



To Empower Your CEO, Create Boundaries

Readers of Good Governance will be aware that we have often recommended the advantages of couching the board's delegation to the CEO in the form of Executive Limitations policies. While we typically refer to these as 'CEO Delegation' policies we continue to use the Limitations or proscriptive method to write the policies.

Developed by USA governance writer John Carver, the limitations style is designed to enable the board to remain focused on creating a vision for the organisation's future rather than becoming dragged into operational decision making. There will, however, be certain operational actions over which a board needs to exercise control. Using the Limitations policy method the board retains 'necessary governance controls' while at the same time creating 'necessary executive freedoms'. In other words, the board creates boundaries within which the CEO is free to determine 'how' to deliver the board-determined outcomes.

Many of the boards that we work with have adopted this approach to documenting the CEO's delegation. Sadly, however, little subsequent use is often made of them either by the CEO or the board. It's back to business as usual. In this short article we hope to bring this approach to delegation and policy making back into focus by offering some guidance about how this proscriptive type of policy should be used.

A duty of care

Directors have a duty of care under the law. While the enactment of certain elements of this can be delegated, there are other elements that most boards determine should not be. No CEO should reasonably expect that his or her board will accord an unbounded delegation. This is where the CEO Limitations policies are intended to have effect, denying the CEO access to certain operational actions or decisions that the board considers are 'off limits'. This is not to say, however, that such actions or decisions should not be completely 'off limits'. It is simply that these are matters (usually because of the risks involved) which the board wants to consider for itself as an essential component of its duty of care.

When confronted with an approach by the CEO seeking permission to breach a board-set limitation or stating that the action must be taken, the board might choose one or other of the following responses:

- a. After consideration it might resolve that the delegation is too narrow and that the freedom to take such actions should be included within the delegation. The board would then change the policy

to reflect the expanded delegation.

b. It might decree that the issue or decision requires the board's authority and thus would exercise this and, in so doing, accept all accountability for the consequences of the action taken. In other words the limitation would stand.

The scope of the policies

In setting the limitations a board should be conscious of the need to make every best attempt to address all foreseeable matters that it wishes to cover. By starting with a broad statement of limitation and then working down through to more detailed statements, a board can, with some confidence, create a delegation that should stand the test of time and occasion. There might, however, be some circumstances that will cause the veracity of the policies to be tested.

The limitations, once adopted, should be sufficiently detailed and well-considered that the board can be confident that it can accept the CEO's '*reasonable*' interpretation of the policy and subsequent action. In demonstrating that a '*reasonable interpretation*' has been made, the onus is on the CEO to show that he or she has not set out to '*defeat*' the policy while making every reasonable effort to honour both the '*written word*' and its intended '*spirit*'.

Using the policies to determine CEO freedom to act

Whereas in developing the policies the board works from the '*general to the specific*', the CEO, in interpreting the policy works from the '*specific to the general*'. Having first established that the action is consistent with the organisation's purpose or the outcomes it must achieve the CEO would check to see if the proposed action is '*within bounds*'. To determine this, the CEO might first check to see if there is a specific prohibition. This is most likely to be found in the more detailed statements within the policy, e.g. the numbered detail. If there is nothing specific but the CEO is still unsure, he/she might then move to the next level and check the head statement for each policy to see if this provides guidance. Some interpretation might be required. For example, the Financial Management policy statement might commence by stating that the CEO must "*... ensure that nothing is done, or authorised to be done, that could in any way cause financial harm or threaten the organisation's financial integrity.*" The CEO might need to examine a proposed action to be sure that no such harm could occur. If still in doubt, the CEO might go to the highest level limitations statement (couched more generally still and embracing all the Limitations policies) and ask whether the proposed action, "*... is in breach of the law, is imprudent, contravenes any organisation specific or commonly held business or professional ethic or is in breach of generally accepted accounting principles.*" The CEO should now be in a position to make a *reasonable interpretation* of the board's policies. He or she would either take the proposed action with confidence that it is within the delegation or refer it to the board for a board-level decision and subsequent action. If, however, there is still doubt, the CEO would approach either the chairperson or the board to seek guidance on an interpretation of the policy.

There is an important distinction to be made at this point. When the CEO approaches the board (or the chairperson) for this final exchange, he or she is not asking permission to act. Rather the approach should be to seek confirmation that the board intended its CEO to have the freedom to make the decision or take the action; in other words to check the interpretation. This is a subtle but crucial distinction. At this point the board might declare that, in setting the policies, it did not anticipate such a circumstance. Given the opportunity, it would have included a further prohibition that was designed to make clear to the CEO that this action was not within his/her prerogative. The

board would thus be obliged to change its policy accordingly. Alternatively the board might declare that it is perfectly comfortable that the CEO should determine whether to act or not. The decision then lies with the CEO as does accountability for the outcomes of the action or decision taken.

Spirit and intent

The challenge for both the board and the CEO lies in the determination and acceptance of the CEO's 'reasonable' interpretation. It is at this point that the 'trust' component of the board-CEO interrelationship is put to the test. The board must 'trust' that the CEO has made an honest interpretation of the policy/ies and has taken an action with genuine intent, full integrity and professional competence. In turn the CEO must 'trust' that the board, having defined a boundary and thus created certain freedoms, will honour its policies.

The policies are not designed to be used as a punitive tool by the board nor should the CEO regard them in a laissez-faire or careless manner. Ideally no part of any policy should constrain a CEO from taking actions or making decisions that are in the best interests of the company. The board must accept that a CEO cannot be held to account for that which he or she cannot control; nor should there be accountability for that which, under normal circumstances, cannot be known. A CEO, however, can and should be held to account for ensuring that there are adequate systems and processes in place to manage all that can or should be known and controlled.

Subject to regular review

As with all other board statements, the CEO Limitations policies should be subject to regular review. The key to effective review is that the board achieves a level of satisfaction with the CEO's demonstration of compliance with the policies. Ideally the CEO Limitations policies are reported against and, at the same time, reviewed by the board on a scheduled basis. Certain of them, for example, the budgeting policy, have a logical time for review, i.e. when the budget is presented. Others might be scheduled for review at a date determined by the board and documented in the board's annual calendar of work. See also *Good Governance* #3, 35 and 42.