EY Center for Board Matters

How to achieve enduring board effectiveness
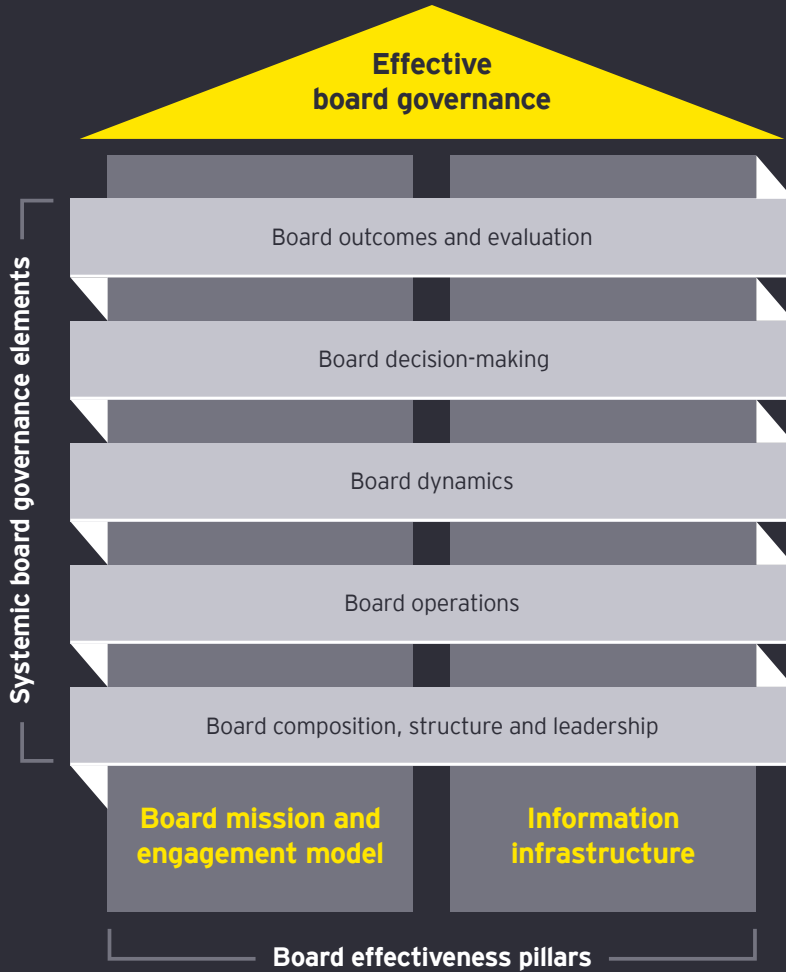
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In a world of constant change, a company's board plays an important role in helping move it forward amid rising complexity, innovation and periodic crises while remaining true to its purpose and values.

Knowing that the business, operating environments and stakeholder priorities will continually change in subtle or seismic ways, boards must help steer companies in the right direction. Boards can execute this critical responsibility by adopting proven approaches to drive, measure and achieve their own effectiveness to better oversee their companies' strategic success and drive long-term value.

In brief

▸ Leveraging the right framework supports boards as they effectively fulfill their oversight role, position their companies for strategic success and drive long-term value.

▸ A strong mission and clear engagement model along with effective information practices are foundational pillars for board effectiveness.

▸ Boards that strive for effective composition, operations, dynamics, decision-making, and evaluations can achieve effective board governance.

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July 2022 | 1

Effective board governance

Systemic board governance elements

- Board outcomes and evaluation
- Board decision-making
- Board dynamics
- Board operations
- Board composition, structure and leadership

Board mission and engagement model

Information infrastructure

Board effectiveness pillars

EY Center for Board Matters enduring framework for board effectiveness

The EY Center for Board Matters has developed a comprehensive approach and framework for understanding and enhancing board effectiveness. The framework includes a series of elements that must be intact for board performance to flourish.

Board effectiveness pillars

Two foundational "effectiveness" pillars guide the work to be done by the board. These flow through five "systemic" layering elements that embody the board's operating environment.

