



Non-executive recruitment: the role of internal audit

This is the first of five pieces from an internal audit perspective on the 2018 UK Corporate Governance Code: Non-executive recruitment (1), **Viability statements** (2), **Audit committee effectiveness** (3), **Culture** (4) and the **Workforce voice** (5).

Recruiting non-executive directors (NEDs) is important not only for the organisation but for internal audit. As governance leaders, they are conceivably the most important aspect of the safety net on which stakeholders depend. So why shouldn't their recruitment fall within the governance remit of internal audit.

Fishermen know the daily catch depends on the quality of their nets; they check them, maintain them and value them. Internal audit has a partnership role with the board to ensure that the organisations safety net is also checked, maintained and valued. Starting with recruitment. Although the Code is for the private sector audit leaders in the public (independent directors) and charity (trustees) sectors should still find it relevant.

RECAP. On 16 July 2018 the Financial Reporting Council (FRC) published its long awaited update to the UK Corporate Governance Code together with revised Guidance on Board Effectiveness.

The revisions support the government's vision of restoring trust in the corporate organisations and the broader social reform agenda which aims to improve the standard of living and quality of life for ordinary working people.

Partnering with the board

Chief audit executives (CAE) have a unique role intrinsically linked to governance, strategy, operations and everything in between with a direct reporting line to the lead/senior NED.

Whilst the outside world put NEDs on a pedestal, expecting superhuman powers of reasoning and foresight, CAEs understand that they are ordinary human beings with their own fallibilities, concerns and limited time to contribute. In confidence and with integrity, CAEs have the opportunity to build relationships with their NEDs to become trusted advisors.

Supporting the board to improve its recruitment process also benefits audit leaders as the impact of an underperforming board has serious ramifications for effective governance and the remit of internal audit. NEDs are under increasing pressure as part-time observers to govern full-time executives...a robust partnership with their CAE is as critical as their capability to perform the role.

Consider for a moment your own board and sub-committees. You know who they are? Are the current NEDs appropriately skilled? Is the board balanced? Does the recruitment process work -is it formal or ad hoc? There is always room for improvement.

Recruitment expectations

An effective board begins with securing the right NEDs for the organisation to provide oversight and direction on risk taking, culture, strategy and control. Fishermen buying poor quality nets operate at high risk regardless of whether they know the best fishing grounds or have the best boat. The same is true of NED recruitment. Does your organisation have a nominations committee? Who chairs it?

In addition to organisational requirements and specific personal qualities there are generic skills that NEDs should have;

Confidence	Integrity	Sound judgement
Mature attitude to risk	High ethical standards	Entrepreneurial
Conflict management skills	Able to communicate ideas	Active listening skills
Willingness to challenge	Commercial acumen	Co-operation and teamworking
Persuasiveness	Political astuteness	Leadership and gravitas
Continuous learning approach	Strategic / Critical thinking	Tenacity
Facilitation skills	Willingness to embrace change	Sense of humour

The **Code** details principles and provisions directly related to recruitment, summarised as;

- Principle J
 - advocates board diversity with appointments based on merit
 - demands a formal, rigorous, transparent recruitment process
 - requires succession planning to be in place
- Principle K
 - requires boards to consider their combined skills, knowledge and experience
 - encourages refreshing membership and mindfulness of tenure
- Provision 7 obliges conflicts of interest to be declared and addressed
- Provision 15 acknowledges the risk of 'overboarding'
- Provision 19 limits chair tenure to nine years
- Provision 20 open advertising, executive search agencies noted in annual report

The **Guidance on Board Effectiveness** (p25) includes questions the nominations committee should consider. It is an essential read for all audit leaders to understand the practicalities of governance from the perspective of the board.

1. Have we assessed what skillset is required for the board and its committees?
2. Do we reassess the make-up of the board as a result of emerging trends?
3. Do we take account of the technical skills and knowledge required by the committees when recruiting members?
4. How often is a skills audit undertaken and are we keeping up with the pace of change?

Role of audit leaders

Activities of the board are a sensitive matter to raise and audit. CAEs may wish to think about their approach, is a formal assurance report appropriate or is consultancy activity more appropriate?

Board Skill Matrix

Within the Australian governance code the use and reporting of a board skill matrix relevant to the organisation is mandatory...perhaps in time the UK will follow this progressive thinking.

A skill matrix requires the board to engage in self-assessment and effectiveness planning, it also supports succession planning. It is a simple yet valuable instrument. Does your board use one? If not, CAEs are well positioned to propose one. An example is included in the toolkit.

