

CIPFA's submission to the EU on the Green Paper: The EU Corporate Governance Framework

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CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

As the world's only professional accountancy body to specialise in public services, CIPFA's portfolio of qualifications are the foundation for a career in public finance. They include the benchmark qualification for public sector accountants as well as a postgraduate diploma for people already working in leadership positions. They are taught by our in-house CIPFA Education and Training Centre as well as other places of learning around the world.

We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance public finance and support better public services.

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1 Introduction

1.1 CIPFA's main sphere of interest is the public services. Rather than addressing all aspects of the EU Corporate Governance Framework we have therefore focussed on a small number of areas where we feel we have a relevant contribution to make.

2 General comments

2.1 In CIPFA's view, one issue for the EU to consider is how the Corporate Governance Framework can reinforce the message that good governance must be demonstrated by the personal conduct of those responsible for governance arrangements within companies. The board should set the tone of the company by creating a climate of openness, support and respect. Board members should act in ways that exemplify high standards of conduct and ethical behaviour. The standards of personal behaviour expected of board members and of staff should be clearly defined and communicated through codes of conduct and protocols.

2.2 It would be helpful for the Corporate Governance Framework to emphasise the need for decision making to further the company's objectives and strategic direction in the medium and longer terms. Companies need to ensure that their decisions are made with appropriate rigour and scrutiny and that underpinning systems and procedures encourage development of strategies and actions which are sustainable in the long term.

2.3 Key policies should be clearly articulated and disseminated throughout the organisation to ensure they are adhered to and that there is clarity for decision making purposes. The company's key overall policies should act as a framework for sound decision making.

- CIPFA has carried out significant work in leading the debate on governance arrangements in the public services. Two of our more recent projects in this area - although focussed on the public service organisations - may have relevance to the EU's work. They are the development and promotion of the *Good Governance Standard for Public Services* and CIPFA guidance on the *Role of the Chief Financial Officer*.

The Good Governance Standard for Public Services

- In 2004, CIPFA and the Office for Public Management (OPM) with support from the Joseph Rowntree Foundation established an independent commission to consider how the key principles of good governance should be applied to all publicly funded organisations. The Commission, chaired by Sir Alan Langlands, subsequently developed and published *The Good Governance Standard for Public Services* to provide guidance for directors and governors of public bodies (a copy is attached).
- The Standard builds on the Nolan principles for the conduct of individuals in public life by setting out six core principles of good governance for public service organisations. It shows how these should be applied if organisations are to live up to the Standard and provides a basis for the public to challenge sub-standard governance. Although this publication is aimed at public rather than private sector organisations, it may be an interesting model for comparison purposes and cross referral. For example, the appendix which identifies questions which members of the public should ask to test governance in public bodies may stimulate thinking about similar lines of questioning by shareholders.

The Role of the Chief Financial Officer

2.7 CIPFA has been developed a statement on *The Role of the Chief Financial Officer in Public Service Organisations*, (draft attached). Although its focus is again on the public services, the approach documented here may have real resonance in the private sector.

2.8 The chief financial officer, as the organisation's most senior finance professional, occupies a pivotal role, both for external stakeholders and

within the leadership team. Chief financial officers everywhere have a responsibility to ensure that their organisations control and manage money well, and that strategic planning and decision making are supported by sound analysis. In the public service context, chief financial officers must also meet the demands of openness and accountability in decision making, balance competition for limited resources across a range of worthwhile objectives, deliver value for money and safeguard taxpayers' money. However, in both the public and private sectors the mere existence of the chief financial officer does not ensure that financial governance is subject to effective leadership and oversight.

