Ten Questions Board Directors Should Ask

(and How to Interpret the Answers and Better Manage Your Fiduciary Responsibilities)

Report by
The Governance Solutions Group and Capital Markets Board

The Governance Solutions Group, LLC.

CMB Capital Markets Board

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Introduction

Directors are in the news, a lot lately. Media reports on recent allegations of corporate misconduct, fraud, conflict of interest and bribery have made board accountability a high-profile issue - causing directors to rethink their fiduciary responsibilities and reevaluate how they govern.
Boards have a duty of care, duty of loyalty and duty of good faith ï but how do directors effectively discharge these fiduciary responsibilities? In exercising their oversight authority, directors are careful not to infringe on the operations role of management and therefore rely principally on information provided by the CEO and the senior team. Courts (and the media) will generally hold boards accountable for having asked reasonable questions to verify the reliability and competence of these management reports.

Most directors care about their organizations and understand their work is about long-term value creation. However, it is easy to get caught up in a single operating issue and to spend too much time on administrative tasks. Board agendas are packed. The binder full of pre-meeting reading materials has gotten thicker. Thereõs more ñin-between meetingò work. How does a director know what she or he doesnõt know? The answer is to stay informed, ask good questions and demand good answers. But, what questions constructively challenge management?

Thatõs why we developed these *Ten Questions Board Directors Should Ask.* Weõve taken the vagueness out of knowing what to ask and offer suggestions on how to interpret the answers. Every company is unique, but we hope these *Ten Questions* will provide a framework for knowing where to focus more board attention and how to do it. Page 9 is a one-page summary of the ten questions board directors should ask.

Sincerely,

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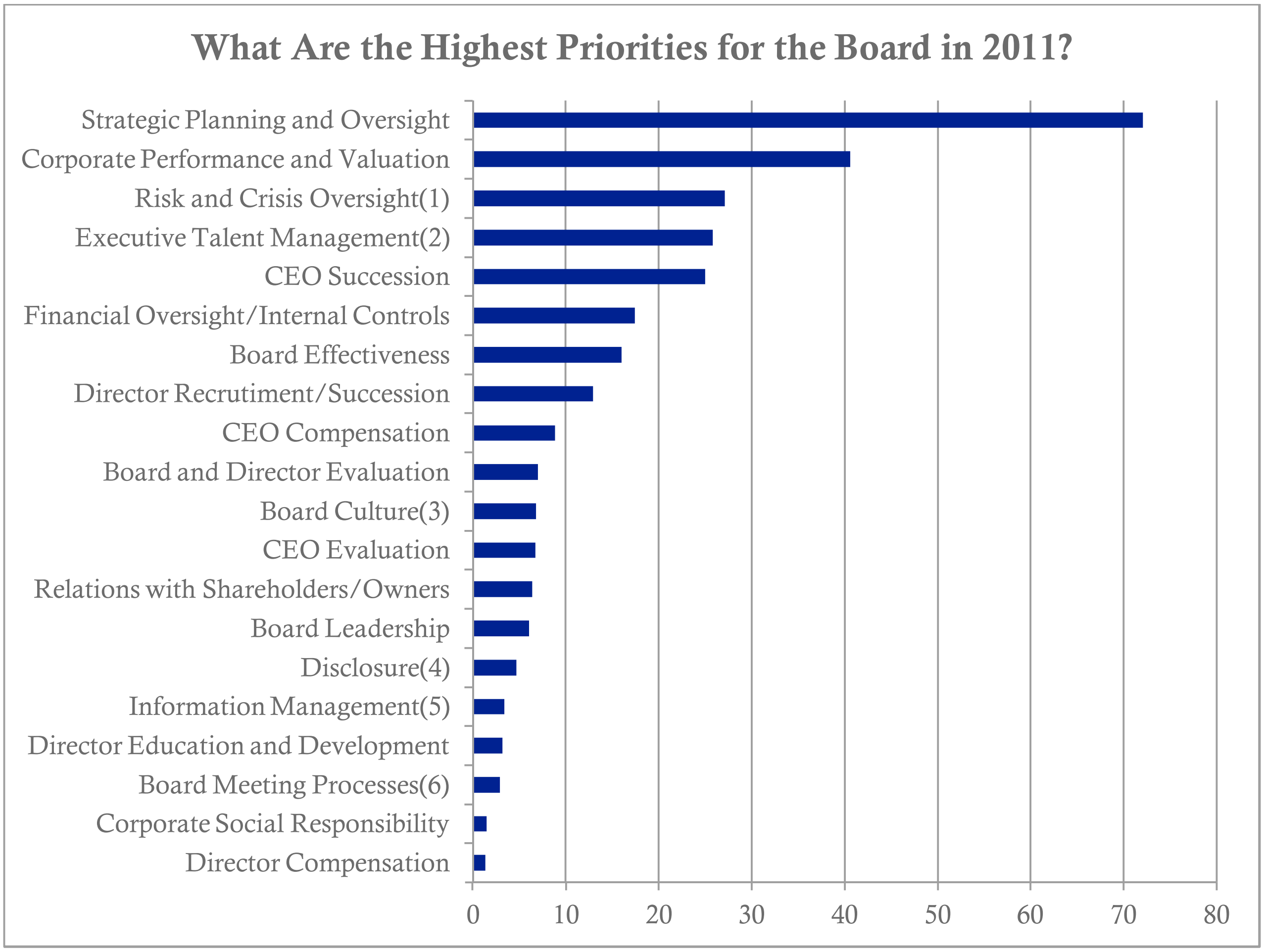
A Look Back



