DIRECTOR EDUCATION AND PERFORMANCE ASSESSMENT

By Alan S. Gutterman[1]

Accepted notions of good corporate governance dictate the implementation of director education programs and regular assessments of the performance of the board of directors. In fact, the NYSE requires that the boards of its listed companies adopt and disclose corporate governance guidelines that address, among other things, continuing education and orientation of directors and annual performance evaluations of the board.

- **Orientation of new directors**

Once the decision has been made to join the board, new directors should move quickly to gain a clear understanding of the board's rights and obligations in general and the company's specific policies with respect to board and committee meetings and the authority of individual officers. New directors also need to study and understand the nature of the business of the company, the industries in which the company competes, and the operational procedures and business strategies of the company. In addition, new directors will need to take the time to keep up with changing business standards and trends which may have an impact on the company. One way this can be accomplished is to have senior managers provide directors, on a regular basis, with a package of materials that includes industry publications and other reports and briefings on new business, technology, and legal developments.

As part of their orientation, new directors should obtain from the company copies of:

- Articles of incorporation, bylaws, and minutes of recent board meetings;
- Financial statements;
- Annual and periodic reports to shareholders;
- In the case of public companies, 10-K, 10-Q, and 8-K reports and registration statements;
- Documents relating to board procedures, organization, and schedules;
- Organization charts and biographies of management;
- Summaries of management compensation and copies of employment contracts and employee benefit plans;
- Product brochures and documents describing the company's business, technology, facilities, and markets;
- Important internal management and financial reports;

---

[1] The material in this report appears in *Organizational Management and Administration: A Guide for Managers and Professionals* by Alan S. Gutterman and is presented with permission of Thomson Reuters/West. Copyright 2011 Thomson Reuters/West. For more information or to order call 1-800-762-5272. Alan Gutterman is the Founder/Principal of Gutterman Law & Business (*www.alangutterman.com*), which publishes the Emerging Companies Blog and the Business Counselor Blog, and a Partner of The General Counsel LLC (*www.thegeneralcounsel.net*).

- The most recent management letter from auditors;
- The general and outside counsel's response to the auditor's request for information;
- Memoranda or "codes of conduct" explaining the company's policies with respect to ethical conduct, insider trading, questionable payments, conflicts of interest, antitrust compliance, and other legal compliance programs; and
- Business plans and strategic summaries.

In addition, new directors should meet with other directors to obtain their views on the company and management and to ascertain the amount of time it will take to serve as a director. New directors should also meet personally with top managers to learn for themselves about the problems and prospects of the company, new trends in the industry, and the quality of the company's internal systems and controls. Another useful idea for easing the transition for a new director is to ask a more experienced member of the board to serve in an informal mentoring relationship for the first few months after the new director has assumed his or her position.

- **Continuing education of directors**

The fiduciary duties and other legal obligations associated with service as a director have turned the position into something akin to a true and separate profession and, as is the case with other professionals such lawyers and accountants, directors continuously educate themselves about the wide range of topics that are relevant to serving as an effective and informed board member. While each director should establish his or her own routine for staying informed about the company and new developments of interest to anyone serving as a director, companies should also establish formal continuing education programs for their directors. While “best practices” for continuing education of directors are still emerging, the following elements should be considered when designing a program for the board of a public company:

- Companies should put together a comprehensive, permanent, collection of materials regarding the background of the company; its organizational structure, including key personnel, departments and divisions; the company’s position within the industry, and the company’s strategic plan. These materials can be used during director orientation and then should be continuously available to directors throughout their term. The materials should be updated from time to time as necessary to ensure the information contained therein remains current and notice of updates should be sent to all directors.
- At least annually, in connection with a regularly scheduled board meeting, directors will be offered a seminar on topics relevant to corporate governance and the responsibilities of directors of public companies. Appropriate topics would include the role of the board in the oversight of management, board performance evaluations, succession planning, responding to shareholder proposals, mechanisms to protect shareholder rights, financial literacy, transparency, drafting and disclosing board guidelines and executive and director compensation.
- Companies should recommend external seminars and conferences for the use of their directors in meeting their continuing education objectives. Recommendations can be made following input from outside counsel, independent auditors and other outside

experts with expertise in corporate governance matters. Directors should be strongly encouraged to attend, preferably with other company directors to encourage discussion of relevant topics, one recommended external seminar or conference per year and the company should offer to reimburse a director's reasonable expenses relating to attendance at such seminars and conferences. Directors should be required to share insights and observations derived from participating in any seminar or conference.

- The company should cause to be prepared and distributed to directors a quarterly update on significant issues, trends, and changes relating to the corporate governance of public companies and other relevant topics. In addition, the company should provide directors with copies of alerts, updates and other materials pertaining to corporate governance matters that the company may receive from outside law firms, accounting firms, regulatory agencies and other organizations.
- The company should require that directors establish and maintain a membership in the National Association of Corporate Directors ("NACD") and cover the costs of such membership. The NACD provides a number of forums and other activities that allow directors to interact with their peers and increase their knowledge of corporate governance topics.
- Companies should arrange for directors to have regular interaction with managers and employees outside of the executive team and should schedule site visits to business operations and informal meetings with representatives to key departments and divisions to receive updates on the strategic activities of those business units and the concerns of those responsible for achieving specific strategic goals and objectives.

