Good Governance Guide

Creating and disclosing a board skills matrix

Board structure

It is **good governance** for a company to create a skills matrix in relation to its board of directors. A skills matrix identifies the skills, knowledge, experience and capabilities desired of a board to enable it to meet both the current and future challenges of the entity. The creation of a board skills matrix is an opportunity for considered reflection and productive discussion on how the board of directors is constituted currently and also how it believes it should best be constituted in the future to align with the strategic objectives of the entity.

The board skills matrix should always be tailored to the unique circumstances and requirements of the company concerned. What is suitable for a small start-up company may be quite different from what is suitable for a large corporate group. The boards of listed versus unlisted entities may have different requirements. What is suitable for a company operating in one industry sector may not be relevant to a company with operations in another industry sector. Similarly, a company that operates across a range of different industries and perhaps countries will have different requirements of its board than a company operating in a single industry and country. These factors underline the importance of not copying another company's board skills matrix.

Importantly, the creation of a board skills matrix is separate from its disclosure. For listed entities, it is **good governance** to disclose the skills matrix or a summary of it. Disclosure will also meet the recommendation in the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* for companies to have and disclose a board skills matrix that sets out the mix of skills and diversity that the board has in place or is looking to put in place.

For listed entities, disclosure of a board skills matrix can provide insight to investors as to the board's thinking on the skills that are needed for the board to supervise the business. However, while unlisted entities will find it useful to create a skills matrix, they may not reap any benefit from disclosing it. Each company will need to consider its own circumstances and decide whether or not, depending on its members, disclosure of the skills matrix will bring benefit to the members.

Ultimately, creation of the board skills matrix is aimed at clarifying board thinking, while disclosure of the skills matrix is aimed at providing confidence to investors/members as to the board's decision-making in this regard.

This Guide outlines the issues a company and its board need to consider when developing a skills matrix, as well as the issues attached to disclosure of the matrix. It will be for each entity to decide the format of its board skills matrix and whether and how to disclose it to its shareholders and stakeholders.

Identifying the existing skills on the board

A skills matrix identifies:

- the current skills, knowledge, experience and capabilities of the board, and
- any gaps in skills or competencies that can be addressed in future director appointments.

A company needs to consider possible approaches it could take to identifying the existing skills and competencies on the board. These may include the following:

- The chair, with the assistance of the company secretary, may review the competencies and experience of each board member, with the chair making an initial assessment of the existing skills for review by the board.
- Each director may be supplied with a questionnaire asking them to self-assess and identify their competencies, skills and experience.
- The nomination committee may review and assess the competencies and skills of each board member, either following completion of a questionnaire by each director or by some other method. The nomination committee could be charged with ongoing oversight of the process of board composition and renewal.

- The board as a whole may review and assess the competencies of board members, either following completion of a questionnaire by each director or as part of an overall collaborative approach to assessing board skills.

Regardless of which approach is taken, the board needs to consider the criteria that will be applied for assessing the existing skills, knowledge, experience and capabilities on the board and the requirements for the future. A number of different lenses can be applied to the assessment process, including identifying:

- executive and non-executive experience
- industry and sector experience or knowledge
- leadership
- governance
- strategic thinking
- desired behavioural competencies
- geographic experience
- subject matter expertise
  - accounting
  - capital management
  - corporate financing
  - industry taxation
  - risk management
  - legal
  - IT expertise
  - HR expertise and/or experience in workplace health and safety
  - marketing
  - environment and sustainability
  - public policy or government relations
  - community relations
- other factors relevant to the particular company.

This list is not exhaustive. Each board will need to decide for itself which lenses are most suitable to apply to the assessment of skills for that company. For example, the lens of industry and sector experience is likely to trigger examination of other competencies related to the particular industry or sector.

When assessing the skills and competencies desired to align with the strategic objectives of the entity, the board can also assess the current and desired diversity that it seeks in its membership, taking into account all aspects of diversity. A board may also wish to take tenure into account when considering its composition.