Not only is it a discussion lever for the board it is also useful for CAEs to use in helping to identify governance partners for specific audit challenges/exec relationships. Why should CAEs not be building powerful partnerships with all governance leaders, not just the chair of the audit committee.

Recruitment Process

The code requires a formal, rigorous and transparent process not a random ad-hoc activity due to its infrequency. CAEs uncomfortable with auditing their board can take comfort that Principle J also applies to senior management so engagements can have a broad scope.

Although not a direct participant, CAEs may have 'gut feel' on how robust this process is? Does it warrant auditing? Although a straightforward audit, it provides an opportunity to surface issues of diversity, recruitment bias and culture; topics that can be hard to broach and may perhaps be deemed to be a 'no-go' area for internal audit.

If issues of recruitment bias are known, a CAE is well placed to raise the topic constructively. It is not possible to address this without participants being aware of the issue. Consideration of a **hiring committee**, extension of the nomination committee may be worthwhile.

Provision 20 of the Code states that NED appointments should be advertised openly or a specialist agency used. It is unacceptable for 'networks' to be the sole source of candidates.

Tips to overcome unconscious bias

1. Talk about it as a board
2. Maintain vigilance, regularly reflect and review
3. Review the wording in job profiles/advertisements
4. Review cv blind, no personal information such as age, sex, name
5. Standardise interview questions
6. Score interviews and include 'likeability'
7. Set diversity goals for the board
8. Test candidates

In response to the 2011 Davies **report** executive search agencies developed a **voluntary code** addressing the principles that support diversity. Has your organisation's agency signed up to it? How was the agency selected? The provision also states that external search consultancies are identified in the annual report confirming independence or noting connections to the company or directors.

When CAEs are recruited, they often meet the audit committee chair to ensure mutual respect and compatibility. Is the same courtesy extended to incumbent CAEs when a new chair is recruited or promoted? Is this an achievable goal for the profession or even for your organisation?

Job Profile/Advertisement

Academic research has found that typically words such as competitive and determined attract male applicants, whereas collaborative and cooperative appeal to women. It is important that there is a balance of gender bias words or use of neutral words to create text. **Free tools** are available to help with this.

Are your organisations advertisements/job profiles compelling? Are they well written, inspiring and culturally accurate? Do they represent the aspiration for future or reflect the issues that need to be overcome?

Succession Planning

Recruitment even at the NED level can be aided by succession planning. Is another NED being mentored to replace the chair? Do they sit on the appropriate committees?

How is a pipeline of diverse, future NEDs being generated? Is it an attractive organisation to join? What role does senior management/stakeholder communications have in promoting the benefits of being a NED within the organisation? Marketing and reputation are key elements of generating a healthy talent pool.

Principle K states that board membership should be regularly refreshed. There is a balance between

consistency, corporate knowledge and new perspectives. Transition planning ought to form part of board thinking, new members joining in advance of year end/strategy days to allow time to get up to speed and recognising specific skill gaps during any periods of unplanned vacancies. Ideally expiration of tenure and notice periods for resignations should provide sufficient planning time for hand-overs. CAEs should be alert to any risk that transitions presents to the quality of decision making.

Induction

The most robust selection process can quickly be undone; recruitment must also include the induction of new board members. This is particularly critical where cultural change is in progress. What is their on-boarding programme? CAEs must ensure they are part of this, not just for a new audit committee chair but for all NEDs.

CAEs should be aware of the needs of the board through relationships with the existing NEDs, chairman and company secretary. Is the new member clear on their remit? Not the role of a NED but why they were recruited, was it a particular skill, experience, positive diversity etc.

It is incumbent on CAEs to gain assurance that the NEDs fully understand governance, risk management and internal control. Any concerns must be addressed, thoughtfully and thoroughly, through coaching and explanation of the role of internal audit. CAEs are well placed to offer annual refresher training to boards on aspects of governance, risk and internal control.

Closing Thoughts

In the modern world of commerce, NEDship's are no longer about 'who someone knows' but 'what they know'. CAEs are the conduit between the profession and the corporate world, educating the board is a fundamental part of the future of corporate governance in the UK. The partnership of CAEs and governance leaders is vital to the recruitment of the next generation of NEDs.

Hiring the right people takes time, the right questions, and a healthy dose of curiosity
Sir Richard Branson

Further reading:

2018 [UK Governance Code](#)

2018 [Guidance on Board Effectiveness](#)

2011 [Davies Report](#)_Women on Boards

2009 [The Walker Review](#)_UK Banking Governance

2003 [Tyson Report](#)_Non-Executive Recruitment

2003 [Higgs Report](#)_Effectiveness of Non-Executive Directors

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