Source: 2011 NACD Public Company Governance Survey

Footnotes for the table above:

1. Anticipating and responding to uncertainty and crisis
2. And Leadership Development
3. Openness, mutual respect, action orientation, CEO relations
4. Ensuring transparency of financial and other information such as outcomes/results
5. Ensuring directors receive the amount, type, and format of information.
6. Agenda, committees, etc.

The questions listed in this report are the authorsô opinion of meaningful questions for directors. The answer/explanations offer discussion guidance.

Each year, the NACD surveys directors and, based on survey results, publishes the NACD Public Company Governance Guide. Additional information on the NACD survey is available at www.nacdonline.org. Many of the governance issues in the above list are reflected in this report, ñ*Ten Questions Board Directors Should Ask*.ò

Ten Questions Board Directors Should Ask

> 1. Is succession planning on the boardôs agenda at least twice a year ï and, does the discussion include three succession plan scenarios?

The hiring, evaluating and, if necessary, the firing of the companyôs chief executive officer is perhaps the boardôs most important responsibility. In good times, succession planning can slip to the back burner if itôs not prominently placed on the boardôs annualized agenda. The three types of succession plans are: planned retirement, poor company performance and emergency succession.

Good boards know that planning for the next CEO begins on a new CEOôs first day in office. Boards must plan well in advance (years, not months) for expected change and be prepared for the unexpected. Succession planning goes hand-in-hand with leadership development. Boards should know the CEOôs direct reports, have a line of sight into management ranks and be knowledgeable of the leadership development process.

> 2. Has the board agreed on its role in formulating the companyôs strategic plan ï and, does the board understand the strategic factors that shape the companyôs success?

A common frustration among board members is that they donôt know how, or how much, to be involved in strategic planning. To answer the question, the board must have an open dialogue with management about how key strategic factors are identified, verified, and how each factor affects the companyôs success. Without these answers, the board cannot effectively assure the company is on the right strategic path to respond to changes in the market and to be in a position for growth.

Engaging in company strategy gives the board the knowledge it needs to carry-out key oversight responsibilities; evaluating the CEO, and overseeing financial reporting, resource allocation, risk management and talent management. Management may spend skilled time formulating company strategy, but the board must play an active role in questioning the underlying assumptions and debating analysis. Board agendas should include ample time for strategic discussion and verification that management is effectively executing a vision that will increase shareholder value.

3. Has your company commissioned an independent investor perception study? If not, should directors ask, ñwhy not?ò

ñValue creationò has increasingly been a ñhot topicò at board meetings. Some investors may simply accept the companyôs message, but do we know investorsô ñunvarnishedò concerns and comments on company-specific value drivers? An investor perception study, conducted by a third party, involves non-threatening professional interviews with 20 or more institutional investors that are confidential and non-attributed to ensure candor.

These investor views are more in-depth than analyst reports and provide candid constructive suggestions that are critical to the future of the company will help directors stay informed on trends and issues affecting company performance and market appeal. It is insightful to hear candid and unbiased comments about the company from someone other than the company.

4. Is the perception of the companyôs value drivers aligned among investors, management, directors and other stakeholders?

