It’s ironic that the one group with the power to decide the fate of a company — the board of directors — is the one group in an organization that is often randomly selected, rarely evaluated, and almost never held accountable. But that is changing.

One key manifestation of the power shift to the board is the move to transparency and accountability. Thus, board and committee assessment is increasingly appreciated — and required — as an essential element of best practices. The New York Stock Exchange requires its issuers to conduct annual assessments of the full board and each of the mandated committees — audit, compensation, and governance. As of January 2006, the Securities and Exchange Commission will require mutual funds to assess their boards and committees. And D&O liability insurance providers are rewarding organizations that conduct assessments with preferred client status.

As the responsibilities of boards escalate, more is expected of committees. So, separate, comprehensive committee assessments are increasingly important. All directors must be confident that their committees are effective and focused. Audit committees in particular, responding to the enormous compliance mandates of Section 404 of Sarbanes-Oxley, have undergone tremendous reform and scrutiny. Costs are huge. Intel and Cisco each spent some $20 million to comply last year. Smaller companies likewise are spending millions for compliance. Committees meet for longer periods and more often. An extreme is the approximately 80 audit committee meetings that PeopleSoft held during its 18-month takeover battle with Oracle.

Compensation committees are next. Consider the situation at the NYSE. If the compensation committee members had conducted a substantive evaluation, would the scale of the executive pay packages been revealed and understood? Could the board have taken action in time to avoid the crisis it confronted?

A specific focus
Committee assessments are similar to overall board assessments, but their focus is specific to committee mandates and to the committee’s effectiveness in serving the requirements of the full board. The accompanying exhibit displays the elements that an assessment approach, and the specific tool used to conduct the assessment, should provide.

The Board Institute — committed to the belief that the only people who can assess a board’s effectiveness are those in that boardroom — has developed an approach to respond to the recommended assessment criteria. A suite of integrated tools includes The Board Index, The Audit Committee Index, The Compensation Committee Index, and The Governance Committee Index to help companies benchmark, demonstrate, and enhance best practices in governance.

As a representative example of our approach to committee assessment, the Audit Committee Index is an objective, 360-degree, board-driven, confidential evaluation tool to allow a company to assess the strengths of its audit committee and highlight areas for improvement. It is completed by directors and others who...
work closely with the audit committee.

The audit committee content was developed in collaboration with the Financial Executives Research Foundation of Financial Executives International (FEI) as well as leading financial and governance experts. Mark Edwards, a Ph.D. in survey research who is often called the “father of 360-degree feedback,” validates the methodology, construct, and resultant data.

**Applying the assessment tool**

*Here is how the Audit Committee Index works:*

1. Specify the number of respondents who are board members and non-board members. At the discretion of the audit committee, others who work closely with the committee are encouraged to respond — such as non-director officers, external auditors, and financial consultants.

2. Designate an administrator (typically a respondent). The administrator may be the audit committee chair, the governance chair, the CFO, the legal counsel, the corporate secretary, or perhaps a consultant such as a CPA or risk management professional.

3. The administrator receives a password and logs on to the system through the Web to complete the brief company information section. This information is used to set certain options in the survey for scoring purposes, and to reference benchmarking information.

4. The administrator keys the system to notify respondents to complete the survey, sets the timetable, and tracks completion rates.

5. At his or her convenience, each respondent completes the survey, which takes approximately 15 to 20 minutes and consists of about 70 questions. Alternatively, the board might choose to complete the survey during a board retreat. The survey is completed anonymously and securely, online or on paper, and offers a range of options in responding, including an opportunity to make anonymous comments when desired. The online survey can be completed in more than one session without losing any answers. If there are key metrics important to the committee that are not included, the index can be customized to reflect those.