A board also needs to consider whether it wishes to give a weighting to the skills, experience, knowledge and capabilities of directors, through the use of a ratings system, such as 'High', 'Medium' and 'Low' and/or whether this has been gained in a management or non-executive context. This also gives the benefit of gaining a deeper understanding of skills.

Creation of the skills matrix

A skills matrix is a document created primarily for internal purposes to enable the board to form a view as to the effectiveness of the board and to inform board renewal and succession planning.

It is **good governance** for the board and company to consider the creation of a skills matrix not as a compliance obligation (if the organisation is a listed entity) or a report card on the competence of individual directors, but as a means of identifying the competencies and skills desired by the board as a whole to fulfil its role and in light of the organisation's strategic direction. It can also be useful to reflect on any gaps in skills and competencies that may be created by the forthcoming retirement of a director or directors or any change in the company's strategic direction. This process will inform the appointment of new directors.

When creating the skills matrix, a board needs to consider whether:

- it might list individual directors and their skills and competencies as it seeks to assess the depth of board skills overall
- it might list any gaps in board skills that the assessment process has revealed.
- any gaps that have been revealed are matters that need addressing in the near future. For example, a small company may lack subject matter expertise on the board. However, given it is a small board due to the size of the company, and given that there is the relevant subject matter expertise on management or external subject matter experts could be invited to

provide input, the board may decide that expanding the board to include such subject matter expertise is not of the highest importance at this stage in time

- professional development initiatives can address any technical deficits, for example, external training in particular skills or internal training with executives providing further information
- any gaps that have been revealed need to be addressed through board renewal.

Review of skills matrix

It is **good governance** to review the skills matrix annually, to ensure that not only the current needs in relation to supervising the company and its operations are being met, but also so that any skills can be identified that may be sought as the strategy is implemented and the environment in which the company operates changes.

If a nomination committee is charged with board renewal and the process of reviewing and making recommendations to the board on director appointments and reappointments, it should undertake the annual review of the skills matrix.

Disclosure of the skills matrix

Listed entities will take into account that the ultimate aim of the recommendation in the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* is to provide insight to investors as to the board's thinking on the skills needed to supervise the business.

Unlisted entities will need to decide if disclosure brings benefits to members.

It is **good governance** for the board to be actively engaged in the discussion as to how the company will disclose the skills matrix and whether all elements of the skills matrix prepared as an internal document for the board will be disclosed.

The disclosure of the skills matrix is required in the annual report for listed entities. It should be noted that while the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* recommend that listed companies have and disclose a board skills matrix, the form of this skills matrix is not prescribed. The board and company will need to consider if the skills matrix will be disclosed as:

- narrative, or
- a table, or
- a combination of narrative and a table.

A board and company will also need to consider if it will:

- list the current board skills and competencies, according to whichever lens has been applied to the assessment process.

  If the company discloses the specific skills it has identified as desirable, it needs to consider if it will specify how many directors hold those skills and whether to identify those directors.

- identify the gaps in skills that may have been revealed.

  While disclosure of the skills matrix is intended to provide investors with confidence that the board has turned its collective mind to the skills needed to supervise the business, there can be a tension between the transparency needed to provide insight to board thinking and the need to ensure that any disclosure of gaps in board skills is not seen as detrimental to the company. Identification of inadequate skills or competencies in one area does not of itself indicate a dysfunctional board. It is likely to indicate a board that is actively considering which skills and competencies will add value to meet the strategic objectives of the entity.

It is **good governance** to consider how best to address this tension in disclosure. For example, if a board skills assessment reveals a gap in skills that the board has identified as important to the supervision of the company and its operations, the disclosure of such gaps may need to be accompanied by narrative explaining why the board is of the view that the current mix of skills is suitable to the needs of the company.

The level of disclosure will depend on the company's circumstances. For example, a company in a particular life cycle stage or market may need to be very precise in its disclosure of the board skills that are sought, in order to address investor concerns. A board of a broad-based company may not have any gaps in board skills and competencies and may not need to be so detailed in its disclosure.