It is important to know how investors view the company; and, because perceptions among investors, management, directors and other stakeholders can vary, directors should be informed of the variances and ask ñwhy?ò Ensuring alignment of perspective among various constituencies is valuable to the decision making process. The CFO of a major publicly traded company said it this way:

> *"It is important for both the board of directors and management to understand the importance of investor perceptions of the company, and understand issues that may be negatively impacting share value. This enables us to address these issues; redefine strategic initiatives, if needed and properly position the company in our presentations. When the board and management understands the viewpoint of investors and analysts on all of our value drivers, including what drives value, and important growth drivers going forward, they are able to make better decisions."*
>
> Chief Financial Officer

5. Does the board know the top three operational risks that could affect the Companyôs business ï and, the top three strategic risks?

Enterprise risk management (ERM) is top of mind in boardrooms. The discussion is an integral piece of the strategy conversation and often starts with agreeing on a common definition of the word ñrisk.ò Creating an effective ERM program takes years and management often goes through a ñprojectò stage, a ñprocessò stage and finally designs a ñfully integratedò (vs. adopted) enterprise risk management program. During each stage, effective boards ask constructive questions about risk awareness, identification of key risks, assessment, probabilities, impact, integration process, action steps, progress and mitigation planning. A common practice for boards, or perhaps the audit or risk committee, is to review a key risk scorecard at each meeting.

6. Does the board know if the companyôs corporate ethics and compliance program is successful ï and, how that success is measured?

Because itôs good business, and because a recurring theme in recent allegations of corporate misconduct is lack of ñtone at the top,ò boards are focusing more attention on ethics and compliance programs. While compliance is about doing what you are required to do by laws or rules, ethics is about doing what you should do, because it is right. Having a strong C&E program is good business. It is not about teaching employees to be ethical ï it is about increasing the likelihood that they will act ethically in all situations. It must be easier for employees to do the right thing, than to do the wrong thing. This ñtoneò starts with the board and directors should ask how the company assesses its employee culture outside of the ñCEOôs bubbleò and how the effectiveness of its C&E program is assessed. The board should periodically review the companyôs ñhotlineò protocols and require regular updates on significant issues and trends.

7. Can directors explain how the companyôs executive compensation plans work - and, how the plans actually incent management?

All directors, not just the compensation committee, should be able to talk knowledgeably about the companyôs executive compensation philosophy, targeted pay levels and incentive plans. Executive pay is almost always a ñhot buttonò with shareholders, and directors should be comfortable with pay levels, benchmarking practices and with the manner in which compensation is tied to company performance.

While the board has likely delegated compensation decisions for management to the compensation committee, the full board should have input on CEO base pay, short-term and long-term rewards. Not all directors stay current with industry practices and trends (including ñgolden hellos,ò ñgolden handcuffs,ò ñgolden goodbyesò and ñgolden parachutesò), so a periodic presentation by the chief human resources officer to the full board is valuable.

8. Do directors fully understand how the company makes money ï and, how different divisions operate and contribute to the bottom line?

Not every director needs to be a financial expert, but every director should have a clear understanding of its financial oversight role. All directors, not just the audit committee, should fully understand how the company makes money and have a working knowledge of financial reporting obligations and the internal control process.

It could be a valuable exercise to periodically hear from the CFO about her role at the company – what he does every day. The position description has broadened in recent years as CFOs focus more on the external factors that affect the company's bottom line.

9. Are directors up-to-speed on current governance trends ï and, what ñbest practicesò should be standard practices at their company?

Concerned investors, activist shareholders, loyal employees and numerous other stakeholders have legitimate interests in how directors govern. New legislation and regulation, notably the adoption of SOX in 2002, following the Enron and WorldCom scandals, and Dodd-Frank in 2010, following the financial crisis, were intended to bring in new eras of corporate governance reform. While the benefits of these initiatives can be debated and regulations have mandated certain tick-box exercises, the basic role of the board has not changed.   Directors continue to be responsible for assessing their governance processes and company performance, and for providing strategic guidance and counsel to management. Consequently, it is valuable for the Board to review best practices and to discuss the principles behind the rules relating to the issues of the day, i.e. ñsay-on-payò proxy-season post mortems, majority voting, compensation equations, sustainability.

Practically speaking, because there is not a ñone-size-fits-allò governance model, it has been helpful to some boards to ask the corporate secretary to prepare a quarterly ñgovernance updateò that briefly describes the current issues and the possible effects on the company. This document can serve as the foundation for a ñgovernance self-auditò and provide assurance that the board is at the top of its game and able to better facilitate long-term shareholder value.

