

**The Role of Boards: a summary of the main issues from the Audit
Scotland report (September 2010) for a Scottish Government non-
executive directors event (13 January 2011)
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In September 2010 Audit Scotland published a report on the role of boards in the Scottish public sector. It covered 67 public sector bodies and 39 colleges as they existed in March 2009 and it looked at the role of boards and how they are accountable to the Scottish Government. The skills and expertise of board members; and how boards operate.

Background to the report

There were two reasons for preparing this report. One reason was the start of the new era in Scotland's public finances. There is a real cut in the Scottish budget for 2011/12 and further reductions to follow through each year until 2015. Having been speeding along in our top spending gear with the needle set at over 5% per annum real growth, we are going into reverse without slowing down, and without a financial route map that will take us beyond the next twelve months. At the same time, there are pressures from all sides, notably from the ageing population and other growing demands for public services. So we have budgets cuts and demand increases bringing us close to something like a "perfect storm". The hard times that lie ahead will test the resilience of boards and their governance systems. Now is a good time to look at how boards operate and to identify the main issues relevant to ensuring their future strength and effectiveness.

The second reason for looking at how boards work is that they will play an important part in navigating through the storm, because boards control a large slice of the Scottish public spending. Of the total Scottish budget, only about 15% is administered directly by the Scottish Government, with separate organisations in the NHS and local government taking roughly 1/3 each. What role can boards play, not only in managing the short and medium term resource reductions, but also in helping to redesign how Scotland's public services are delivered to make them as effective and efficient as possible?

If boards are to contribute well to addressing the challenges that lie ahead, the accountability arrangements need to be transparent, robust and fit for purpose. The right people need to be in place with the right skills, experience and commitment to get the job done in difficult times. And boards as collective entities need to work well.

There are the three main themes in the Role of Boards report:

1. The system of accountability
2. People and relationships
3. Board performance

Before looking at the three themes, it is worth noting that boards can look very different from each other. In the group of organisations covered by our audit, the average board has 14 members, 12 of whom are non-executive members. It has six committees supporting its work and meets seven times a year. In the private sector, by way of comparison, the boards of FTSE 100 companies have an average of 11 members.

The average masks a wide variation. Two boards have 32 members. The smallest board has four members. Some boards are wholly non-executive. In others, for example executive agencies, executives form the majority. Some boards have just one committee, namely the audit committee. At the other end of the spectrum there are over twenty committees.

The system of accountability.

Boards are an important connection between public bodies and Scottish Ministers, then to the Scottish Parliament and ultimately to the electorate. That system of accountability can be seen as complex and hard to understand. For example, chief executives, as accountable officers, have a formal accountability to Parliament as well as to their boards. The report attempts to clarify the picture.

The system has evolved piecemeal over a long time, rather than being the result of a considered view of what works best. Sir Gus O'Donnell, the Cabinet Secretary, said recently at the UK level:

“The more I look into these bodies, the more convinced I am that the current situation owes far more to history than it does to operational effectiveness.”

I would suggest that this observation might also apply to some extent in Scotland, since large parts of the current system pre-dates devolution. If we are considering a redesign of the public sector, should we think about whether the system could be improved?

People and relationships

The nature of public bodies' relationships with the Scottish Government varies. Within the collective body of government there are longer arms and shorter arms – NDPBs are more arms-length than either NHS bodies or executive agencies. And some NDPBs are more arms-length than others.

NDPBs' experience of their relationship with the Scottish Government can vary depending upon the individual civil servants whom they deal with. Sponsors are the conduit through which the relationship between boards and ministers is managed. Given how critical NDPBs are to the delivery of major services, it is essential that there is a really good relationship between an NDPB and the part of the Scottish Government that sponsors it. An individual public body will probably find that the nature of the sponsor relationship will vary over the years, depending on whether or not there are any high profile political or policy issues affecting the board's work. There will inevitably be tensions in the relationship between central government and public bodies. It is difficult to foresee these tensions disappearing. As the financial environment becomes more challenging, it will be increasingly difficult for boards to balance the imperatives of getting costs down, delivering more efficiencies, but at the same time preserving staffing standards and safeguarding and improving services. The report suggests that the Scottish

Government might seek ways to strengthen the sponsorship role as we enter challenging financial times.

Board chair/chief executive relationships are vital for good board performance. If these work well, the organisation can perform. If they don't, then there is a strong chance that board performance will suffer. Both the chair and chief executive clearly have a leadership role to play. These roles are different and complementary. They must support each other in every way but each is also an important check and balance on the other.