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Issues to consider in board evaluations

Board structure

It is **good governance** for an organisation to implement a process for regular, formal evaluations of the board, its committees and individual directors as well as addressing any issues that may emerge from that review.

A formal periodic evaluation not only involves examining past and current performance, but has a strategic focus in looking forward at how the board can add further value to the performance of the organisation.

Benefits of board evaluation

Board evaluation can provide a board with meaningful information as the basis for improvement, and will assist in optimising board performance and effectiveness.

A formal evaluation process is an opportunity to:

- assess the extent to which the board believes it is meeting its responsibilities at law and as set out board and committee charters, and whether those charters are still fit for purpose or require change
- review whether individual directors are meeting the time requirements of a non-executive director and whether they have sufficient time capacity going forward
- clarify individual and collective roles in the organisation's governance system
- optimise the effectiveness of board and committee meetings
- reflect upon the relationship between the board and management
- identify areas for improvement in internal and external reporting, including information provided by management to the board and its committees
- examine areas for training and development of board members
- review the effectiveness of the board's strategic thinking and decision-making
- review board and committee composition (the development of a board skills matrix will also assist in this regard — see *Good Governance Guide: Creating and disclosing a board skills matrix*)
- assess board behaviours and provide team building opportunities among directors.

Objectives

First, the board should establish the purpose of the evaluation. Clearly identified objectives enable the board to set specific goals for the evaluation and make decisions about the scope of the review. Each organisation is unique and each board will need to determine its own role and basis for operating. This will often change as the organisation itself evolves. The board needs to articulate its expectations of high standards of performance to set a benchmark against which it can measure itself.

The periodic board evaluation is an ideal time to assess the board's composition, and develop the board skills matrix as recommended by the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*. This is also an opportunity for directors to indicate areas for the individual and collective development of skills and knowledge so that the company secretary can develop an ongoing education/development program for directors.

Disclosure

ASX-listed entities will need to take account of the recommendation in the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* that a listed entity should have and disclose a process for periodically evaluating the performance of the board, its committees and individual directors; and disclose whether a performance evaluation was undertaken in accordance with that process.

Disclosure of the process and undertaking of a board evaluation in a reporting period is aimed at providing confidence to investors that the board takes governance seriously and is committed to regular, critical evaluation of its performance with an objective of improvement.

The *process* of board evaluation enables critical examination of the board's operations and how it can improve its effectiveness and performance. The board needs to consider whether it is appropriate to disclose detailed outcomes of board evaluations that do not create sensitivities, to provide the confidence that investors/members seek, with year-on-year monitoring of outcomes and follow-up. How any such outcomes are communicated is important, as any room for improvements noted in the evaluation should not be taken as flaws or dysfunction in current board practices.

While unlisted entities will find it useful to undertake board evaluations, they need to consider if disclosing the process or the fact that one was undertaken is of benefit. Each organisation will need to consider its own circumstances and decide whether or not, depending on its members, disclosure of the board evaluation process will bring benefit to the members.

Method and timing

The board needs to decide the best methodology for undertaking a board evaluation. The method chosen may differ from year to year. The different options available include:

- internally or externally facilitated review
- questionnaires and/or interviews
- group and/or individual appraisals.

A board should set a time for the periodic review of its performance as part of its annual calendar of commitments. It should establish the terms of the review, its performance measures and expected outcomes, and garner the support of all the directors in the process.

An external reviewer may be used every second or third year, with the board conducting an internal review in the alternate years. An external review can be supplemented by a review of the committees or a review of the independent directors in the intervening years.

APRA-regulated entities are required under the prudential standards to undertake a review at least annually of the board's performance relative to its objectives, as well as a review of individual directors in this regard.

Internal review

A board may choose to conduct individual interviews, using questions designed especially for the exercise and administer it internally. An internal evaluation may be conducted under the leadership of the chair, or the lead independent director or deputy chair (if one has been appointed), or a board committee chair, and the company secretary. An alternative internal approach is for the board evaluation to be led by a special board committee or the nomination committee. Selecting the right questions is the first step to ensuring that the board review questionnaire is appropriate to the needs of the board and the organisation.