One ñbest practiceò that is worthy of a call-out, is the boardôs review of its nominating process and its review of director skill sets. As the board considers the strategic issues facing the company, it should look at its own make-up and consider whether it has the right skill mix, right diversity of perspective and right culture.

10. Do directors remember the three most important action items discussed during the boardôs last annual assessment?

In the midst of important strategic and operational tasks, a board can easily forget that it is responsible for ensuring the effectiveness of its own operations. The annual board assessment is a way for the board to validate and demonstrate that it is doing a good job. Keys to a meaningful board evaluation include: clear and agreed upon objectives, use of the appropriate tool(s), response analysis, director discussion, and a follow-up plan/board objectives.

Too often, board assessments become another check-the-box exercise and fail to get to the heart of evaluating the boardôs effectiveness in carrying out its oversight responsibilities and providing strategic guidance to management. An effective assessment is a candid exploration of board culture and board work. It may include self-evaluations, peer evaluations and committee evaluations. The tools and processes used must be chosen with consideration of corporate culture and strategy. The end goal is enabling the board to continually improve and to increase its own asset value. A meaningful board evaluation and governance ñcheck-upò will help directors sleep better at night because they can be confident that they are doing everything they can to ensure that their board is top of class and the company is successful.

The Corporate Dashboard – one answer to director's "information overload"

Directors are often sent 200-300 pages of ñpre-meetingò reading materials each quarter. As a result, management is trying harder to find the right balance between quality and quantity of information. Regardless of whether directors receive materials through a web portal or still receive the traditional hard copy ñboard book,ò one way to help the directors get better prepared for meeting discussions is to require all management reports to be 1-2 pages only, with addendum materials included for reference and better comprehension.

Another helpful tool is for management to prepare a corporate dashboard that is updated for each meeting. Typically, this is a one page scorecard of key issues that compares company performance to operating and/or strategic goals and managementõs next action steps to improve performance. Corporate scorecards can be developed in-house or with the help of an external source. There are many styles and formats but, as with shaping your companyõs governance model, the format must be meaningful to your unique company.

Summary

Ten Questions Board Directors Should Ask	YES	NO
1. Is succession planning on the board's agenda at least twice a year? • *And, does the discussion include three succession plan scenarios?*		
2. Has the board agreed on its role in formulating the company's strategic plan?		
• *And, does the board fully understand the strategic factors that shape the company's success?*		
3. Has your company commissioned an independent investor perception study?		
• *"Value Creation" has increasingly been a "hot topic" at board meetings*		
4. Is the perception of the company's value drivers aligned among investors, management, directors and other stakeholders?		
5. Does the board know the top three operational risks that could affect the Company's business? • *And, the top three strategic risks?*		
6. Does the board know if the company's corporate ethics and compliance program is successful? • *And, how that success is measured?*		
7. Can directors explain how the company's executive compensation plans work? • *And, how the plans actually incent management?*		
8. Do directors fully understand how the company makes money? • *And, how different divisions operate and contribute to the bottom line?*		
9. Are directors up-to-speed on current governance trends? • *And, what "best practices" should be standard practices at their company?*		
10. Do directors remember the three most important action items discussed during the board's last annual assessment?		
✓**If you checked "no," should this topic be on your board's next agenda?**		

Source: The Governance Solutions Group and Capital Markets Board

Take time to look at the quality and quantity of your boardôs pre-meeting reading materials. What would make meeting preparation more effective? Should you consider a corporate scorecard, a one page dashboard that highlights performance metrics and perhaps requiring one page summaries of lengthy board reports?

About The Governance Solutions Group

The Governance Solutions Group is a governance advisory practice. Services for boards of directors include facilitating the annual board and committee assessments and helping directors to better understand the boardôs fiduciary and oversight responsibilities. GSG also assists boards in developing orientation and education plans, mentors new directors and CEOs new to boardroom protocols, and shares practical guidance to help directors establish key succession and leadership development plans.

For more information, visit www.governancesolutionsgroup.com

About Capital Markets Board

Capital Markets Boardôs business is making companies more valuable. Everything we do is built around improving shareholder value creation and alignment. Alignment of management, board and investors, linking and integrating value drivers with the broader strategic plan ï thus unlocking shareholder value. Disconnects between management, the board and shareholders lead to dissatisfaction, discontent, lower stock value and negative impact throughout the entire organization. *Some companies exceeded 175% stock price appreciation in the first six months*.

For more information, visit www.capitalmarketsboard.com

CMB provides three main areas of service which support those foundational components:

- Strategic Improvement
- Improve Messages To investors
- Executive Assimilation

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