Systemic board governance elements

With a strong mission and engagement model supported by effective information practices, boards have a solid foundation for effective performance. The systemic board governance elements encompass the operating model and principles of an effective board.

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July 2022 | 2

Board effectiveness pillars

Pillar 1: Board mission and engagement model

The board's fundamental mandate is to provide insight, foresight and oversight on mission-critical issues that drive the company's governance as it advances its strategy, operations, financial performance, and stakeholder engagement to drive long-term corporate value. Guiding this mission are the board's own values.

In today's business context, such mission-critical issues are expanding the traditional purview of the board and demanding oversight of complex, fast-evolving external risks and opportunities like those related to climate change, cybersecurity, and shifts in the political and social landscape. Companies, and increasingly their boards, are being called to weigh in on policies and positions related to the company's values that may challenge its relationships with stakeholders. The board plays a significant role in overseeing that the company's strategy, operations and policies are aligned with the company's stated purpose and values.

Effective board directors must do the work to be as well prepared as possible, stay abreast of governance issues, and look to continually improve their performance. Of course, boards cannot do these things without efficient and effective

engagement with each other, management, advisors and key stakeholders. Key engagement goals include communicating with, inspiring and empowering others as well as providing effective guidance to management.

This board effectiveness pillar is also anchored by the idea that boards can achieve higher levels of effectiveness when they develop a shared mission, engagement model and vision for excellence that they document in the company's corporate governance guidelines.

Writing down and communicating these standards provides a clear North Star that guides boards in progressing the company's purpose, strategy, performance and long-term value, regardless of circumstances. The engagement model documentation should also describe the board's engagement model around policy, strategy and risk topics, and include details about when the board will weigh in, when it will vote on various topics, which policy-setting elements require board insight, and when it must be consulted before management can act. This clarifying model is critical to a high-functioning board and forms the foundation of the work to be done.

Evidence of an effective board mission and engagement model

▸ The board's corporate governance guidelines articulate the board's purpose, values and core engagement strategy and practices.

▸ Every board member can consistently state the board's mission and the company's purpose, strategy and long-term value proposition.

▸ Board members and management are in clear agreement about the mission-critical company issues that demand board oversight.

▸ Each board member individually embodies core traditional leadership values and skills, including ethics and integrity, diligence and conscientiousness, executive-level communication skills, and a commitment to progress.

▸ There is clarity as to the company's core policies, strategies and risk management approaches, and when and how the board engages to oversee them.

Pillar 2: Information infrastructure

Effective boards are rooted in the diligent design and maintenance of reliable and efficient information practices that provide timely access to the highest-quality information and people (e.g., advisors, stakeholders, customers) needed to identify, illuminate and address evolving mission-critical issues.

Boards should be specific with management about their information needs so that management is not overburdened with immaterial questions and potentially driven to expand board materials to include tangential information or excessive detail.

An effective board information infrastructure delivers in a timely way board meeting materials that are complete, accurate, clear, and concise. Tailored benchmarking can provide insight to boards on how their company compares with others, including the operational gaps and resource allocation needed to improve. Current and forward-looking information about complex and emerging issues should be presented in understandable forms, including graphics where appropriate and helpful.

Boards should regularly ask, "What information can we get — from whom and in what form — that will help us more clearly identify, understand, analyze and act on mission-critical issues?" They should not randomly reach out to management for information but look to the company's corporate secretary to help manage information requests in a way that is mutually effective for boards and management.

It can help to develop a board reporting and notice matrix that lists the matters that require board oversight (mission-critical issues) and those that do not (management matters). It's also important to address how matters in the gray area should be handled. For example, in what circumstances does management need to notify the board, and should that happen promptly or at the next meeting? This kind of matrix can provide the backbone of an effective information infrastructure and a foundation for a rational board decision-making matrix.

Boards should never rely solely on management for their education and information. Broader and more strategic engagement, both inside and outside the company, is necessary for boards to obtain the information they need. Boards should ask for reporting on customer, supplier and other key stakeholder behaviors, trends and related economic headwinds and opportunities. Board members should also get into the field to see firsthand how the business operates and bring direct insights back to the boardroom for discussion.

