist candidate to be interviewed by the Board or the search committee. An increasing number of Canadian companies are advising potential directors that they are being considered amongst a small group of other highly qualified executives and that only one person will be invited to the Board. The experience of recruitment firms shows that if handled appropriately, this approach is quite acceptable to the candidates being considered.

19. How should we do background checks?

Recruiting a director is as significant as recruiting a senior executive and the process should be equally rigorous for both. When recruiting people who are not well known to members of the Board or executive it is essential to conduct a background check that includes references. This has become more important as the pool of potential directors is broadened. It is also preferable not to rely exclusively on recommendations from directors and executives but to use other sources.

The fiduciary nature of directors' responsibilities makes it important that they are free from any factors that could bring into question their fitness to serve. The Board should also take steps to confirm that potential nominees do not have criminal records or restrictions imposed by regulators on their capacity to be directors or officers of a company.

Other steps could include contacting credit agencies, and confirming with professional associations that the individuals are in good standing. It is very important to check references beyond those provided by the candidate (if any). Where possible, references should be checked informally early in the search process to determine a candidate's effectiveness, behavioural style, track record of attendance and preparedness, etc. This can be a valuable way to refine the short list of suitable candidates and to avoid surprises in the more formal referencing process.

CAUTION:

Reference-checking is a difficult and sensitive process that is often undervalued and delegated to juniors. So much information can be gained by a good reference check that it should be conducted by a skilled, experienced, senior individual.

20. Does the Nominating Committee have the time and resources to conduct an effective search?

Recruiting a good Board is a time-consuming and challenging task — particularly for new companies that must recruit an entire Board or companies that need to replace a large number of directors. Boards should consider the resources available to them to determine if they are sufficient to select a good Board in the time available. A professional search firm may be a cost- and time-efficient option that can provide a more rigorous process and expand the scope of recruitment beyond the people known to the Corporate Governance Committee members.

Companies typically engage a firm that is experienced in Board search and in regular contact with current and potential directors to:

- perform a Board composition analysis — identifying gaps in the Board’s needs now and in the future;

- identify candidates who meet the search criteria;
- conduct in-depth interviews, and report to the Corporate Governance Committee the results of these interviews as an aid to ranking candidates for appropriate fit; and
- conduct detailed reference checks.

In performing recruitment services a professional search firm can provide:

- **Objectivity** — companies often want to be recognized for being highly objective in the selection of new directors — the use of an outside firm adds credibility to the objectivity of the recruitment process.
- **Due diligence and referencing** — a search firm is able to do a considerable amount of background checking on a prospective director without the referees knowing who is making the inquiry — the objectivity and anonymity of this process is one of the most highly value added components of a search firm’s service.
- **Scope** — a search firm should give a company a greatly expanded candidate list, particularly if the mandate is to seek those from outside Canada or from “non-traditional” sources within Canada.

Appendix: Director recruitment planners

Because of the complexity of most businesses, it is impossible for any one person, or even a small number of individuals, to be familiar with all of the issues that might come before a Board. By building a Board on the basis of the competencies and knowledge each individual brings, you create a Board that as an entity represents the broad expertise needed to succeed. A matrix, like the example below, can help to focus the search effort and improve the balance of the Board. It should be tailored to the specific needs of the company. Other matrixes may be developed, as appropriate.

The matrix does not contain the names of individuals to preserve confidentiality. The names and detailed résumés are provided to selected individuals on a need-to-know basis.

Background and experience matrix

Background and Experience	Directors					Prospects		
	1	2	3	4	5	1	2	3
Business case analysis								
Corporate governance								
Corporate law								
Entrepreneurial experience								
Environment								
Executive compensation								
Finance								
Financing								
Geographic — political/cultural								
Government								
Human resources								
Industry experience								
Information technology								
Internal control								
Investment								

Law								
Management experience								
Marketing								
Mergers & acquisitions								
Privacy								
Regulatory issues								
Risk management								
Strategic planning								
Taxation								
Technology								

Where to find more information

Canadian Institute of Chartered Accountants publications

The 20 Questions series

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20 Questions Directors Should Ask about Director Compensation
20 Questions Directors Should Ask about Executive Compensation
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Guidance for Directors: Dealing with Risk in the Boardroom
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Integrity in the Spotlight: Opportunities for Audit Committees

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