It can be beneficial to make the review process an inclusive one and collect this information from a broader sample of key stakeholders, including senior management and the company secretary, as well as major shareholders, who may have knowledge and opinions of the board that could differ from those of the directors themselves.

External review

An external facilitator has the advantage of providing an impartial appraisal process and an unbiased reporting of the review findings. Directors are more likely to contribute openly if they can do so confidentially. If the decision is taken to use an outside group, the external reviewer is likely to suggest individual interviews, using questions designed especially for the exercise.

Individual director assessments

A confidential question and answer session can give board members the opportunity to comment on the strengths and weaknesses of their colleagues. These comments can be compared to the answers given by the directors about themselves. Any peer review that examines the contribution of individual directors requires a sensitive approach, with buy-in from all involved.

If there is a feeling that a particular individual has been not contributing effectively or is disruptive and that change is necessary, a director review may become an important part of the process of change.

A review of the performance of the chair is an important aspect of individual director assessments, and they should be evaluated as a director and the leader of the board. A lead independent director, who may be the deputy chair (if appointed), or a board committee chair may assist in this process.

Informal evaluation

While a formal board evaluation may be undertaken only periodically, informal board evaluation can be undertaken more regularly to provide more immediate and ongoing feedback. Different methods can be considered, including:

- directors holding a private session after the formal board meeting to assess how the meeting was conducted, looking at the quality of the information provided, the quality of presentations given, the quality of debate among directors and the way in which directors reached decisions
- a director being appointed by the board to provide feedback to the other board members on how the meeting was conducted and board performance. The appointed director contacts the other directors after the board meeting seeking their feedback and collates the responses, which are provided without attribution to the directors at the next board meeting.

Measuring performance

Establishing KPIs that are measurable and relate directly to the board's role and sphere of influence is important in ensuring a valid assessment process. This can be a difficult objective to achieve even when establishing them is a desired outcome from the board review. Measurements of board performance are likely to be both quantitative and qualitative.

While the key issues may change from year to year, it is desirable that the process remains stable. This puts the onus on the board to establish a robust process so that various measures can be compared from year to year, and if there is a marked deterioration, corrective action can be taken quickly. It will be clear to the board if performance generally is improving or deteriorating.

The company secretary

One element of the board evaluating its own performance is to monitor the effectiveness of the company secretary in their role of being accountable to the board, via the chair, on all matters relating to the functioning of the board. The board should consider setting performance goals and key performance indicators for the company secretary and review the company secretary's performance against them.

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Options for board evaluation

Governance Institute of Australia

Board structure

The ASX Corporate Governance Council's guidelines require listed entities to disclose whether or not they have had a board performance evaluation during the year. It is considered **good governance** for a listed entity to have a policy that requires the entity to carry out performance evaluations of the board and its committees from time to time which are appropriate to the entity. The matters to be considered could include the following:

What are the purposes of the evaluation?

- improving the effectiveness of the board to achieve objectives
- identifying any issues for improvement
- clarifying individual and group roles
- team building among board members
- improving relationships between the board and management
- improving corporate performance.

What is to be evaluated?

- the administrative arrangements
- performance against the agreed role of the board
- the attainment of strategic objectives.

Who will be evaluated?

- the board
- the committees
- the chairman
- the chairmen of the committees
- individual directors
- the company secretary.

How will the evaluation occur?

- internally or externally facilitated
- questionnaires and/or interviews
- group and/or individual appraisals.

Who will be involved in the evaluation?

- board only
- senior management
- recently departed directors.

How is the evaluation reported?

- confidentially
- presentation to the board.

Who is the evaluation provided to?

- the chairman only
- the board.

Consideration needs to be given to how often should the evaluation should occur. It is good governance for an externally-facilitated evaluation to take place every two to three years with an annual internal evaluation in the intervening period.

It is also good governance for a regular review of the implementation of the recommendations arising from the evaluation to be undertaken.