Consultation with independent advisors is increasingly important on emerging and complex issues. Also, it has long been understood that board members, with their rich and diverse backgrounds, are expected to provide their perspectives, stay informed and bring insight and information to the board and the company.

Evidence of effective board information infrastructures

▸ Board meeting materials include a cover memorandum that succinctly describes in a clear narrative form all items on the board agenda.

▸ Technical documents, such as financial reporting, equity compensation plans, merger agreements or other material contracts, are fronted with a one- or two-page (max) executive summary of material terms.

▸ All board materials are presented with draft resolutions clearly specifying the matters the board or its committees are being asked to act on.

▸ Boards and management are diligent about how they engage with each other to share information, respecting established communications channels and security issues.

▸ Neither the board nor management feels unduly overburdened with information overload or requests for information, respectively.

▸ The board regularly hears perspectives from third parties on critical issues and complex matters.

Systemic board governance elements

Board composition, structure and leadership

Making effective determinations about the competencies, backgrounds and experiences needed on the board is key to building a strong board, keeping in mind that diversity across multiple dimensions is essential to board effectiveness.

Based on an understanding of the companies' strategies and emerging mission-critical issues, key stakeholder demands, and increasing regulatory scrutiny of board effectiveness, boards should develop and maintain, in collaboration with senior management, a competency map (or board skills matrix) that identifies and scopes the skills and type of experience needed on the board. This analysis, which should have a forward-looking orientation, enables a more accurate and objective determination of effective board composition, size and committee structure.

The best board members have traditional leadership values and skills, such as strong ethics and integrity; diligence and conscientiousness; an executive-level ability to communicate with, inspire and empower others; and a commitment to progress. Besides these qualities, board members should demonstrate curiosity, a continual learning mindset and a forward-looking entrepreneurial energy. They should be well prepared, stay abreast of governance issues and look to continually improve their performance.

Board size is largely dependent on the competencies needed on the board and should therefore be flexible and change as necessary based on the circumstances. Every director should understand and acknowledge that board seats are not open-ended guarantees: His or her presence on the board will be based on the board's needs for his or her individual competencies and performance on the board. Processes for director refreshment and on- and offboarding directors should be clear and timely, and board succession planning should be evergreen.

In view of the board's collective competencies, boards should strategically allocate member talent across committees. Due to regulation and exchange requirements, boards have established audit, compensation, and nominating and governance committees and financial services-regulated risk committees. Today, more boards are establishing other standing committees to absorb some of the work overload faced by existing committees and/or to drive focus on strategic issues. Our research indicates that the most common additional committees are executive, finance, risk, and compliance committees. Additionally, ad hoc committees can be very useful in nimbly addressing important shorter-term board matters.

Even when committee structure is established, questions arise around whether and how to allocate certain mission-critical board matters effectively across committees. For example, risk and technology continually expand and metamorphosize. The focus on environmental, social and governance (ESG) matters is also evolving to highlight historical long-term value drivers and illuminate new priorities. We see that boards are allocating

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July 2022 | 5

such topics across multiple committees, with certain overall responsibilities resting with the full board.

Effective board and committee leadership is critical. Board committees themselves should select their chairs based on competencies and leadership ability. Any board leader, whether an independent chair or lead independent director, must be dynamic, organized and free of any conflicts of interest.

Board renewal or refreshment, like diversity, is seen as a significant driver of board effectiveness. Data shows that effective board refreshment can lead to better corporate performance and avoid board staleness or complacency.[1] To support effective refreshment, boards should engage in evergreen director succession planning.

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Evidence of effective board composition, structure and leadership

- ▸ The board maintains, in collaboration with management, a detailed board skills matrix in assessing board size and composition.

- ▸ The board's corporate governance guidelines and committee charters clearly allocate roles and responsibilities between the board and its committees, including mission-critical issues such as strategy, risk, culture, compliance, technology, cybersecurity, and climate change.

- ▸ Board members periodically move across different committees, and committee structure and composition are reasonably fluid based on the company's needs.