2.9 Delivering the responsibilities outlined above requires careful positioning of the chief financial officer role within the overall governance framework and structure as well as a range of personal qualities. CIPFA's Statement sets out five principles that should apply to ensure that a chief financial officer is positioned correctly in practice. They define core activities and behaviours that belong to the role of the chief financial officer:

The chief financial officer:

- is a key member of the leadership team, helping it to develop and implement strategy and to resource and deliver the organisation's strategic objectives sustainably and in the public interest
- must be actively involved in, and able to bring influence to bear on, all material business decisions to ensure immediate and longer term implications, opportunities and risks are fully considered, and alignment with the organisation's financial strategy
- must lead the promotion and delivery by the whole organisation of good financial management so that public money is safeguarded at all times and used appropriately, economically, efficiently and effectively.

To deliver these responsibilities the chief financial officer:

- must lead and direct a finance function that is resourced to be fit for purpose
- must be professionally qualified and suitably experienced.

2.10 For each principle the Statement identifies the key responsibilities of the chief financial officer role within the organisation. Summaries of personal skills and obligations then detail the leadership skills and technical expertise organisations can expect from their chief financial officer. These are drawn from the key requirements of CIPFA and the other professional accountancy bodies' codes of ethics and professional standards to which the chief financial officer as a qualified professional is bound.

2.11 The Statement sets out a compliance framework reflecting the organisational requirements to ensure that the chief financial officer is able to operate effectively and perform core duties successfully. It recommends that organisations should report publicly where their arrangements do not conform with the compliance framework.

2.12 Since there is a huge range in the size of public service bodies and in

the scope of services delivered, the CIPFA Statement adopts a 'substance over form' approach. It focusses on the principles that capture the essential characteristics of the chief financial officer role in any public service organisation.

3 Issues for comment

Should the EU seek to ensure that the functions and duties of the chairperson of the board of directors and the chief executive officer are clearly divided

- In CIPFA's view, the chair and chief executive should share in the leadership role. The chair's role is to lead the governing body, ensuring it makes an effective contribution to the governance of the organisation; and the chief executive's is to lead the organisation in implementing strategy. A good working relationship between the two can make a significant contribution to effective governance.
- The chair and the chief executive should be separate and provide a check and balance for each other's authority. We believe that the EU should encourage this clear division of roles.

Should recruitment policies be more specific about the profile of directors including the chairman, to ensure that they have the right skills and the board is suitably diverse? If so, how could that be best achieved and at what level of governance ie at national, EU or international level?

- The board should assess the skills that members need to fulfil their functions. It should appoint board members who have these skills using an open and skills based recruitment process.
- The board should decide how to encourage people from a wider cross section of society to become board members to ensure suitable diversity. This includes reviewing the board member's role to ensure that it is coherent and feasible within the support available and that it is sufficiently well understood by potential board members. The search for a more diverse membership should not be at the expense of a membership that has the necessary skills.

Do you agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted?

- CIPFA supports the 'comply or explain' concept, but for it to work effectively, non-executives and shareholders must be sufficiently well informed to challenge non-compliant behaviour and to understand that it is their role to do so. In CIPFA's view, it maybe helpful to emphasise this point in 2.1 of the Framework. At present, CIPFA is concerned that the 'comply or explain' concept may make it too easy for companies to justify non-compliant behaviour without significant challenge.

- Linked to this is the need for directors, managers and shareholders to feel fully confident and comfortable in their ability to ask the right questions. Nothing should inhibit them from offering constructive challenge. Companies need to create a climate of openness, support and respect which will enable all stakeholders to maximise their contribution to the success of the company.

Should disclosure on remuneration policy, the annual remuneration report and individual remuneration of executive and non-executive directors be mandatory?

- In CIPFA's view, the remuneration committee – and the board as a whole – should ensure executive remuneration arrangements promote long term sustainable performance and appropriate risk taking. There should be clear linkages to the long term development of the business which points to a balanced scorecard of performance measures rather than excessive emphasis on financial results. It may also be helpful to use a system of deferred bonuses to ensure that there is a much stronger linkage to long term success. This should also help ensure retention of key staff.
- CIPFA believes that boards need to take into account the way their remuneration arrangements will be viewed outside the company. Transparency is important in establishing and maintaining the confidence of shareholders, other stakeholders and the general public.