A continuing education program for directors will only be effective if someone is asked to take ownership of the process and the board itself sets aside adequate resources to fund the process and ensures that educational activities are a regular feature on the agenda for director meetings. Responsibility for education should be vested in the Nominating/Corporate Governance Committee and the adequacy of the educational program should be evaluated as part of the regular board performance assessment process described below.

- **Performance assessment**

Boards of public companies must, as a matter of good practice and in accordance with specific legal and regulatory requirements, conduct regular evaluations of the performance of the board as a whole as well as each of the individual directors. As noted above, NYSE-listed companies must include annual performance evaluations of the board in their corporate governance guidelines. In addition, the NYSE requires that its listed companies establish an independent nominating/ governance committee that will be responsible for overseeing the evaluation of the board and management. Evaluation activities are not limited to the board of directors as a whole but must also be conducted with respect to activities of key board committees. The NYSE requires that each audit committee must have a charter specifying duties of the committee, including evaluating the audit committee on a "regular basis" (presumably at least annually). Similar requirements for an annual performance evaluation apply to the compensation and nominating/governance committees of NYSE-listed companies. As for NASDAQ-listed companies, they must "certify" that they have has adopted a formal written audit committee charter, and that the audit committee has reviewed and reassessed the adequacy of that charter annually. In addition, the charters of the audit committees of NASDAQ-listed companies generally call for annual review and assessment of the performance and effectiveness of the committee.

Board evaluation is a relatively new phenomenon and standards are still emerging on the right questions to ask and how assessments should be conducted. Moreover, in order for the evaluation and assessment to be meaningful there needs to be some understanding as to just what is meant by the term "effective board". One report on board evaluation advised that in order for the board to be effective it must have the right people, the right culture, the right issues, the right information, the right process and the right follow-through. Each of these elements can be explained briefly as follows:

- The board should have a substantial majority of independent directors with a wide range of talents, expertise, and occupational and personal backgrounds as well as an independent-minded spirit to act courageously for the best interests of the corporation and its shareholders.
- The board should develop and encourage an internal culture that promotes candid communication and a rigorous approach to collecting and evaluating information and making difficult decisions regarding issues that are appropriate for the board.
- The board should focus its attention and activities on the design, implementation and assessment of corporate strategy and should be actively involved, in conjunction with management, on all issues that are materially relevant to maximization of long-term shareholder value.
- Directors must have access to, and carefully review, all relevant information necessary for them to make informed decisions; however, when requesting information directors must make reasonable demands that allow management to provide prompt and thorough replies.
- The board should establish a formal evaluation process that begins with developing a description of the specific duties, goals, and objectives of the board as a whole and each of the directors individually, and then deploying the tools necessary to measure actual performance against those responsibilities.
- Once the evaluation is completed the results should be shared with the full board as well as each individual director and action plans should be developed in order to address areas in which improvement is necessary.

As noted above, boards of public companies typically delegate the evaluation and assessment process to an independent committee, generally the nominating/governance committee. The members of that committee should be versed in the methods and tools that have been developed to make the assessment process more efficient and objective including the use of questionnaires and interviews. Individual evaluation of directors can be carried out in a variety of ways including self-evaluation, peer evaluation, a combination of self-evaluation and peer evaluation, evaluation by the nominating/governance committee and evaluation by an outside consultant. Hopefully one of the byproducts of the evaluation and assessment process is that the directors gain a fuller appreciation of their value to the company and the important role that they can play in setting and executing company strategy and supporting the activities of the management team that they are overseeing. The results of the evaluation should be taken seriously and the board should formally accept recommendations for improvement and require progress reports on remedial actions as a regular part of the board agenda.

Director Education and Performance Assessment

- Orientation of new directors
    - Publications and other reports on new business, technology and legal developments relevant to the corporation
    - Charter documents and board minutes
    - Financial statements, shareholder reports and reports filed with the SEC and other public agencies
    - Board procedures
    - Organizational charts and manager biographies
    - Corporate governance policies and procedures
    - Business plans and strategic summaries
    - Meetings with other directors and top managers
- Continuing education of directors
    - Collection of materials regarding the background of the company; its organizational structure, including key personnel, departments and divisions; the company's position within the industry, and the company's strategic plan
    - Regularly scheduled internal seminars on topics relevant to corporate governance and the responsibilities of directors
    - Support for attendance at external seminars and conferences on topics relevant to continuing education objectives
    - Regular reports and updates on significant issues, trends, and changes relating to the corporate governance and other relevant topics
    - Support for membership in the National Association of Corporate Directors
    - Regular interaction with managers and employees outside of the executive team and site visits to observe operations of business units
    - Responsibility for continuing education should be vested in nominating/corporate governance committee of the board
- Performance assessment
    - Establish a formal evaluation process
    - Develop a formal description of the specific duties, goals and objectives of the board as a whole and each of the directors individually
    - Deploy the tools necessary to measure actual performance against the stated duties, goals and objectives
    - Share the evaluation results with the full board and individual directors
    - Develop action plans to address areas in which improvement is necessary
    - Require progress reports on results of remedial action plans