- ▸ Committee chairs regularly collaborate on the most effective ways to govern overarching board responsibilities relating to strategy, risk and long-term value.

- ▸ Board and committee oversight responsibilities are periodically revisited as business environments and priorities shift.

- ▸ Committee chairs report to the board when they need additional resources, refreshed competencies or workload reallocation.

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[1] "Why companies must seriously consider board refreshment," podcast discussion with Neil Amato and Charles Elson, *Journal of Accountancy*, April 13, 2020, available at https://www.journalofaccountancy.com/podcast/corporate-board-refreshment.html.

Board operations

After carefully designing the right board structure, the right operating practices must be implemented for effective governance. Board and committee leaders should know what mission-critical issues they need to address and collaborate with management to develop and maintain meeting schedules and orientation programs with appropriate frequency, sufficient time and relevant content. Meeting and orientation agendas should drive scheduled meeting times rather than the other way around.

Using last year's calendar to create this year's is no longer an effective practice. Boards and committees should anticipate spending more quality meeting time, both in person and virtually, in discussion with – vs. hearing presentations from – management, independent advisors, employees and other key stakeholders. All directors should understand that it is their duty to come prepared to engage, discuss issues and deliberate at meetings and not simply to review board materials and hear presentations.

Time is an issue. Many boards lament that there is not enough time for board governance necessities. To help,

boards should get clarity on mission-critical company issues to help reduce board scope; improve the board information infrastructure to obtain timely, high-quality, clear and concise information on current and emerging mission-critical issues from the right people; use unanimous written consents for board or committee action on routine noncontroversial matters (or in other appropriate circumstances); and/or make more time.

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> Boards and committees should anticipate spending more quality meeting time, both in person and virtually, in discussion with — vs. hearing presentations from — management, independent advisors, employees and other key stakeholders.

Evidence of effective board operations

‣ Board and committee meeting schedules and core agendas are formalized for the upcoming year or two, reducing scheduling conflicts and director absences, but flexible to meet board and company needs.

‣ Board meetings are focused on discussion and deliberation, do not run over time, and agenda items are not deferred until a future meeting or converted at the last minute to a request for unanimous written consent.

‣ Board members do not suffer surprises at board or committee meetings.

‣ Executive sessions of the independent directors, with and without management present, are reasonably planned

and appropriately documented in the company's books and records.

‣ All directors attend all (or a vast majority of) meetings of the board and committees on which they sit.

‣ The board calendar (still) includes a two-day off-site meeting for strategy, long-term value and related matters, including talent, capital allocation and budgeting, but strategic topics are also included in routine meetings.

‣ Board orientation is carefully tailored to the needs of the company and the board – time and resources are not expended on "template" learning.

Systemic board governance elements

Board dynamics

A positive board dynamic is one of the most critical elements in achieving board effectiveness. Many also believe that consistently maintaining a positive board dynamic can be challenging. For this reason, all board members, especially board leadership, need to work to nurture and consistently demonstrate respect and trust for each other. Without a culture of respect and trust, boards cannot engage in constructive debate and instead devolve quickly into dysfunction. In their discussions and deliberations with each other, at meetings and informally, all board members should show evidence of their commitment to the board's mission, values and engagement model through active, informed and productive engagement.

All board members should actively seek out, hear and share new learnings, points of views and ideas. Board members should be intentional about diversity so they can gain enhanced perspectives that enable better problem identification and solution, stronger innovation and reduced blind spots. To elicit broad perspectives, all directors must be receptive to differing points of view and boards must practice inclusion – making space for fresh ideas.

Board members also need to exercise practical professional skepticism and hone their skills for engaging in candid and constructive debate. Each director must call up the courage and conviction needed to raise red flags, within the board itself and with management, and obtain satisfactory answers before lowering them. All board members should have an appreciation for and seek to build a culture of continual feedback.

Achieving a highly collaborative culture requires intentionality and skill, especially since board members will have different competencies, backgrounds and personalities to meet diverse company needs. Boards should acknowledge and proactively look to avoid the potential for bias, disconnect or misunderstanding. Upgrading individual communication skills and conflict resolution is one approach.