6. Upon completion of the surveys, the admin-

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**Assessment tools: What to look for**

*In choosing an assessment approach, look for a tool with the following characteristics:*

- Independence and objectivity
- A comprehensive approach that is both qualitative and quantitative
- Serves public and private organizations
- Evaluates the effectiveness of the committee by focusing on performance rather than process and going beyond compliance and being complementary to compliance tools
- An approach based on the broad range of relevant experience and expertise
- Scalability
  - All directors should be respondents, and at the board’s discretion, include those working closely with the committee, such as non-director officers, external auditors, consultants, attorneys, and perhaps even shareholders
- Security and confidentiality
- Respondent anonymity

- Ease of use
- Speed of use
- Validated methodology
- Exclusive allegiance to the board
- Absence of conflicts of interest (i.e., assessment provider not selling other services)
- Substantive report with current information:
  - Nonprescriptive
  - Generates a positive experience in the boardroom
  - Educational
- Reporting of results controlled and managed by the board or, at the board’s discretion, a designated administrator or consultant
- A standalone diagnostic to platform a focused discussion in the boardroom and/or supported by an attorney, CPA, compensation consultant, governance expert, or other relevant consultant
- Can be readily benchmarked
  - Against best practices
  - Internally
  - Against peers

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*— Susan F. Shultz*
The following is a template used by a New York Stock Exchange company for its board committees to conduct a self-evaluation. “Committee Interaction and Dynamics” (exhibited below) is the first part of the three-part evaluation; the other two parts focus on “Committee Meeting Characteristics” and “Committee Effectiveness.”

<table>
<thead>
<tr>
<th>Committee: ________________________</th>
<th>For Year: _____________</th>
<th>Date: ______________</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Current State</td>
<td>Future State</td>
</tr>
<tr>
<td>Performance Rating (check one)</td>
<td>Comments?</td>
<td>Any Ideas for Improvement?</td>
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<td>Acceptable</td>
<td></td>
<td></td>
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<tr>
<td>Needs Improvement</td>
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</tbody>
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### I. Committee Interaction and Dynamics

A. Quality of participation/discussion at committee meetings?

B. Committee acts with common purpose?

C. Committee willingly and constructively engages difficult matters when necessary?

D. Mix among committee members of collegiality/respectfulness and candor/frankness?

E. Balance of committee interaction with management between support and challenge?

F. Management’s candor and willingness to appropriately engage committee in discussion?

G. Management and committee chairman support of and flexibility in accommodating committee members’ needs/interests?

H. Overall effectiveness of committee chairman in facilitating committee’s work?

Anything you want to say about this area not covered above?

Source: Directors & Boards
istrator locks the system, and the responses are automatically compiled, taking into account specified variables affecting that company, such as size, type of board, and the exchange it’s traded on, if any.

7. The resulting report, titled Inventory, is available online and/or in printed format, depending on the preference of the committee. The inventory highlights strengths and areas for improvement and the range of responses. A detailed inventory of the individual questions show the mean, variance, and range of responses, as well as any individual anonymous comments. It includes specific best practices, current exchange mandates, regulations, and legal requirements.

8. The committee can choose to discuss the results internally, perhaps facilitated by the audit committee chair, the CFO, treasurer, chief accounting officer, or corporate secretary.

9. Alternatively, the committee may choose to have an external consultant, perhaps a consulting CPA or governance expert, work with the committee to dig more deeply into key issues and develop an action plan. The Audit Committee Index is designed to serve as a platform for such consultation.

For confidentiality purposes, there is no identifying information in the Board Institute system. The anonymity can be valuable. A controversial compensation plan was recommended in an anonymous comment, discussed in the boardroom, and rejected. Had the board known the CEO was the author, the outcome might have been different. In another situation, a director of a NYSE company revealed a serious conflict that was previously unknown.

A credible sense of effectiveness
If directors and officers can be confident that they have credible insights into the effectiveness of their board and their committees, they can improve their boards and reduce risk. Most important, they can turn their attention back to adding the strategic value that undergirds every great board.

You get what you measure. Outcomes include the ability to attract the best directors, spend more time on strategic discussion, enhance transparency, improve shareholder relations, provide targeted information and education, engage in more interactive and focused discussions, and objectively evaluate the committee’s effectiveness and value.

Even if a board’s practices are affirmed, assessment is a positive. The focus is where it should be—on best practices. The opportunity is to move beyond compliance to a strategic board that adds value to the business. This can only be to the good.

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