The most important factors in determining the performance of any board are the quality of the people on the board and how well they work together. We need to attract talented people from a diverse range of backgrounds to become non-executive board members. There must be a mix of talents that will help the board to function well. Ronnie Mercer, chair of Scottish Water, was one of a panel recently giving evidence to the Public Audit Committee on the Audit Scotland report. In the course of his remarks he said "I am not looking for the non-executive people on our board to make their reputation. I am looking for people who arrive with a reputation to lose." A strong board will have members who are there with a track record of success and a wealth of experience: it will have experts to question and advise; and it will have people who know well the communities and client groups affected by the board's work. It is of the greatest importance to ensure that there is clarity about what talents, experience and backgrounds are needed for a board, and for the appointments process to achieve the required balance and diversity.

Having the right qualities in applicants is as important as attracting the right numbers. However, the report picked up that there was a decline in number of applications for public appointments between 2004/05 and 2008/09. The Audit Scotland team heard that potentially good applicants might have been put off by the general perceptions of public bodies which are fuelled by biased media stories and the use of pejorative terms such as "quangocrats". They also got the impression that there may be a disincentive arising from the

nature of the appointments process and how long it took – on average, six months.

The Scottish Government has been taking steps to revise and improve the public appointments process and it is most encouraging that the Commissioner for Public Appointments has reported a significant increase in applications during 2009/10.

There seems to be an issue about the time commitment that is expected of chairs and board members compared with what is actually needed. Once someone joins a board, it seems very frequently the case that the time taken up by board duties was greatly in excess of what was expected – on average 30 per cent more. And one chair told the audit team that he spent three times as much time on board business than he was “contracted” for.

This general finding about time commitment perhaps raises two questions. Firstly, are accurate assessments being made of how much time non-executive board members need to put into the job? The report recommends that the Scottish Government reviews the time commitment expected of non-executive board members to ensure that it gives a realistic indication of how much time the job will demand.

The second question is perhaps a slightly delicate one. Are board members in some cases getting too involved in the detail of the organisation? Training can clearly help non-executives to get the balance right. We found good examples of systems of induction, training and performance assessment of board members and this needs to become the standard.

Board performance and risk management

One of the core tasks of a board is to hold management to account and to scrutinise their work. As part of the audit, board members were asked to self-assess their performance. Almost three-quarters felt that they were scrutinising and challenging management well. This is encouraging. But it

behoves an Auditor General to point out a half empty glass when he sees one. The finding does leave a significant minority who felt that the level of challenge and scrutiny of management was only adequate or worse.

A number of Audit Scotland reports have stressed the importance of having good financial and performance information which are, critically, linked to each other. Financial and performance information has also to be better linked to robust risk assessments. The audit found that, generally, boards were as not as focussed on risk management as they should be. In all the boards visited by the Audit Scotland team, the main responsibility for risk management was delegated to the audit committee, and in some cases, risk was not reported to the main board. It is appropriate for risk management to be delegated to the audit committee, but it is important that the whole board takes ownership of the risk oversight function. All members should be fully aware of the major risks and be satisfied that the right preventative action is being taken

In view of what lies ahead for the public finances, there has never been greater need for interconnected financial, performance and risk management information to be presented to and considered by the board.

The audit also found that there is an extensive use of committees within boards. There is a broad range within the average of six committees per board. Do all of these committees strengthen and enhance decision-making and scrutiny of management or do they slow down the system and draw non-executive board members into too much operational detail? Knowing where the line is between understanding the work of the organisation and being drawn into too much operational detail could be difficult for non-executive board members to determine- but it is important to get the balance right.

In contrast with pre-devolution Scotland, the openness and transparency of boards has increased greatly, but the report found great variations in practice between different types of public body. Even in the short decade since devolution, increased openness and transparency has been made easier by

the internet. Making board papers available online is now straightforward. There are also more demanding public expectations about openness. In its consideration of the role of boards report, the Public Audit Committee in the Parliament has stressed that the general requirement must be for openness, with the only exceptions being matters that must remain confidential such as personnel or commercially sensitive information.

In the report there is a dozen questions for board members to ask themselves, both individually and as a group about their board. The questions are pitched at a high level so as to be applicable across all different types of public body, but they cover the key things that should help to make a board work well.

The report drew on a recent revision to the private sector Corporate Governance Code and made the suggestion that board reviews should be facilitated by an external peer who could act both as a facilitator of discussion and also as a “critical friend”. In view of the challenges that lie ahead, there has never been a more important time for boards to review how they are operating and performing.

In summary there are six main issues arising from the Role of Boards report:

1. The systems of accountability for boards and whether they could be further improved
2. The importance of ensuring that the right mix of talented people are attracted to take boards through the challenging times that lie ahead
3. The time commitment expected of board members
4. The importance of main boards taking ownership of risk oversight, linked to good performance and financial information
5. The proper role of committees within boards
6. The best ways for boards to assess their own performance