Informal and constructive director communications between board meetings can improve director understanding and focus; however, directors must ensure that any critical offline conversation is brought to the full board as necessary. Boards should also work to schedule social opportunities and events for board members to meet and find common interests outside the boardroom to increase camaraderie and drive diverse board member inclusion.

Positive board dynamics include the board's relationships with management. Boards should be mindful about developing and maintaining a strong rapport with management to enhance trust, information flow, and strengthen their respective performance.

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> Board members should be intentional about diversity so they can gain enhanced perspectives that enable better problem identification and solution, stronger innovation and reduced blind spots.

Evidence of effective board dynamics

▸ Director participation at meetings is balanced: No single director or group of directors dominates agenda formulation, discussions or deliberations, and no single director or group of directors is passive or disengaged.

▸ If interviewed, each director would state that he or she felt included, heard and respected, and that all members demonstrate respect and trust.

▸ There are no "camps" or "factions" among board members or among board members and management.

▸ Directors say something when they see something, and the board takes appropriate action.

▸ The board engages in informal ways between meetings to enhance trust and build personal connections.

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July 2022 | 8

Systemic board governance elements

Board decision-making

Boards should be highly conscientious and intentional about when and how they make decisions. Leading boards develop a process to support effective decision-making, based on applicable state and relevant laws and the board's mission and engagement model. This process should include a clearly articulated "authority matrix" or RACI (Responsible, Accountable, Consulted, Informed) model maintained in alignment with the information infrastructure practices described previously. Simple RACI mapping that highlights various board topics and defines who (e.g., full board, management, a particular committee, lead director) is responsible or accountable for making the decision and who must be consulted or informed after a decision is taken can be incredibly effective around clarifying the decision-making process.

The matrix should be detailed enough to define for management when it must seek board approval to act and what the process is to communicate relevant information on matters not requiring board decision but still part of the governance process. Boards and management should agree on when the board expects to be consulted or informed about matters not formally requiring board approval or notice.

When engaged in the decision-making process, boards should diligently assess whether they have all relevant information. They should ask whether there are gaps in their knowledge or understanding, identify and examine key assumptions, and have practices to discover and address any biases or blind spots. They should ask probing questions and demand satisfactory answers

about issues before them. For highly complex or significant matters, boards should work with the CEO or other members of senior management to fully understand all aspects of the matter. And, of course, boards must comply with their organizational and governance charters, including bylaw provisions, corporate governance guidelines, committee charters and, as relevant, company agreements calling for board approvals on certain matters (such as around valuation, indebtedness, specific policy, etc.). Decisions must also be documented in board minutes, so it is clear what agreements have been achieved.

For every matter before them, boards should question and assess how well the decisions they may make align with the company's purpose, culture, strategy, risk tolerance profile, and sustainability goals. Boards need to spend the time, access appropriate resources and consider alternative scenarios and outcomes before making final decisions.

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> For every matter before them, boards should question and assess how well the decisions they may make align with the company's purpose, culture, strategy, risk tolerance profile, and sustainability goals.

Evidence of effective board decision-making

▸ The board and management maintain a delegated authority matrix, specifying corporate business matters that require board decisions.

▸ The board maintains a checklist of approval requirements in its organizational documents and under relevant law.

▸ The board chair establishes appropriate transparency around director voting by discouraging informal decision-making discussions and overseeing that the board's books and records are in order.

▸ The board does not make decisions without sufficient considerations about the quality of the information, timing, and risks and rewards.

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July 2022 | 9

Systemic board governance elements

Board outcomes and evaluation

The ultimate outcome of a high-performing board is reflected in the success and prosperity of the business itself. A board should see the evidence of its efforts manifest in company financial performance, including growth through the innovation it fosters and cost reduction from the risks it helps the company avoid.

Indeed, investors, regulators and other stakeholders are seeking greater board effectiveness and are increasingly interested in board evaluation processes and results. The final component in the pyramid includes a board evaluation process that not only results in a more effective board, but also leads to investor trust.

A rigorous and strategic evaluation, especially when facilitated by an independent third party, allows boards to more objectively examine whether individual directors, board committees and the full board have the skills, experience, judgment, dynamics, and processes necessary to act as effective stewards of their companies and what changes may be implemented to enhance board effectiveness. Board and individual director self-evaluation plus peer evaluation can enhance board and personal performance as well as unmask board and director dysfunction.

Ongoing evaluations should encourage and maintain a real-time feedback process where directors provide constructive advice and criticism on current board operations or performance. This effort can identify how certain processes could be adjusted to drive greater relevance, clarity and conciseness.

Prior to designing and implementing an evaluation process, boards should determine the specific goals and objectives they want to achieve. The process should not be used simply as a way to assess whether the board, its committees and its members have satisfactorily performed their required duties and responsibilities. Instead, the evaluation process should be designed to carefully test whether the board's composition, dynamics, operations and structure are effective for the company and its business environment, both in the short and long term.

Leading boards use targeted questions with the goal of eliciting valuable and practical feedback about board dynamics, operations, structure, performance and composition. High-quality feedback is what enables boards and directors to see how they can better perform and communicate, with the result that the company itself better performs and communicates. Template evaluation questionnaires cannot achieve the same depth of insight as a well-drafted, bespoke questionnaire.

Additionally conducting one-on-one interviews as part of the evaluation process can elicit valuable, detailed, sensitive and candid director feedback that may not be captured through questionnaires alone. Hiring an independent third party to facilitate the evaluation can meaningfully enhance the objectivity and rigor of the process and results. Third-party specialists provide new and different perspectives that can lead to improved action item development and evaluation results.

> " **High-quality feedback is what enables boards and directors to see how they can better perform and communicate.**

Evidence of effective board outcomes and evaluation

- ▸ The board, its committees and each director conducts a self-evaluation annually, enhanced by third-party facilitation when needed.

- ▸ The evaluation process results in the identification of concrete actions the board agrees to take within a specified period to enhance effectiveness through the achievement of specific milestones.

- ▸ The board's collective competencies map to the company's strategic and technical needs.

- ▸ The company's disclosures around the board evaluation process enhance trust in the board.

Conclusion

A highly effective board of directors is a great asset to a management team and a critical component of company success. Our experience finds that boards must deliberately manage the board effectiveness pillars to be certain they are working on mission-critical elements of the business and procuring the right information to drive decisions. Also, high-performing boards carefully address each element of the systemic governance framework to establish the use of an optimized approach that directly drives board value.

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July 2022 | 11

Questions for the board to consider

‣ How does the board evaluate whether management is "living" the company's purpose and values as described in the company's code of business conduct and ethics?

‣ How does the board engage with management in rigorous ongoing analyses of material and mission-critical growth drivers, risks and opportunities?

‣ How can board materials evolve to include narrative stories that explain matters being presented to the board as well as practical dashboards, graphics, data, and key performance indicators?

‣ On mission-critical issues, how does the board diversify its information sources beyond management by engaging with independent advisors to broaden its perspective?

‣ Do the board's corporate governance guidelines provide clear standards for director qualifications, continued service, tenure, and removal?

‣ Has the board discussed using additional committees to address expanding board or committee roles and oversight responsibilities, particularly around risk, technology, cybersecurity, climate change, human capital management, and material ESG matters?

‣ Does the board calendar make sufficient time for board engagement with management, key investors and other stakeholders, and independent advisors?

‣ Is every director consistently prepared for board and committee meetings, as demonstrated by his or her engagement and contribution? And if not, how is that feedback provided?

‣ Is the board effectively managing and leveraging diversity in backgrounds and perspectives? Is there sufficient diversity in views to promote progress in the board's mission?

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Effective corporate governance is an important element in building a better working world. The EY Center for Board Matters supports boards, committees and directors in their oversight role by providing content, insights and education to help them address complex boardroom issues. Using our professional competencies, relationships and proprietary corporate governance database, we are able to identify trends and emerging governance issues. This allows us to deliver timely and balanced insights, data-rich content, and practical tools and analysis for directors, institutional investors and other governance stakeholders.

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